

Gas Distribution Price Control Review Cost Reporting Consultation



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Target audience: Consumers and their representatives, gas distribution networks (GDNs), independent gas transporters (IGTs), gas shippers and suppliers and any other interested parties.

Overview:

We have already agreed with the GDNs that we will collect relevant information on their costs and the drivers of those costs on an annual basis during the next price control period. This data will be instrumental in our assessment of appropriate revenue allowances for subsequent price controls.

The annual process will be similar to that already set up for electricity distribution and gas and electricity transmission. We are developing the Regulatory Reporting pack (RRP), which will contain the cost data in a conformed format and the Regulatory Instructions and Guidance, (RIGs), which will specify the details of how and when to complete and submit the RRP and any supporting information

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Context

We are carrying out the first full gas distribution price control review since the sale by National Grid Gas plc (NGG) of four of its eight GDNs to three new GDN owners on 1 June 2005. As a result, the current industry structure is substantially different from that in place at the time of the previous price control review. In particular, the creation of separately owned, managed and operated GDNs allows effective comparisons to be made between the businesses. By the time we are setting the next price control (2013-2018) we should have up to 7 years' worth of data from the separated GDNs on which to carry out our comparative analysis. This analysis is facilitated by taking all steps to ensure that the companies' submissions of cost data are on as consistent a basis as possible.

We have established that it is appropriate to introduce an annual cost reporting requirement and have introduced a licence condition (Standard Special condition A40 Price Control review Information) to that effect, which is awaiting activation by the Authority. The purpose of this consultation is to raise issues relating to the specific information that is to be collected, the format and the timing of the submissions and the interaction with certain other requirements.

Associated Documents

- GDPCR Initial Proposals, May 2007 (Ref. 125/07)
- GDPCR Fourth consultation, March 2007 (Ref. 49/07);
- GDPCR One Year Control Final Proposals, December 2006 (Ref. 205/06);
- GDPCR Third consultation, November 2006 (Ref. 203/06);
- GDPCR One Year Control Initial Proposals, September 2006 (Ref. 169/06);
- GDPCR Second consultation, July 2006 (Ref. 123/06); and
- GDPCR Initial Consultation, December 2005 (Ref. 259/05).

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Summary

When we approved the sale of four of the eight GDNs by National Grid Gas in 2005, we had to make a number of licence changes. We took the opportunity to insert a new standard special condition (A40 Price Control Review Information), which enabled us to require the licensees to deliver on an annual basis, information pertinent to the price control. We indicated that we would require this annual data, or cost reporting, from the start of the next price control.

Since then we have instituted an annual cost reporting process in the other two price controls we have set recently, i.e. transmission and electricity distribution. The electricity distribution process is in its second full year, and has already proved successful in forcing the licensees to ensure their reporting systems are robust and in improving our understanding of their costs, as well as allowing us to report on progress against the price control allowances.

We are in the midst of the gas distribution price control review for 2008-13, and so we are beginning the process of developing the regulatory reporting pack (RRP), which is the spreadsheet template that each GDN will have to complete with annual cost data and the Regulatory Instructions and Guidance (RIGs), which contain the price control reporting rules, i.e. how and when to provide the information. This consultation is to allow industry stakeholders and other interested parties to express their views on the form and content of the RRP, the outputs of the annual review process, the desirability of an external audit review and other related issues.

1. Background

1.1. During the most recent electricity distribution price control review (DPCR4), Ofgem found that there were difficulties experienced in gathering data on a comparable basis across the electricity distribution networks (DNOs) in order to carry out benchmarking and other analytical techniques.

1.2. The 14 DNOs are owned by 7 different corporate groups, which employed a variety of overhead allocations (partly influenced by the different corporate structures), different capitalisation and other accounting policies, and defined cost categories differently. The first Regulatory Reporting Pack (RRP) was developed subsequent to DPCR4 in the light of these difficulties. It was hoped that by collecting information in a conformed spreadsheet template (the RRP), backed up by specific Regulatory Instructions and Guidance (RIGs) it would be possible to collect 5 years' worth of comparable data for each DNO, thus providing a substantial and robust dataset for the next price control, as well as allowing Ofgem to measure performance against the existing price control.

1.3. An annual information-gathering process, involving detailed meetings with each DNO group as well as reviewing and analysing the completed spreadsheets will allow the project team to begin the subsequent electricity distribution price control review with a greater understanding of the businesses' cost base than hitherto. Finally, an annual report on performance against the price control, including indicative RAVs will give the DNOs and other interested parties useful information regarding performance across the industry.

