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Dear Richard,

Quality of Service for Gas Distribution Networks – Initial Consultation

Thank you for the opportunity to provide comments on quality of service as part of the above consultation. This letter sets out NGT's response. NGT provided an initial high level response on 6th August, in summary this stated:

- Service levels should not be tightened or financial exposure increased without proper consideration of the associated funding and efficiency issues. It is NGT's opinion that these areas are best considered as part of a full price control review.
- The last price control proposed the development of incentives relating to quality of service. The initial view was that these would relate to non-contractual interruptions to supply. NGT believes that focussing on interruptions may not now be appropriate.
- Consistent with the last price control settlement, any eventual quality of service incentive mechanism should provide Distribution Networks with the opportunity, should they wish, to improve quality of service in return for increased income.

The Existing Regulatory Framework

The consultation invites views on the appropriateness and effectiveness of the existing regulatory framework in respect of quality of service. It also asks for gaps and weaknesses to be identified together with possible remedies.

The consultation proposes that the current "RPI-X" regime has the potential to incentivise cost reductions at the expense of customer quality of service. In the absence of "counter balances" this may be the case. However there is a wide range of counter balances, some of which are identified in the consultation, that encourage maintenance and/or improvement in quality of service. These include:

- Guaranteed Standards
- Overall Standards
- Company reputation
- Output performance/delivery reporting under the RIGs
- Costs of non performance via complaint management and remedial action
- Network Code requirements and liabilities
- Licence obligations and potential enforcement action by Ofgem
- Ofgem's Asset Risk Management (ARM) process
- Compliance with health and safety legislation
- Compliance with environmental legislation

Via these mechanisms, Distribution Networks are accountable for quality of service to a wide range of bodies including customers, regulators and shareholders.

The existing framework ensures the provision of a high quality of service to customers and it is NGT's opinion that, taken in aggregate, it should be effective in protecting customers' interests, both in the short and longer term.

However, much of the existing framework concentrates on the achievement of a specified level of service, effectively a hurdle to be cleared. If there is a weakness it is that it fails to encourage the exploration of efficient changes to the quality of service provision beyond the level of the hurdle.

Opportunities for enhancing the regulatory framework

The outcome of Transco's last price control proposed the introduction of a mechanism with symmetrical revenue adjusting incentives based on quality of service.

The objective of these incentives should be to encourage the optimisation of performance levels, costs and customers' willingness to pay.

Such incentives should give Distribution Networks the opportunity to vary performance if they believe that the marginal cost is less than the incentive rate. Responses to the incentives could provide valuable information on the cost of service provision for use at future price control reviews.

Incentive development should have regard for a number of principles:

- The output/s to be incentivised must be valued by customers.
- Incentive payments (rates) should be related to customers' willingness to pay.
- Targets should be based on current performance.
- Performance should be within the Distribution Network's control.
- Conflicts with safety requirements should be avoided.
- The mechanism should be symmetrical with equal opportunity and reward/penalty for both improving and decreasing performance.
- Rewards/penalties should be based on absolute performance by an individual Distribution Network.
- There should be avoidance of overlaps with existing quality of service frameworks, e.g. guaranteed and overall standards, Network Code, etc.

The initial view for the introduction of additional incentives was that they could be applied to the number and duration of non-contractual interruptions to supply. NGT believes that these are not appropriate outputs to incentivise directly because:

- The number of interruptions is driven by the safety based mains replacement programme and is largely outside Transco's control
- There is a significant volume of occasions where, in NGT's experience, customers may not value reduced duration of interruption (for example, where quicker restoration involves night-time access, when the customer is not at home, etc.)

NGT believes that the use of an overall customer satisfaction measure would be more appropriate. Such a measure could include factors relating to interruptions as well other factors such as effectiveness of communication, flexibility, etc.

Performance could be gauged by means of customer surveys carried out upon completion of works relating to their gas supply/premise. This would directly measure the quality of service provided by Distribution Networks and, to improve performance, it would be necessary to target areas valued by customers.

NGT would welcome discussing this proposal in detail with Ofgem. NGT also believes that robustly assessing current performance levels for target setting is important and this may influence when incentives could be introduced.

