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29 August 2006

Joanna Whittington,
Director – Gas Distribution
Ofgem,
9 Millbank,
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Dear Joanna

**OFGEM CONSULTATION: GAS DISTRIBUTION PRICE CONTROL REVIEW SECOND CONSULTATION DOCUMENT**

This document is the formal response to the above consultation by Wales & West Utilities Ltd.

For the avoidance of doubt this reply is not confidential and may be placed in the public domain.

Yours sincerely

Bob Westlake
Regulation Manager

**Wales & West Utilities Limited**
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**OFGEM CONSULTATION: GAS DISTRIBUTION PRICE CONTROL REVIEW SECOND CONSULTATION DOCUMENT**

**WALES & WEST UTILITIES LTD**
**RESPONSE TO CONSULTATION**

## EXECUTIVE SUMMARY

WWU is one of the eight gas distribution companies established by National Grid in 2005 and one of the four sold to third parties. The price controls to which Ofgem refers in its consultation will eventually apply to us, and we see the outcome of the reviews of both the extension year and subsequent five year period as critical to our success as a business, and critical in terms of the range and quality of services that we are able to offer to our customers.

We are firmly of the view that the extension year control should, as far as possible, involve a simple as possible a roll forward of the present control, with minimum change. We also agree with earlier proposals that the considerable capital investment (capex) overspend should be resolved as part of the extension year control process. Apart from that, we consider that there are irrefutable arguments for dealing with the costs of shrinkage gas and pensions, as these are both at levels not envisaged when the control was previously set, are causing a serious deterioration in our bottom line and are subject to cost influences over which we have no control. These elements excepted, we consider that the roll forward should be on the basis of the present control.

At this stage we have a number of serious concerns with the proposals contained in the consultation paper, and the practical effects of some of those proposals as described to us by Ofgem. The most important concerns are:

- whilst we consider that there are real difficulties in applying a rigorous approach to dealing with the capex overspend, we do not accept that the Ofgem proposals are appropriate for several reasons, including:

  ⇒ we do not consider that there has been proper consultation on those proposals, especially in terms of their detailed application, and the end result is in our opinion an *ex post* series of policy proposals, whose effects are both negative and serious for us, rather than an *ex ante* set of proposals to apply going forward;

  ⇒ the proposals specifically involve reopening detailed, in some cases very detailed, elements of the 2002 price control settlement, without considering the fact that in that settlement, as in all others, the proposals had to be taken as a package; the approach thus ignores the inevitable tradeoffs that Transco had to make at the time;

  ⇒ the detailed application of the proposals involves, amongst other things, the assumption that capex forecasts are to be adhered to in all cases and that, for example, any underspend is by definition inefficient; this is in direct contrast to the statement in paragraph 3.15 of the Developing Monopoly Price Controls consultation paper in May 2003, which said that deferment could be efficient;

- the proposal to move to a post tax cost of capital has been put forward in previous consultation papers, but there has been little or no assessment of the practical implications, and these are again significant. We do not consider it appropriate to introduce such a fundamental change without a full assessment of the implications, and this cannot be conducted within the timeframe of the one year extension.

There are a number of other concerns that we discuss in our response, and we also amplify our reasoning behind the above statements. We hope that further dialogue can resolve what are at present extremely difficult issues for us in terms of policy development and its application. We also consider that the more important issues need careful consideration and are better dealt with in the five year control review and not the extension year.

**Responses to Ofgem Questions**

We set out below each of the Ofgem questions and our responses to them.

## Chapter 2 - High level framework of the price controls

***Question 1: Should Ofgem retain the form, structure and scope of the current price control during the one year control?***

We consider that it is entirely appropriate to maintain the existing form and structure for the one year extension. We also consider it appropriate for the roll forward to be made as simple as possible, in other words for it to deal with most elements as though the initial review had been for six years rather than five. We do have particular problems with individual cost items subject to externalities over which we have no control, however, and we therefore think it appropriate that the roll forward should deal with shrinkage and pension arrangements.

***Question 2: Should Ofgem introduce a new revenue driver other than the volume driver and, if so, what variable should it be linked to?***

We do not think that the present revenue driver arrangements properly reflect our cost structure. In particular, within sensible upper and lower bounds, our costs, with the exception of shrinkage gas, are largely fixed and do not vary much with volume. Because of this, the present 35% volume driver is completely out of line with actual cost movements. The risks that we face here are not symmetric, as there is considerable empirical evidence to show that the present demand and volume forecasting models used throughout the industry do not fully reflect the impact of recent warmer winters, and as a result actual gas throughputs are regularly below those forecasts, so the impact of the volume driver has been negative for several years. More generally, volume drivers should reflect changes in costs due to changes in volumes and should not lead to windfall gains or losses due to matters outside the control of the transporter.

Revenue drivers should reflect actual cost drivers, and our analysis shows that there are several different drivers, which could be dealt with through a formula approach which treats each separately:

- whilst a proportion of our costs are driven by changes in customer numbers, analysis shows that network length and plant such as district governors are more appropriate cost drivers than simple customer numbers;
- there are other major one off cost impacts, at present the most significant being connection costs for new generation. These could be dealt with through a separate revenue driver such as £s per KW with an element of pass through

Going forward, we think that it would be sensible for this issue to be subject to detailed analysis by each network, and for a revised composite revenue driver, which properly reflected variable cost drivers, to be introduced for the main control.

***Question 3: What revenue and/or costs should be treated as excluded/de minimis/pass through? What principles should be used to classify revenues and/or costs as excluded/de minimis/pass through?***

This question contains a number of elements which it is necessary to separate out. It also masks confusion over the expression "excluded services" which has come to encompass a number of quite different concepts.

***Excluded services***

The first point to be made is that what is or is not an excluded service is a matter of law based on the true construction of the licence. The phrase "excluded services" therefore needs to be understood clearly. It has come to encompass any revenue/turnover (whether capital or income) (for this purpose all such money is referred to as "revenue") not included in the transportation business formula; it has therefore come to cover:

- Revenue outside the transportation formula
- Revenue that needs to be treated as outside the transportation formula ("excluded revenues")
- *De minimis* revenue
- Metering costs not included in the tariff caps cost calculations ("excluded costs")
- Metering and Meter Reading revenue

This is wrong in law and leads to confusion in practice. The licence is in fact quite clear in law as to the various regulatory treatments of costs and revenue, once the activity concerned has been properly identified. To do this, it is necessary first to consider is to what business (permitted or *de minimis*) any particular business, activity, revenue or cost belongs. Again the licence clearly differentiates these.

***De Minimis* activities**

Under Transco's licence prior to 1999 excluded services were services permitted under Special Condition 8A and were services not comprised in the transportation business (which then included metering and metering reading). Those services were therefore in modern parlance *de minimis*.