1.4. For all these reasons we are proposing to develop a similar annual reporting programme for the GDNs. The eight GDNs share only four owners and they have only been separated for two years. Owners knew from the outset that our intention was to collect information in a way that enabled comparisons to be made between GDNs and over time. The differences in the way information is collated are generally less than in electricity distribution. Nevertheless, the fact that they are no longer under common ownership brings with it the risk that the systems, processes and policies that underlie their cost accounting information will become increasingly divergent, unless we ensure that we collect costs on a consistent basis across all GDNs.

1.5. Following the Transmission price control review, we have also developed RRP for each of the transmission owners and system operators. Since this includes the NTS, which is part of the same corporate entity as four of the GDNs, there is likely to be some interaction between the GDN RRP and the NTS RRP.

1.6. The structure of this document is as follows:

- Chapter 2 sets out our expectations of the outputs from the cost reporting process and a draft timetable

- Chapter 3 discusses a number of policy issues related to the cost reporting process
- Appendix 1 explains the response process and summarises the questions raised
- Appendix 2 gives a brief overview of each sheet in the draft RRP
- Appendix 3 sets out the Authority's powers and duties
- Appendix 4 is a glossary of the key technical terms used in this consultation
- Appendix 5 is a feedback questionnaire

2. Cost reporting outputs and timetable

Question 1: Are the proposed contents of the annual report appropriate?

Question 2: Are there any reasons why, consistent with our desire to promote transparency, we would not publish RRP data?

Question 3: Do you have views on the annual timetable including deadlines for submission of information to Ofgem?

Regulatory reporting pack (RRP)

Form and contents

2.1. The RRP will take the form of a spreadsheet template with multiple worksheets. Each GDN will get essentially the same template so that data is collected on a conformed basis - this also makes spreadsheet maintenance more efficient. To ensure the integrity of the RRP, the sheets will be locked, except for the cells where GDNs need to input data, which will be indicated by yellow shading.

2.2. We should only collect data we need. Determining the boundary between this and information we are merely interested in is not easy. For example, in the current review, our assessment of the companies' opex requirements is based on disaggregated benchmarking, partly due to issues around the recent sale and separation of some of the GDNs. As such, there is a limited historical dataset for individual GDNs, which arguably covers an atypical period of change in ownership and management. This gives us less confidence in the results of top-down benchmarking. However, by the time of the next price control, and in part due to the cost reporting process, these concerns should no longer apply and top-down benchmarking may be more appropriate. In this case, we might not need cost data at the level of detail collected by the Business Planning Questionnaires (BPOs). But at this stage it is not possible to predict precisely what techniques and types of analysis we will look to utilise for the next price control. Collecting information in an aggregated form might preclude us using techniques we would otherwise wish to carry out and limit the scope of any ex post review that could be carried out comparing actual with forecast performance.

2.3. Cost data should be collected on a cash typical basis. This ensures comparability year-on-year. We will need to collect information on atypical accruals and provisions elsewhere in the RRP, both to confirm that they are atypical and to reconcile back to regulatory/statutory accounts.

2.4. A draft cost RRP has been uploaded to the Ofgem website. It can be found on the same section of the website as this document.

Publication of data

2.5. In the interests of transparency, we would prefer to publish as much of the data as possible - ideally the full RRP. However, there may be valid reasons why this is not appropriate. If some of the data is excised, we may create a summary schedule in the RRP that displays the data for publication. In any case, we will probably make data public alongside the annual report, to give some context to the information.

Governance arrangements

2.6. As the data contained in the RRP will be crucial to setting appropriate allowances, its accuracy and reliability is of paramount importance. While we expect the GDNs to apply rigorous standards to the quality of all information they send us, the cost reporting process should have a sufficiently high profile within the licensee's business such that systems of control and other governance arrangements are kept under regular review by the directors of the licensee with a view to ensuring that they remain effective for this purpose.

Regulatory instructions and guidance (RIGs)

2.7. The RIGs are an essential part of the cost reporting process. They set out the purpose of each section of the RRP and the definitions of each term in the RRP, in order to ensure that they are filled in correctly. They specify the required level of accuracy and set out the timetable for submission and other important aspects of the process. To the extent that any external audit work is to be carried out on the data contained in the RRP, the procedures will be specified in the RIGs. We have yet to draw up a set of RIGs, but they are likely to be similar to the guidance for the BPQs.¹

Annual report

2.8. The content of the annual report is expected to follow that developed for reporting on electricity distribution, which includes: high level summary of costs incurred during the year; analysis thereof, including a commentary on differences between companies and from year to year, and operational issues or trends observed; performance against allowances; indicative RAVs; outstanding issues with the completion of the RRP.