Points of detail

The consultation raises a number of specific detailed points. NGT's responses to these are set out in the attached annex.

Should you wish to discuss any of the points raised in this response in more detail please do not hesitate to contact John Meehan, telephone 01926 655355.

Yours sincerely

Tim Tutton

Annex 1 – NGTs further comments on detailed points raised in the consultation

Objectives of quality of service incentives

NGT agrees with the general categorisation of the objectives (as summarised in Table 1 of the consultation document) however, we would question the emphasis on “improving” these areas. Whilst improvements in themselves are welcome, it must be recognised that they often come at a cost. Driving for improvement without this recognition can lead to inefficiency (“gold plating”). Quality of service incentives should encourage an optimisation of performance and cost whilst taking into account customers willingness to pay.

Duration of Interruptions

The average duration of non contractual interruptions to supply is quoted as being 16 hours. This is taken from Transco’s interruptions reporting system for the period April to June 2004. Whilst this information is more accurate than earlier information provided from the system, it is NGT’s belief that this still overstates the true duration. The Examiner appointed by Ofgem also concluded, in their draft findings, that the reported duration was overstated. Transco is implementing some of the draft findings of the Examiner to improve data quality in this area.

Given the probable overstatement of the average duration and NGT’s own customer satisfaction work, which shows customers are happy with the time taken to restore supplies, NGT does not believe there is a requirement for specific additional incentives (for example via a tightening of guaranteed standard 1). Further, Ofgem’s customer research work, undertaken as part of the last price control, suggested that the majority of customers felt that reconnection within 24 hours was reasonable.

Worst served customers and comparison with electricity interruptions

In the electricity distribution sector worst served customers are subject to a guaranteed standard which applies to customers that experience four or more interruptions lasting three or more hours in a 12 month period. By definition this involves interruptions totalling at least 12 hours although in reality most affected customers probably experience total durations substantially in excess of this. Additionally, a single interruption greater than 18 hours is captured by a guaranteed standard.

Ofgem’s customer research identified that customers experience greater inconvenience as a result of electricity interruptions (amongst other things, an electricity interruption can also prevent the use of gas appliances).

It is noted in the consultation that it may not be appropriate to define worst served gas customers by reference to frequency of interruption, primarily few gas customers experience the frequency of interruption experienced in the electricity sector. NGT agrees with this view.

Given the comparative inconvenience caused and the relative guaranteed standard “trigger points” in gas and electricity, NGT believes the current definition of worst served customer in electricity is analogous to Transco’s current guaranteed standard for interruptions greater than 24 hours. As such worst served customers within the gas sector are already protected.

Guaranteed and Overall Standards of Service (GSOPs and OSOPs)

NGT supports Ofgem's proposal to consult on technical changes to OSOPs to changes across the industry; with particular regard to development of choice for the provision of metering services, the proposed sale of networks and improving incentives in connections. NGT has previously expressed the view that in considering new service standards for connections it is important that the interactions with other measures such as OSOPs and GSOPs are considered to ensure consistency and avoid duplication. Where necessary OSOPs and GSOPs could be amended, removed or developed in order to provide appropriate incentives for GTs, whilst ensuring the safety, operational and financial implications of such changes are understood and addressed.

It is NGT's opinion that the purpose of guaranteed standards is the provision of compensation to customers when a service, that they would normally expect, has not been delivered. This is based on the premise that whilst customers should receive a particular level of service it is inefficient (and not possible) to provide 100% service delivery. This is a practicable realisation of efficient network operation and is distinct from a penalty regime. It follows that payment levels should reflect the inconvenience and/or additional cost experienced by the customer as well as their willingness to pay for the service.

In order to incentivise a particular behaviour, guaranteed service payments could be increased (either directly or via tightening of the performance threshold) to a level greater than the fair value of compensation. However this will drive inefficiency, leading to performance being greater than customers are willing to pay for or, in the event improvements are not achievable, higher payments under the standard. In either case costs could increase, eventually leading to higher charges for customers.