After December 1999 Special Condition 8A was revoked and the concepts of permitted purpose and *de minimis* came in. A *de minimis* activity is defined in Condition SSCA36(4)(a)) to be ‘any business or activity carried on by the licensee ….other than the business or activities falling within paragraphs (a), (b) or (c) of the definition of “permitted purpose” ’ ((a), (b) and (c) being defined elsewhere as transportation, metering and meter reading). An activity cannot therefore by definition be both *de minimis* and one of transportation, metering or meter reading or indeed be "treated as" *de minimis*. Which side of the line any activity falls is a matter of construction of the licence.

It should be noted that there is a category of business that is neither transportation, metering, metering reading nor *de minimis*. That is those activities which would have been *de minimis* but for the fact that Ofgem has consented to them under SSCA36(4)(a)(ii). These are *sui generis*. They do not count towards the *de minimis* thresholds but cannot be transportation, metering or metering reading, because if they had been Ofgem's consent to them would not have been needed.

**Transportation business**

It is not possible for a revenue or cost item to be both transportation and metering or meter reading. The definition of the transportation business in Condition SSCA3(1) expressly excludes the meter business and the meter reading business and therefore any costs or revenues arising from activities comprised in them.

It is only in respect of the transportation business that it is necessary to consider "excluded services" properly called. Even then the phrase is confusing. What should be considered are excluded revenues, i.e. revenues which should be included as a matter of definition in the transportation formula but which are treated as not being included.

These revenues were until the licence changes in 2002 contained in Transco Price Control Condition Special Condition 9C. That condition required Transco to ensure that ….."its Average Transportation Price per kilowatt hour shall not exceed the Maximum Average Transportation Price per kilowatt hour"… Average Transportation Price per kilowatt hour was defined as the Transportation Revenue for that Formula Year divided by the Deemed Transportation Quantity for that Formula Year. Transportation Revenue was defined as "turnover …derived from the Supply of Transportation Services for Shippers….”

The Supply of Transportation Services was defined as "the undertaking and performance for gain or reward of (a) engagements in connection with the conveyance of gas through the Transportation System;(b) engagements for the prevention of the escape of gas which has been taken off the Transportation System, by the licensee for other persons except engagements relating to the acquisition or disposal of gas otherwise than for the efficient operation of the Transportation System or for replacing gas lost from that system, not being the provision of Metering Services or the provision of Meter Reading Services"

The definitions of Transportation Revenue and of the Supply of Transportation Services are now replaced by "Distribution Network transportation activity revenue" and the "supply of Distribution Network Services" in Special Condition E2A (1). In particular it should be noted that Distribution Network transportation activity revenue continues to mean the revenue derived by the licensee from the supply of Distribution Network services to gas shippers in respect of the Distribution Network transportation activity.

By definition, therefore, only revenues from shippers can ever be DN transportation formula revenue and then only if deriving from the supply of Distribution Network services. All other revenue is as a matter of law excluded from the DN transportation formula.

In the pre 2002 definition of Transportation Revenue certain revenues from shippers were excluded from being included as transportation revenues. This provision was required because otherwise by definition the revenue would have been transportation formula revenue. They were therefore "treated as" excluded.

These included revenues now contained in Special Condition E4(3)(a), (b), (c) and (d) - others went into the TO and SO conditions. Special Condition E4 continues to need to "treat" these revenues as though not formula revenue to the extent that they derive from shippers for the reasons above. Special Condition E4 does not deal and does not need to deal with revenues from non shippers as they never need to be "treated as" excluded. They are excluded by definition.

Special Condition E4 does need to continue to apply to one category in the old definition of excluded revenues in 9C which was " revenue derived from the Supply of Transportation Services which otherwise are not ordinarily required by shippers”. This category allowed the licensee to make a case that services not, for example, anticipated and therefore not allowed for at the previous price control, should be excluded from transportation revenue. Ofgem should consider the criteria for this type of service within the context of E4.

***Question 4: Should Ofgem link some or all of allowed revenues to a price index other than RPI?***

RPI is a well understood measure and enjoys public support. Many components of our costs move differently to RPI, however, for example contractor and material prices. Therefore whilst it is still appropriate to use RPI for the overall price control in building allowed revenues it would be correct to use other indices for specific building blocks, such as Baxters for contractor rates.

There is a separate issue relating to the composition of RPI. There is a body of academic research which shows that general productivity improvements in the national economy are reflected in RPI. This is also intuitively sensible, in the sense that if there are general productivity improvements, at a high level the only way that they could find expression would be in the general level of consumer prices. We therefore consider that future efficiency

targets should recognise the efficiencies already imposed by the application of a price control based on RPI.

***Question 5: Should Ofgem specify certain issues that could be the subject of a reopener and, if so, which issues?***

In general we consider that companies should be encouraged to manage an appropriate level of risk, and therefore agree that reopeners should only be used where there is considerable uncertainty over the level of costs and where a GDN has only minimal or no ability to control such costs. Examples include TMA and large connections such as CCGTs that were not known at the time of the BPQs or were sufficiently uncertain as to not include with the forecasts.

In terms of the mechanisms to be applied, we do not favour arrangements that require a typically substantial threshold to have been breached before reopening is contemplated, as that appears to create a cost penalty that we are unable to manage. Whilst we accept that there should be a sensible *de minimis* constraint, this should not apply to known areas of costs. The Traffic Management Act (TMA) is an obvious example; if in the first year of its application the costs involved did not reach a threshold, we would be required to bear them even though it was known in advance that they would arise.

We therefore favour mechanisms that provide protection for customers, in the sense that revenues will not be adjusted inappropriately, but also provide us with comfort that relevant costs will be recognised. This requires potentially different mechanisms for particular cost items. For example, it is possible to construct mechanisms that automatically adjust revenues under certain circumstances such as the costs of connecting a new load. For other items of considerable uncertainty such as TMA it is appropriate to place within the price control licence conditions a specific mechanism should such costs arise and in this regard we believe the Licence Condition A3 introduced for the electricity DNOs would also be appropriate for the GDNs.

## Chapter 3 – Assessing Costs

**One Year Control Issues**

Our view has always been to support the concept of the extension year, namely to roll forward opex controls on as simple a basis as possible, and deal with the capex overspend. We have major concerns over shrinkage gas and pension costs, both subject to external factors over which we have no control, and we welcome the direction of Ofgem's thinking on these issues as set out in the consultation paper. Other than those two areas, however, we continue to hold the view that the one year control should be based on present controls as much as possible. There are other issues to be addressed, but we think it more appropriate for those to be considered in the main control, rather than the one year extension.