¹ Ofgem 114/06 GDPCR Business Plan Questionnaire for the main control - Guidance and Narrative Questions

Annual timetable

2.9. Although the design and development of the RRP is a cornerstone of the cost reporting process, it is the associated analysis and discussions with the companies that ensures it delivers value. A likely outline timetable of the process, broadly similar to that adopted by the other sectors is as follows:

Action	When
Issue finalised RRP and guidelines for year ending 31 March	February/March
GDNs complete and return RRP	By 31 July
Desktop review and queries – resubmission if required	August/September
Detailed cost visits to each GDN group (1 per week)	October/November
Publish annual report	January
Lessons learned and update of RRP as required	January/February
Issue finalised RRP guidelines for year ending 31 March	February/March

3. Issues

Question 1: Is it realistic to seek to create benchmarking opportunities across sectors for generic cost types, such as indirect costs?

Question 2: How should we determine the criteria for requiring details of cost information from GDNs' service providers whether they are classified as related parties or not? What practical issues are there in requiring detailed third party cost information?

Question 3: Should we seek to collect detailed xoserve data directly from xoserve, or via each GDN's RRP?

Question 4: Should we look to commission external audit work on any aspect of the RRP or should we rely on our own review process? If so, should we engage auditors directly or rely on the GDNs' statutory auditors?

Question 5: Do the regulatory accounts as they stand provide value to stakeholders?

Question 6: Under what circumstances, if any, should we consider relaxing the requirement to publish audited regulatory accounts?

Question 7: Under what circumstances, if any, should we consider relaxing the requirements to submit a statement of allocation of costs and revenues and to have the application of that methodology audited?

Consistency with other RRP

3.1. There is clear merit in maintaining a consistent approach to cost reporting across the different networks regulated by Ofgem, including similar formatting for collecting data that is likely to be generic to the different types of networks, such as debt schedules, tax computations, pension scheme information and indirect costs. The latter, in particular, if collected on a consistent basis could allow for benchmarking across all networks, rather than just a particular sector. For multi-utilities that will be completing packs in more than one sector (e.g. National Grid, Scottish and Southern Energy, Scottish Power) it can also aid the completion of the RRP and allow Ofgem to cross-check more effectively. On the other hand there may be areas where there are relevant differences between the sectors or the terms of their price control that point to differing approaches for elements of the RRP.

3.2. Since four of the GDNs are part of National Grid Gas (NGG), which is also the license holder for the gas National Transmission System (NTS), there is obviously some merit in conforming those areas of the gas distribution pack to the transmission one. This would assist us in checking that the total of the RRP for the four GDNs and the NTS can be reconciled to NGG's company accounts, and that allocations are on a consistent basis. It should also make it easier for NGG to complete the packs. However, the other four GDNs are not, and it is equally important that the RRP are identical for all GDNs to facilitate comparative analysis. There may be some tension in reconciling these objectives.

3.3. Furthermore, it follows that there may be merit in aligning the indirect cost analysis with that used in the electricity distribution RRP. The cost reporting process

for the DNOs is now well-established and so there would be concerns about a major redefining of the indirect cost activities at this stage. A sensible minimum aim would be to have a set of high-level categories to which each RRP's indirect cost analysis can be clearly mapped, without each RRP necessarily having the same analysis at the detailed level.

Data from related parties and contractors

3.4. Where substantive elements of the GDNs' operations are subcontracted to a related party, we should be able to capture costs at the level we would do if they were carried out by the licensee. This is particularly important in the case of NGN, who has subcontracted all their operations to United Utilities Operations Ltd. A further point for consideration is whether we should attempt to extend this requirement to capture genuine third party costs, where there is no element of common ownership. We will have to consider how we determine the criteria for requiring details of cost information from GDNs' service providers, and what practical issues the GDNs may face in obtaining detailed, reliable cost information from suppliers to whom they are not otherwise connected.

Xoserve

3.5. Xoserve is an unusual case, in that it supplies services to all eight GDNs and the NTS (who own it jointly), and their price control allowances each reflect their share of its capex and opex. During the price control review, we have collected data directly from xoserve in a special BPQ. This is probably the most efficient way forward for collecting annual cost information. However, xoserve itself is not a licensed entity and is not bound directly by the conditions of the licence. It is arguably harder for us to enforce compliance with the cost reporting rules.

3.6. If we were to collect the data via the GDNs, we would need to add an extra worksheet to the RRP for them to record their share of xoserve's costs. It is unlikely that the resources required of xoserve would be significantly reduced in this instance, since they would have to prepare the same level of analysis and then supply the data to each of the GDNs. In any case we will need to collect summary level information via the GDN packs, in order to roll forward the RAV, for example.