As part of the last price control review Ofgem carried out customer research relating to guaranteed and overall standards of service. This included understanding potential losses caused to customers and their willingness to pay for service provision. The final price control settlement also accepted that aiming for 100% service delivery is not efficient and within Transco's allowances there was a sum included for limited payments where the standard would not be met. NGT believes that the principles applied by Ofgem at the time of the last PCR were correct and that a move to set guaranteed standards at a penal level would not be in the best interests of customers.

Network Code

Standards of service for shippers are managed via the Network Code which includes mechanisms for adding or altering these. NGT believes that the existing framework in this area is adequate and there is no requirement for additional mechanisms to be put in place outside of the Network Code for "industry players".

Major incidents and exceptional events affecting continuity of supply

Guaranteed standard 1, and the similar arrangements for incidents caused by third parties/water ingress, apply in full up to 50,000 affected customers and a maximum of £1000 payment per customer. Beyond these thresholds Distribution Networks have no further liability for compensation. Whilst unlikely (but still possible) a single incident of this magnitude could equate to approximately 20% of annual revenue for a typical Distribution Network. There is no limit on the number of incidents per annum.

Within the electricity sector “exceptional events” qualify for a relaxation in financial impact. The DPCR4 Initial Proposals also suggest exposure should be capped at 4% of revenue. Whilst the number of customers affected in an electricity exceptional event could be significantly higher than 50,000, the cost and manpower requirements to restore supplies gas supplies is considerably greater per customer than for electricity.

In 2002/3, the electricity DNOs experienced 11 exceptional events that qualified for exclusion under the IIP incentive scheme. DPCR4 suggests there could be approximately 30 exceptional events per annum that qualify for a reduction in the customer compensation payments or exclusion from the interruptions incentive. In contrast NGT’s records going back to privatisation (1986) show no incidents that would qualify for a relaxation of the standards under the current regime.

In summary, the number of events qualifying for relaxation of payment in the gas sector is far fewer than for electricity and the financial risk in the gas sector is far higher. Therefore, NGT believes that current arrangements are adequate for protecting customers affected by major incidents and there is potential for considering a reduction in the financial exposure of Distribution Networks by reduction in the current 50,000 customer threshold.

Asset Maintenance

Due to the potential hazards caused by uncontrolled gas releases and losses of supply many of the Distribution Network’s key asset maintenance activities are governed by health and safety legislation. Whilst the RPI-X regulatory regime drives efficiency, the legislative requirements provide an extremely strong counterbalance that ensures this activity is properly undertaken and as a consequence there are no adverse impacts on quality of service.

As noted within the consultation, in addition to scrutiny from the HSE (and the Environment Agency), Ofgem undertakes its own Asset Risk Management survey. NGT notes Ofgem is considering running this survey again. Given these existing controls and the emergence of other cross industry initiatives (such as the Institute of Asset Management’s “PAS 55”) NGT believes the current framework in this area gives customers adequate protection.

Output and Medium Term Performance Measures

The reporting required as part of Outputs Reporting (RIGs) and ARM are extensive. The consultation requests views on whether Medium Term Performance (MTP) measures should be introduced similar to those in the electricity sector. NGT believes that Transco already provides MTP reporting albeit under different nomenclature. For example:

- Under MTP measures DNOs report on asset replacement. The majority of the Distribution Networks’ replacement activity is reported as a RIGs “Output”.
- DNOs are required to provide an analysis of faults on their networks. Transco reports faults under a combination of RIGs “Outputs” and “Supporting Measures”. For example service pipe failure and significant governor failures are reported as outputs, mains fractures are a supporting measure, etc.

Due to the extensive scope of current reporting NGT does not believe that additional reporting would provide additional customer benefits. However, as part of the next steps for this project NGT believes that the RIGs should be reviewed in a number of areas. In particular, in the light of experience since the RIGs were initially set, it needs to be questioned whether the cost of interruptions reporting in the current format is disproportionate to the customer benefit derived. Consideration of the impact of potential industry restructure and Network sales is also needed, for example where should responsibility for reporting the shipper query and CD-ROM outputs lie?

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