***Question 1: Is our approach to carrying out ex-post assessments of historical efficiency appropriate?***

In principle, the approach set out in paragraph 3.25 of the consultation paper is appropriate. That said, we have concerns over its application. In particular, as previously advised to Ofgem, we do not think that there has been sufficient engagement to enable a proper application of the various approaches set out in paragraph 3.25 to be undertaken. We have supplied a large amount of material, in the form of BPQ submissions, answers to narrative questions and the provision of substantial appendices and annexes, and we do not think that many of the points that we made have been taken into account. Where a substantially different view appears to have been taken, we have not seen any serious rebuttal of a number of the points that we have put forward.

We do not agree with the approach to forecasting efficiency described in paragraph 3.26. This approach ignores the fact that all reviews, including the 2002 gas settlement, take issues

in the round. We understand that NG was uncomfortable with several aspects of the review, including capex forecasts, but agreed on balance to the proposals. To look now at the forecasts in the way proposed, without taking into account the factors that led NG to accept those forecasts, is not appropriate. In effect, the settlement is being partially reopened, and if the balancing items are not taken into account a spurious level of accuracy is being assigned to capex forecasts, and companies are then being penalised for failure to meet those forecasts.

Although not set out in the consultation paper, we understand that part of the application of the approach described in paragraph 3.26 involves looking at overspends and underspends within individual categories of capex. In particular, it is proposed to disallow all underspends and not set them off against overspends in subsequent years. In terms of principle, we consider that the application of underspends on particular sub-categories in particular years is a completely new policy, not mentioned in the March 2004 Open Letter or subsequently, on which there has been no consultation. We comment below on the general approach in this area, but we are not aware that there has been any reference to the lack of ability to vire between years or categories. We also think that this approach undermines the basis of incentive regulation for several reasons:

- the implicit requirement to forecast accurately for around seven years ahead (taking into account the normal lead times in PCRs), by each sub-category of capex, creates the perverse incentive to over-forecast, to avoid the potential underspend penalty. Whilst we accept that to some extent such an incentive is always present, it is made worse by the penalties for underspending if there is no offset for overspends, because now the perverse incentive will be to over-forecast each sub category, as opposed to the overall figure, which will inevitably increase the total;

- perfectly sensible decisions to delay or advance projects, often taken because more information is available than at the time that the forecast was made, are discouraged by this requirement;

- the proposal does not appear to be consistent with the statement in paragraph 3.15 of the Developing Monopoly Price Controls consultation paper in May 2003. That paragraph says that deferment can represent an efficient decision. The proposed approach implicitly assumes that all delays are inefficient, because there is no viring between underspends and subsequent overspends. If instead it was assumed that underspends in one or more years are the direct cause of overspends in later years, then viring should be allowed between years;

- when allowances for the period were set, NG operated its gas distribution business as an integrated entity. It therefore would presumably have been managing each line item within its capex allowance over all eight networks as a whole. At a later date to assume, as the proposed approach does, that it should have managed them by network when it had no need or incentive to do that is inconsistent with the arrangements at the time, and assumes that NG should have known both that disaggregation would occur, and that a policy that was not stated at the time would subsequently apply. We do not think that the application of such hindsight is reasonable or consistent with minimising regulatory risk.

***Question 2: Is our proposed regulatory treatment of our conclusions on efficiency appropriate, transparent and practical?***

We do not consider that the proposed approach is appropriate. We accept that it is sensible to apply a methodological approach to the treatment of overspends, but that has to follow proper process, not least that it is consulted upon and the effects are transparent *ex ante*. We do not think that this applies in the present case, as we consider that the policy on the treatment of overspends has remained unclear until now. Our reasoning is as follows;

- we think that the first substantive policy discussions on such issues were in the Initial Conclusions paper in June 2003, part of the series in Developing Network Monopoly Price Controls. Most of the relevant proposals in that paper were in terms of dealing with

underspend, and whilst a number of options for dealing with capex variances were discussed (pages 34-36), no conclusion was actually offered;

- Ofgem sought to clarify the position on the treatment of overspends in an Open Letter in March 2004. That letter states that the approach to be adopted for GDNs is to be based on the principles set out in the December 2003 consultation paper on electricity distribution price controls. Again that paper tends to focus on capex underspend rather than overspend - with paragraph 3.77 noting that historically underspend has occurred and 'the treatment of overspend has not been an issue'. It then goes on to say that some DNOs have argued for greater clarity in this area, discusses options and presents a table of potential improvements without concluding on the policy stance of the Authority;

- it is important to realise that the Open Letter was written at the express request of National Grid to clarify the treatment of overspends, because of the doubt that existed at the time. The fact that the letter was written confirms that doubt and the need to clarify the position. Furthermore, if the then policy was clear then the letter would specifically have referred to it. We consider the fact that it did not do so to be significant in terms of the industry generally, and the buyers in particular, believing that the letter was making new policy proposals, indeed that was its intent;

- we consider that the policy proposals in the Open Letter in relation to overspend were new, even though they were set in the context of previous capex policy proposals. In particular, whilst the letter does mention symmetrical treatment of over and under spend, it does not state that this is a capex roller or that the presumption is that overspend will go into Type 2 unless 'exceptional', a word subsequently used by Ofgem to describe Type 3 allocations in relation to overspends. Classifying Type 3 expenditure as exceptional is a new proposal and not consistent with the definitions used in the Open Letter.

Our view is that the Open Letter states new policy and we therefore consider there are a number of important issues to be addressed when interpreting it and the more recent Ofgem proposals in relation to the treatment of capex overspend;

- we think it important to consider any proposals in the context of regulatory risk. We accept that the treatment of capex overspend relates back to fundamental questions about what sort of risks we are expected to accept as a monopoly gas transporter. Whilst we are willing to engage in that debate, it appears to us than it should be on the basis of *ex ante* proposals to apply during the next price control review. An *ex post* change to the rules after the controls were set is an example of regulatory risk that could not have been envisaged at the time those controls were accepted, and could not therefore have been taken into account. Had Transco known the importance that it is proposed should be attached to capex volume forecasts and unit costs, for example, it is reasonable to speculate that it might have taken a different attitude to the tradeoffs inherent in any settlement;

- the Open Letter was written to set out policy on the treatment of overspends, and it was done so at a time when the quantum of overspends was already an issue. If Ofgem had the intention then to consider the volume and unit costs forecasts and allowances as effectively sacrosanct, as the proposed approach now appears to do, that should certainly have been made clear. As it was not, we consider it a departure from the letter subsequently to state that forecasts have the role that it is proposed to assign to them;

- we also do not think that the proposed approach takes proper account of the need to invest in response to statutory and licence requirements, particularly in terms of volume estimates where we have little or no discretion over investment in specific response to customer demand. Given that our discretion is limited, to penalise us for under-forecasting volume five years into the future seems perverse, and certainly a new risk that would not have been taken into account when the controls were agreed;

- the emphasis on symmetry has to be seen in the context of previous capex spend profiles as compared to allowances. Until DPCR4 the trend in both gas and electricity distribution had been to underspend. For example, the February 2001 consultation paper Review of Transco's Price Control from 2002, noted this in relation to gas (for example paragraph

6.44 and 6.47). Similarly, paragraph 3.37 of the December 2003 document, and the fourth paragraph of the Summary of the subsequent March 2004 Policy Document make the same point in relation to electricity distribution. In our view it is not reasonable that when the balance swings from capex underspend to overspend, Ofgem proposes to change the treatment rules in ways which provide short term benefit for underspend and short term penalties for overspend. The advantages of symmetry certainly do not apply to us in the present review.

***Question 3: Is our initial view on how to set capital and replacement expenditure allowances for 2007/08 appropriate?***

There is relatively little description of this approach, other than that in paragraph 3.43 of the consultation paper. in principle the approach is appropriate, but our experience so far is that the intention is to do little more than roll forward a view of the past which in any event we consider erroneous, without attempting to take into account the fact that different owners might approach capex and repex forecasts differently from NG.

***Question 4: Which of our options is most appropriate for setting the operating expenditure allowance for 2007/08?***

In principle we favour the use of allowances, as that is consistent with the principle of a simple opex review for the roll forward. We do not consider that this damages customer interests, as the costs and benefits of a full review have not been taken into account, and it is hard to say what the overall effects of such a review might be. We also agree that the costs in the control years are atypical, and that it would be difficult to 'aim off' to deal with them.

This view assumes that pensions and shrinkage are dealt with separately, and we expand on our reasons for this in relevant answers to Chapter 4 questions.

***Main control issues***

***Question 5: Is our proposed approach for setting capital and replacement expenditure allowances for 2008-09 to 2012-13 appropriate?***

We support the general approach to setting capital and replacement expenditure allowances. We agree that capital forecasts need to be consistent with the policies, procedures and governance arrangements within each GDN. In that regard it is likely that divergence is occurring and certainly we have held a major review of our approach to capital planning and as a result our future forecasts will now reflect these new policies.

In respect of cost trends it is important to recognise that one GDN on its own does not set or in any major way influence the market rate for contractors. That market continues to place premium prices on scarce civil engineering skills, because demand outstrips the supply of such skills. It will be important for Ofgem to benchmark forecast costs against market rates using appropriate indexes such as Baxters.

Clearly the impact of considerable increases in capital expenditure across the utility industry including Transmission will have a significant impact on contractor prices. At present, we are experiencing very significant increase in prices for specific projects and are experiencing difficulties in finding contractors willing to take on small projects at reasonable rates.

***Question 6: Is our proposed approach for setting operating expenditure allowances for 2008-09 to 2012-13 appropriate?***

We support the use of benchmarking and comparative techniques to inform the setting of future operating costs. Any such comparisons, however, must take into account the cost drivers of the business. For example it would be appropriate to look at the opex costs per pipeline km, as assets clearly drive costs. Other factors such as network density are also

important; for example we have 3.3 times the national average of Local Transmission System (LTS) pipeline per customer, reflecting our geography and the relatively dispersed nature of our customer base.

We know that each network will have its own reasons for attaching more or less weight to particular cost drivers and whilst accepting the principles set out in the consultation paper, we think it essential for the networks and Ofgem to discuss further what factors should be taken into account to ensure that costs are properly comparable.

***Question 7: How should we deal with the uncertainty surrounding the level of costs associated with the Traffic Management Act?***

We support the general approach set out in the consultation paper and welcome Ofgem's commitment to provide allowances for the TMA. We support the use of *ex ante* allowances where there is a good degree of certainty in relation to the expected costs. Forecast costs are uncertain at the moment, however, due to both implementation delays and a variety of assumptions about take up rates by Local Authorities, and unless these become more certain prior to final proposals we agree it would be appropriate to include a specific reopener consistent with the approach of DPCR4 and as described in outline in our response to Question 5 of Chapter 2.

***Question 8: What are your views on our principles for assessing GTMS replacement costs, SOMSA exit and ongoing system operation costs?***

We welcome Ofgem's commitment to allow the efficient costs of replacing GTMS going forward.

In terms of separation costs, we see a clear distinction between establishment costs and operating costs. For establishment costs, we accept that Ofgem made clear statements about the costs of separation not falling upon customers. In terms of the treatment of System Operation costs generally, we consider that disallowance of establishment costs should be confined to the marginal costs over and above setting up and running a single national control room.

We do not accept the Ofgem proposal to cap ongoing opex costs to the costs incurred by NGG in the years preceding the sale. We are a separately licensed GDN and as such require recognition of our ongoing costs as a separate business. If Ofgem is to obtain benefits for customers in terms of comparative regulation, the main reason for its approval of the sale process, then it is only reasonable to allow efficient operating costs for all comparators. If the present proposal is adopted, it discriminates against gas network operators, because electricity DNOs are allowed the efficient costs of running their own control centres.

## Chapter 4 – Outputs and Incentives

### One Year Control Issues

***Question 1: Is Ofgem's initial view on how to update the mains replacement incentive mechanism for 2007/08 appropriate?***

In principle, the approach set out in paragraph 4.4 is appropriate. The practical issue will be whether or not reasonable and practical unit cost assessments are used in the analysis.

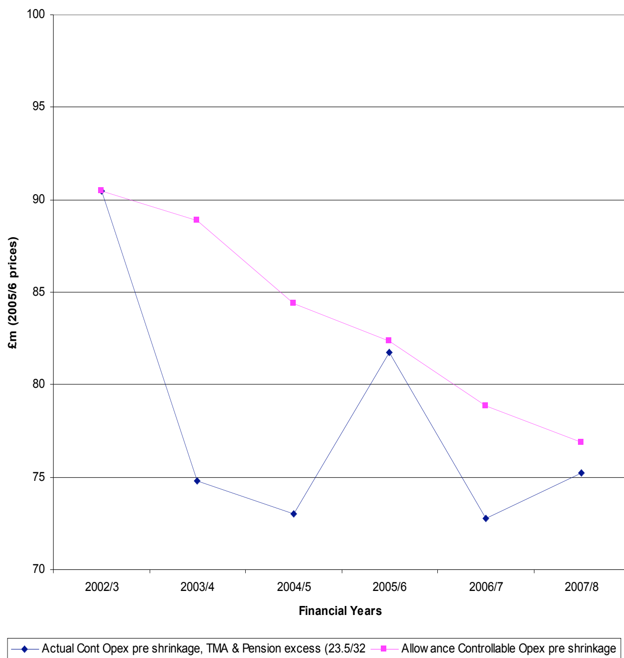
***Question 2: Is Ofgem's initial view rolling incentives during the one year control appropriate?***

Given that we have strong reservations about the proposed approach in Chapter 3, in particular our answers to Questions 1 and 2 in that Chapter, we have equal reservations about its application in the extension year.

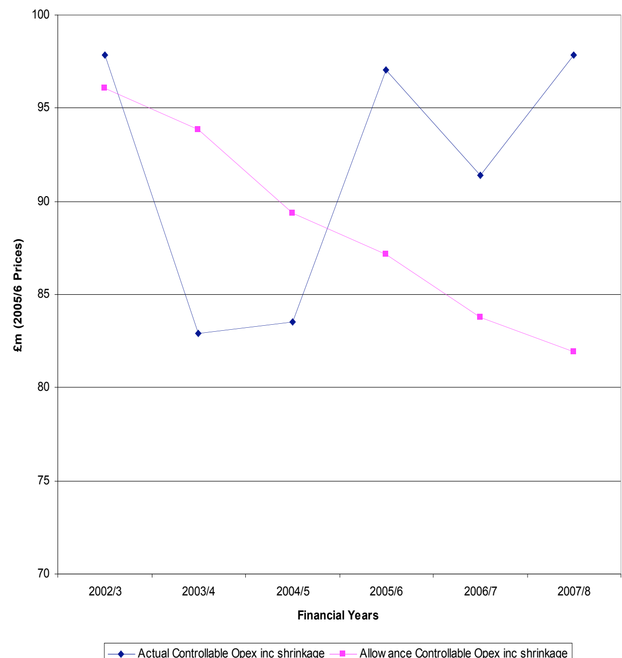
***Question 3: How should Ofgem determine shrinkage allowances? Should Ofgem adopt one of the options presented in this chapter or a different option?***

We face major problems with regard to shrinkage and pensions. In summary, the amounts allowed for these items have proved completely inadequate in the light of recent experience, and these are costs over which we have little or no control. The total effect has been to offset any correction that would otherwise accrue from the normal application of incentive regulation, as the graphs below show[1]:

Controllable Costs Excluding TMA, Pensions and Shrinkage




Controllable Costs Including TMA, Pensions and Shrinkage




Whilst we propose a simple approach to the one year control, we must get the significant shortfall represented by shrinkage and pension costs addressed in 2007/08. We are therefore pleased that Ofgem has listened to our concerns and is proposing to resolve the situation. At the moment, we are the only element in the gas supply chain that has not been able to raise its charges to deal with the huge increase in gas prices in the last year or so.

Our general view on shrinkage gas is that we do not think it appropriate for a gas transporter to bear price risk or volume forecasting risk. We do consider it appropriate, however, that we should be incentivised to reduce shrinkage. We therefore favour in principle Option 2 in the consultation paper as the right long term approach. We are concerned at detailed aspects, such as the comment in the consultation paper that we will bear risk based on a notional level of gas prices, and we would welcome more details on the precise application of this option.

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[1] For the years prior to 2005/06, the above graphs are based on the NG methodology for allocating allowances and actual costs to networks; at this stage, they do not take into account the misallocation reported in paragraph 4.48 of the consultation paper. In addition, the costs prior to 2005/06 contain a significant proportion of allocated costs, and the bases for those allocations changed between years.

We accept that a short term solution may not be able to address such implementation issues, and we therefore agree with Ofgem that Option 1a is appropriate for the one year control.

We remain of the view that given the scale of the mismatch between allowances and actual out-turn, shrinkage is a genuine exception and therefore Ofgem should provide retrospective adjustments to operating cost allowances. This is consistent with the approach proposed by Ofgem to look at each component of historical capital expenditure and then allow or disallow expenditure down to specific years and separate activities and not look at the whole picture over the five years; if such an approach is adopted that we consider that the same treatment should apply to operating costs. Therefore the significant shortfall in operating cost allowances should be recognised as a discrete matter and operating cost corrections should be put in place to allow GDNs to recover the considerable shortfall on shrinkage gas allowances that has been experienced.

***Question 4: Should Ofgem carry out further work on incentives as part of the one year control review, other than that set out in paragraphs 4.1 to 4.23?***

For the avoidance of doubt, we assume that the reference should be to paragraphs 4.1 to 4.25, this being important as paragraph 4.25 contains Ofgem's conclusion on the treatment of shrinkage gas costs for the one year control.

As a gas transporter, we are prepared to accept risks if we are incentivised properly in relation to them, they are genuinely within our ability to control and if the downside costs of the risk occurring are proportionate. We therefore consider it appropriate to look at incentives in the context of those risks that we reasonably ought to bear. In that regard, we consider that the outcome of deliberations on such issues are likely both to be lengthy and produce more rather than less complexity. We therefore do not think it appropriate to undertake further work on incentives as part of the one year control review.

Another reason for considering such issues in the main control review as that the greater the number and complexity of incentives, the more that our overall risk increases and we feel strongly that this needs to be taken into account in cost of capital, especially if any risks are asymmetrical. We therefore consider it appropriate to carry the incentives discussion forward in parallel with the cost of capital discussion, and as stated earlier we think the latter is firmly an issue for the main control.

***<u>Main control issues</u>***

***Question 5: Should the interruptions and NTS offtake incentives on the GDNs be part of the overall RPI-X price control or separate incentives with caps, collars and sharing factors? How should the price risk for each of these incentives be addressed?***

***Interruption*** – We do not think that it is appropriate for interruption to be incentivised via the RPI-X mechanism. Although DN Interruption reform is still under development, Ofgem has stated that all customers should be treated equally and that firm customers should not subsidise the interruptible sector. It is envisaged that the future incentive mechanism will see all DN connected loads paying firm exit capacity charges. The payment made to those customers who are successful in tendering for interruptible services will be a compensation type payment which should be treated as a cost for avoiding investment. We favour this approach and consider that a cap, collar and sharing factor mechanism is appropriate.

***NTS Offtake*** – The current incentive arrangements are based around capacity targets set by Ofgem, which are compared to annual Offtake bookings. There are no operational incentives to ensure that daily requirements match annual bookings, which means that DNs could make erroneous bookings to avoid the incentives. To avoid this, under exit reform it is likely that daily overrun charges will apply to DN daily bookings, which will ensure that the annual and daily bookings are aligned. In addition, under the proposed changes to payment mechanisms, the DN will be responsible for paying for transportation to the Offtake and will recharge this to the Shippers along with distribution transportation charges. There is a

potential for Ofgem to incentivise the DN to ensure that long term bookings are aligned with Shipper requirements so that we are not overbooking capacity and recharging this to Shippers through transportation charges. A cap, collar and sharing mechanism may again be appropriate in the future.

The two mechanisms proposed have a similar structure and a further refinement could be to combine them into a capacity incentive.

***Question 6: Is it appropriate to adopt rolling incentives and an information quality incentive mechanism for capital expenditure for gas distribution? If so, what should be the features of the incentives?***

We agree in principle with the implementation of capex rollers. However, this needs to be considered in the context of setting appropriate allowances and the *ex post* treatment of overspends. At present, as discussed in our response to Questions 1 and 2, Ofgem are proposing to penalise companies for failing to predict accurately the volume and cost drivers of capex six to seven years ahead by disallowing the expenditure completely or disallowing the return and depreciation element for five years. We do not think such a penalty is appropriate.

The proposed methodology for dealing with the overspends is currently flawed as it does not allow for efficient deferment, contrary to the statement in paragraph 3.15 of the Developing Monopoly Price Control consultation paper in May 2003, and does not take account of movements between costs pots or across years as GDNs strive to be efficient and utilise their assets in the most efficient way. Therefore this approach will clearly drive GDNs to be extremely risk averse in their future forecasts and consider extremely carefully the individual components of the price control proposals as distinct from previously considering it in the round. Whilst we therefore accept the principle of a capex roller, this is only on an *ex ante* basis, with clarity over the ways that it will be applied.

***Question 7: Should the mains replacement incentive mechanism be carried forward in its current form, adjusted for particular factors such as service pipes, or abandoned in favour of a more generic incentive?***

We believe that the Mains Replacement Incentive Mechanism scheme should be carried forward. In future we consider it important that the scheme recognises practical issues that arise from virtually all replacement projects and deals with them appropriately. In particular, mains abandonment schemes are linked to associated mains replacement and in virtually every case the latter includes service pipe replacements, and it is a very unusual event where services are not replaced or transferred as part of a mains replacement. As such costs occur only because of the mains replacement, it seems sensible to include them within the overall mains incentive scheme. The current allowed revenue framework in effect excludes the costs of services and so the DN has to argue for the ‘overspend’ relating to services to be allowed at the end of the control period. We do not think it appropriate for us to be exposed to the risk of disallowance for work that arises as a logical consequence of the mains replacement programme, and in our view the risks are exacerbated by the proposed treatment of overspends, an issue on which we have already commented in several previous answers.

In a revised scheme, the Matrix Values should take into account the upward cost pressures that the industry faces in the Contract market and should not be based on what we consider to be arbitrary reductions in unit costs on a year on year basis. It is also necessary to consider appropriate ways of sub-dividing the large pipe category, that is above 12" in diameter, to reflect the large cost differences that can occur within this category.

***Question 8: Is it appropriate to adopt rolling incentives for operating expenditure for gas distribution?***

In principle we support rolling retention mechanisms that allow the benefit of outperformance to be retained for five years. We think it appropriate to incentivise regulated companies

continually to improve efficiency, and not hold back particular initiatives to fit with the regulatory cycle. Considerable work needs to be undertaken, however, to establish the detail of any such mechanisms before a proper consideration can be given. We understand that there are concerns over the measurement of the amounts to be rolled forward in this way, and we think that the planned introduction of regulatory cost reporting should provide a much better platform to enable such measurements to be conducted in an even-handed manner.

***Question 9: How can the quality of service arrangements be improved? In particular what are your views on the high level options proposed by Ofgem for the quality of service and outputs arrangements for 2008-2013?***

We believe that the current quality of service arrangements work reasonably well; the majority of guaranteed and overall standards drive performance in areas that are important to customers. We agree that the framework could be simplified, however, and therefore support Option 2 in the consultation paper, Incremental Improvements.

In particular the Overall Standards add little value directly to customers when compared to the compensation arrangements under the guaranteed standards. We will demonstrate this in our detailed response to the relevant BPQ narrative questions as part of the price control review process. In summary:

- we would support the suggested change in relation to the complaints overall standard being changed into a guaranteed standard with a £20 compensation payment for a failure;

- we also accept that customers value information about planned interruptions and we would therefore understand if the existing overall standard to provide advance notification was changed into a guaranteed standard with an appropriate compensation payment for failure;

- it is important, however, that incentives are appropriate in order to deliver performance. The suggestion of making a compensation payment for not accurately estimating a supply restoration time provides a perverse incentive; encouraging companies to give an over-cautious estimate of the restoration time rather than a realistic time in order to avoid making compensation payments.

The only other overall standard that is of value is responding to uncontrolled and controlled gas emergencies within 1 hour and 2 hours respectively, this is also included in our safety case with the HSE In summary we would suggest that the overall standards are removed.

In relation to the removal of guaranteed standards that consumers find of little value, we would suggest that the current guaranteed standard to provide alternative heating and cooking facilities to priority customers within 4 hours of an interruption is removed. In practice we offer alternative heating and cooking facilities to any consumer and did not make any payments under this guaranteed standard in 2005/06. We therefore do not see a need for this guaranteed standard going forward.

We agree that consumers should receive compensation for incidents caused by third party damage and water ingress. We therefore do not have any issues with the proposal to incorporate these arrangements within the Guaranteed Standard (Regulation 7) and the UNC Failure to Supply Gas arrangements provided that there is an opex allowance set to cover an efficient level of compensation that has not been caused by WWU.

Within WWU we are continually reviewing our processes and we undertake periodic audits in relation to the quality of service outputs and we believe this is sufficient, without the need for Ofgem to require audits.

***Question 10: What are the advantages and disadvantages of the different approaches to setting capacity outputs and providing appropriate incentives for efficient behaviour by the GDNs in the next price control?***

Capacity requirements of Users with the DN are currently only directly signalled to the DN where Incremental Capacity is required such as specific reinforcement for a new connection. Provided the DN has obtained an appropriate level of User commitment for this additional capacity, through an ARCA, it is appropriate for the asset to be included in the RAV.

Indirectly User requirements are signalled through the Transporting Britain's Energy (TBE) process and then are developed into the supply and demand figures. However the DN does not have any direct arrangements with individual Shippers to ensure that these requirements are translated into contractual commitments for capacity. Under the enduring offtake reform DNs will be required to make a long term user commitment to exit capacity. It is assumed this will take the form of a "take or pay" type arrangement between the DN and NTS. Whilst it is unclear how the payment flows between Shippers and Transporters will work, DNs can assume that Transmission Transportation charges will include a pass-through of the NTS exit charges. Therefore the difference between the capacity booked through the long term process and that purchased by the Shippers will be the area required to be incentivised. In addition the relationship between the long and short term bookings is an area for consideration however whilst the Shippers are exposed to reconciliation within the NDM market, the relationship between Shipper nominations and DN daily capacity bookings is not clear. Within the UNC there is provision to apply an overrun charge to the DN exit capacity, but there is no mechanism to apply this to the NDM market.

A Unit Cost Allowance mechanism could be developed to reflect the cost of providing additional capacity at a specific point on the network. However the revenue entitlement generated from a UCA is dependant on the release of additional capacity at the specific point. It is not clear how this type of mechanism could be applied to capacity requirements within a DN as it would encourage the DN to build additional capacity beyond any committed requirements.

***Question 11: Are there any other areas where outputs or output based incentives for GDNs should be developed including safety and the accuracy of gas pipeline records? If so, what should they be?***

We understand that historically there has been an issue with the accuracy of records in the gas networks and, as an industry, significant work is being undertaken to reduce the consequential risk of such an issue. As such, we do not consider it is necessary for outputs or output based incentives to be developed in this area.

We take our responsibilities seriously in minimising risks to the public at all times, including other utilities and contractors. In addition we are always seeking to ensure a safe working environment for our own staff and contractors; continually improving working practices, implementing more efficient procedures and safe working. We acknowledge there have been industry wide issues as a consequence of providing information to IGTs which has led us to ensure our ongoing commitment to providing timely and accurate information to them enabling safe working on their networks.

We have a well established error correction process in place. Generically termed the DR4 process, this incorporates a highly specified procedure which requires all staff working with records or involved in mains and service work to report errors in asset plans or databases to a centrally managed team. We have also commenced a significant programme of recovery of the accuracy and completeness issues that we have inherited. We are looking at implementing a new system that will enable field staff to update asset records electronically whilst on site, both for new and existing assets. This is a more timely process, enabling office based staff to undertake quality assurance checks immediately after the field staff have submitted the electronic drawings.

A range of measures are reported against on a monthly basis as part of our management information including progress against the timeliness of records update, the correction of errors under the DR4 process and the backlog of undigitised pipes.

In addition to the monitoring of management information, we undertake an annual audit of a selected number of processes. Audit outcomes are recorded in the WWU Audit Action Plan. The audit process is risk based and its principles have been accepted by the HSE.

In summary, we believe that our programme and management focus for ensuring accurate records is comprehensive and effective. We take this as a very serious issue within WWU and we are in regular communication with the HSE about this matter; they are satisfied with our plan and have appreciated our proactive stance and commitment to resolving the issues.

***Question 12: Does any aspect of the operation of a GDN require more investment in technical innovation than occurs at present?***

We anticipate a modest amount of R&D expenditure going forward. There are a number of issues where R&D could help our efficiency and investment initiatives. For example, we would like to research techniques for establishing external pipeline condition without recourse to excavation. This is particularly important in terms of our plans to replace parts of the network in North Wales where condition surveys are an important investment driver and at present excavation is usually necessary to determine condition.

Where projects of industry wide significance/value are identified, for example at the Network Cooperation Forum, then an appropriate contribution would be considered.

We therefore take the view that revenues should allow for modest R&D to incentivise GDNs to explore opportunities that will ultimately benefit the customer in terms of better services and lower costs.

***Question 13: Should Ofgem consider any other form of incentive mechanism in the context of GDPCR?***

Our comments on incentives are covered in the paragraphs above.

## Chapter 5. Financial issues

**One year control issues**

***Question 1: Is Ofgem's approach of calculating a post-tax cost of capital and an ex ante tax allowance appropriate?***

We believe that any move to a post-tax Cost of Capital for the extension year at this stage constitutes a lack of proper consultation process, is not consistent with a “light touch” extension year control and additionally has major implications for our financing model.

Our clear view is that consideration of the Cost of Capital and any subsequent changes should only be undertaken as part of the main review when sufficient time and consultation can be devoted to what is clearly a key element with major implications.

The extension year This question falls under the one year section

Our view has always been to support the concept of the extension year, namely to roll forward opex controls on as simple a basis as possible and deal with the capex overspend. We have discussed extensively the problems with shrinkage gas and pension costs, and we welcome the direction of Ofgem’s thinking on these issues as set out in the consultation paper. Other than these two areas however, we believe strongly that the roll forward should be based on present controls as much as possible.

Consequently the cost of capital in the extension year should remain as in the present control, not least because to do otherwise invites a full review which would take time that neither of us have, and also because such an approach is not in the spirit of a light touch roll forward.

In relation to the tax treatment, we accept that the outline principle has been set out by Ofgem in previous consultation papers. It is essential however to look further at the impact and the timescales over which any change in policy should be implemented. Apart from the obvious process issue, the change proposed would represent a considerable detriment to our bottom line.

We believe it wholly inappropriate to bring in such a fundamental change to what is supposed to be a straightforward roll forward for the extension year. Subject to assumptions about the calculations involved, and bearing in mind that NG have not yet been able to agree closing tax written down values (our opening tax written down values) with the Revenue, we estimate that the reduction in post-tax earnings annual that would arise would be either 1% or 2% dependant on the underlying assumptions in arriving at a post-tax WACC and also on whether GDN specific gearing is included. Such an approach should only be undertaken after full consultation on both the practical implications and the principle.

Main Price Control Review

A review of the basis and treatment of WACC is entirely appropriate for the main price review. However, any move away from the current ex-ante pre-tax WACC will still need very careful consideration and full consultation through a proper due process.

Before moving from a pre-tax WACC to a post-tax WACC there are a number of significant matters of principle which need to be considered. Key factors amongst these are:-

- Risk/reward of changes in tax related cashflows in the context of a risk adjusted WACC for the whole business,

- What encouragement should there be on a GDN to plan for tax efficiency and how should the associated risks and rewards be allocated?

- The impact on GDNs of changes in:
    - tax legislation, and
    - specific tax treatments agreed with the Revenue (i.e. taxation treatment of repex),

  together with the symmetry/asymmetry in respect of changes in the above,

- The adoption of a generic or GDN specific WACC,

- Generic or GDN specific treatment within the tax charge of items such as:
    - the tax treatment of repex expenditure,
    - interest costs and hedging arrangements,
    - Gearing,
    - Pensions costs,
    - The difference between the annually indexed regulatory allowed depreciation compared with the historic cost capital allowances claimable in each year generate a taxable profit,

  A significant factor in a DN's tax cost will be funding costs and gearing %, which we believe to be a matter for the licensee,

- Impact of a post-tax WACC would require consideration of financeability,

- The impact on the credit ratings (and in particular the PMICR of GDNs – which is a pre-tax measure) and therefore their ability to efficiently raise investment funding,

- The timing of any move to a post-tax WACC and the potential impact on past and future investment,

Applying a post-tax WACC “penalises” those GDNs who have established an efficient tax structure, and is neutral to those who have not. A move to a post-tax WACC and some loss of regulatory certainty is likely to increase the future net cost of equity, as equity investors will require a higher return as tax efficiency/planning will not supplement returns. Should this be a bulleted paragraph?

***Question 2: What, if any, financial indicators should be used to assess financeability (also relevant for the main control)?***

The key requirement is to enable the licensed entity to achieve its licence requirement for an investment grade credit rating. Consequently when assessing financeability, the use of financial indicators should be confined to those such as PMICR and debt to RAV ratios upon which credit rating analysts rely.

**Main control issues**

***Question 3: Should Ofgem use its traditional approach to calculate the cost of capital or should other approaches be considered?***

The traditional approach to calculating pre tax cost of capital provides consistent approach which is understood by the industry and enhances regulatory certainty.

***Question 4: How should Ofgem approach the issue of the level of gearing to be used in the calculation of the tax allowance? Should Ofgem ensure that consumers share in any benefits arising from companies having higher actual gearing than the regulatory assumption?***

Ofgem’s current assumptions for gearing are lower than than actual gearing for a number of DNs. However, this higher gearing is achieved through a combination of acceptance of a higher volatility of cash flows to equity holders than assumed by Ofgem and utilisation of finance structures which provide additional security for providers of debt finance; such security normally being given up by equity holders; in an effort to mitigate the negative impact of higher gearing on credit rating, debt risk, and consequently the cost of debt.

Consequently, higher gearing increases the volatility and reduces the certainty of returns to equity holders. The final allocation of risk and reward (which may be different from that assumed by Ofgem) is the result of negotiation between debt and equity holders, having regard to the views of credit rating agencies.

Ofgem should, and do, assume a gearing level, and implicitly a balance of risk and reward between providers of equity and debt capital, which is consistent with financeability of the network and the requirement for the licensee to retain an investment grade credit rating. Any actual increase in gearing above the assumed level is the result of a reallocation of risk/reward between the funding parties as noted above. Customers should not benefit from higher gearing as it is the result of risk reallocation, and does not affect the overall cost of funding of a business.

***Question 5: Are there any arguments for changing the depreciation rates used in the price control?***

We do not believe any new factors have arisen since the last price control which materially impacts an assessment of the economic life of gas distribution assets.

Regulatory consistency would support continuation of the current policy.

***Question 6: Is Ofgem's initial view on the treatment of pensions, and in particular the treatment of the GDNs' pension deficits, appropriate?***

We broadly agree with the approach adopted in DPCR 4. Consequently the efficient cost of pension schemes provided to employees should be allowed as part of allowed income. This would include any costs arising under the PPF levy.

Retrospective correction of pensions costs should be included in allowed income calculations for subsequent periods. This is particularly important because of the timing difference between pension scheme actuarial valuations, normally resulting in an adjustment to pension funding rate, which are typically on a three year cycle, and the five year r price control.

***Question 7: Is Ofgem's proposal on the mechanism for recharging NTS pension costs appropriate?***

We support Ofgem's proposal for setting allowances in the NTS Price Control. As these costs will be subject to RPI-X controls, we therefore consider that they should be treated as pass through items in the GDN licence.

***Question 8: What should be the timing of allowances for under recoveries from the current price control and deficit repair costs? CH***

Allowances for under-recoveries should be over the following PCR period. Allowance should be calculated by recognising the funding cost incurred by the licensee since the payment in excess of allowance was made.

Deficit repair costs allowance should be consistent with the cashflow required to fund pensions deficit consistent with prudent, but efficient, actuarial assumptions. This should be consistent with the deficit repair cost and period agreed with the pension scheme Trustees by the Licensee (which is also subject to review by the Pensions Regulator).

***Question 9: How will the changes to pensions law affect the price control?***

Recent changes to pensions law have increased costs of operating pension schemes due to:

- Compliance costs
- Defined benefit pension scheme PPF levy
- Influence of Pensions Regulator in pensions scheme valuations and the Trustee's strategy (and hence cash cost to Licensee) to address any defined benefit pensions deficits

These additional costs, efficiently incurred, will require funding under the price control.

***Other***

De Minimis limits should be set as % of RAV or turnover. The shareholder funds test is not commercially relevant – particularly as shareholder funds for new DNs are a function of the funding model adopted rather than net worth of the underlying business.

## ***Chapter 6 - Other issues***

***Question 1: Are the three options for the funding of xoserve appropriate? Should we consider different options?***

Of the three options listed it is imperative that that xoserve moves to a users pay basis. Without the application of this fundamental principle there will be no incentive for users to curtail their demands, indeed they will actively seek additional services if that in turn means they can reduce their own costs. As an individual GDN with only a small shareholding in xoserve we do not have the ability to control the actions of the xoserve board and are not able

to veto proposals by shippers or other parties that will in turn impact on our cost base. This is a wholly unsatisfactory position which if unchanged must lead Ofgem to consider xoserve costs as a pass through item on the basis they are not controllable.

More generally we think that there is time for a debate within the industry on who should bear what risks in relationship to xoserve costs and how that should be reflected in price controls, shareholdings, incentives and the structure of charges. We are therefore disappointed that a more radical approach to the funding of Xoserve has not been included in the options. Given that final proposals for the main price control are still over a year away we believe there is sufficient time to undertake a thorough root and branch review.

***Question 2: Should Ofgem consider the outcome of an industry dialogue as part of its assessment of the funding required to replace UK-Link?***

We fully support the promotion of dialogue and the development of a report on the most appropriate way forward. This must be as part of a process, however, that places costs fairly on those parties that benefit from changes and increases in specifications.

***Question 3: Which, if any, of the 5 options for facilitating network extensions should Ofgem consider in more detail?***

We fully support options 3, 4 and 5. These are not mutually exclusive and can be used in combination with each other. In terms of ease of implementation, particularly if we are looking at a possible trial for 2007/8, option 5 has considerable merit. Using the excluded revenues route will enable customers to pay for their network extensions over a 45 year period, leading to rural and remote extensions becoming a real possibility for thousands of customers for the first time, many of whom are in fuel poverty. This approach will require working in partnership with other bodies such as Warm Wales, DTI and energywatch and we are committed to continuing dialogue with these bodies as we develop our proposals further.

In respect of the 10 metre rule in principle we can see that this would enable more affordable connections for the person requiring the connection, although as now the effect would be for the cost to be borne by the general body of customers. There are ways, however, in which such a mechanism could work in the context of competition in connections; for example through the use of a unit cost allowance for the first ten metres that would be payable to a third party connector. There are a number of detailed points that will require substantive work and by itself we do not see the proposal as sufficient to resolve the issue of properties that are some distance from the existing mains.

## ***Chapter 7 - Timetable and process***

***Question 1: What issues to be addressed as part of GDPCR should be considered in an impact assessment? BW***

Whilst we agree with the list on page 59 there is one fundamental item missing. Give the scale of its impact, any possible move to a post-tax cost of capital that is not consistent with previous gas price control reviews must be addressed through a full Impact Assessment.