Auditing the information

3.7. We are considering whether it would be appropriate to require an audit of part or all of the information. The licence allows for this possibility, by reference to a nominated "reviewer", which could be Ofgem staff or a third party. Any audit work carried out on the RRP could be in the form of agreed upon procedures (AUPs), in which the tests to be carried out would be pre-defined with the Authority's agreement, and the auditors report on the results of those tests. They would not express an opinion on the accuracy of the information as they would do with a set of statutory accounts. The auditors could be the GDNs' own statutory auditors, or they could be a third party engaged by Ofgem to carry out the work for all GDNs.

3.8. Clearly either option would impose costs, either directly on the GDNs if they engaged their own auditors, or on Ofgem if they engaged an auditor independently (which would ultimately be passed on to the GDNs via the licence fee). We have to weigh up the benefits to be gained from such an exercise against these costs. Devolving part of the review process to a third party may limit the depth of understanding gained by Ofgem staff. The electricity distribution RRP is not independently audited, but the Ofgem team visit each DNO annually to make detailed enquiries into the pack. It is also notable that several DNOs have declared mistakes in their submissions when they have discovered them. On the other hand, the water industry regulator, Ofwat, which has been collecting detailed cost information annually for many years, has a rolling audit programme focussing on different sections of the data each year.

3.9. Any decision on audit is in part dependent on the role of the regulatory accounts. This is discussed below.

Interaction with regulatory accounts

3.10. At one time, the basis of some networks' regulatory accounts were specified by reference to detailed guidelines that allowed us to receive them in a format that aided our understanding of the businesses, which statutory accounts prepared under UK GAAP or IFRS do not always do. In this way, they had a similar function (albeit they didn't provide data at such a detailed level) as an RRP. Over time, the guidelines have been changed so that the basis of the regulatory accounts is now aligned with that of the statutory accounts, with the main differences being that the accounting period is aligned with the regulatory year and we require a form of segmental analysis that separates the business from a regulatory perspective (transportation, metering, excluded services, de minimis and other). Once the cost reporting process has been robustly established, the main uses of the regulatory accounts will be limited:

- Regulatory accounts give us an audited set of figures for the regulatory year – some companies have different accounting periods (NGN's year end is 31 December). Whilst a reconciliation to statutory accounts could be required in the RRP, this would not be audited unless we specifically required it
- Regulatory accounts give us an audited separation of the statutory company into relevant regulatory businesses. For some of the GDNs, the non-transportation element of their business is sufficiently small that the value of this may be limited. However, four of the GDNs, as well as the NTS and a significant metering business are all part of the statutory company NGG plc, which also has a number of subsidiaries. Its statutory reports are, as a result, of limited value to us.
- The current format for regulatory accounts include two narrative reports, an Operating and Financial Review (OFR)² and a Corporate Governance statement

² The scope and contents of the OFR were defined with reference to the government's original plans, which following representations from business were scaled back. Therefore none of the companies have a statutory requirement to produce a report in this level of detail. National

that some of the GDNs, as privately owned companies would not have to include in their statutory accounts, and arguably provide useful, publicly available information on strategically important businesses.

3.11. It would not in any case be appropriate to remove the obligation to produce regulatory accounts before we had established the reliability of the RRP process. Even then, it may be appropriate to keep the regulatory accounts in order to make publicly available certain financial or operational information. Finally, the optimum solution may be to have a set of criteria, by which it is determined whether regulatory accounts are required (for example a financial year end different from the regulatory year end, multiple regulated businesses in the same statutory entity, and so on). Views are invited on these alternatives.

Interaction with statement of allocation of revenues and costs

3.12. Special condition E3 of the GDNs' licences requires licensees to submit an annual statement outlining their methodology for allocating and attributing costs and revenues between their transportation business and other businesses. This statement is accompanied by an auditors' report based on a set of agreed upon procedures. To the extent that the RRP contains detailed explanations of allocations and their basis, it may supersede some or all of the requirements of E3. As with the regulatory accounts, we would want to be comfortable with the quality of information contained in the RRP before we considered relaxing other licence requirements.

Avoidance of unnecessary duplication

3.13. One concern that the GDNs have raised in initial discussions on licence drafting is multiple requirements for the same information via different licence conditions. It would be good practice for us not to request information through the RRP that we are already collecting elsewhere (e.g. quality of service data) except where it is relevant to understanding the costs of the business as a whole. Similarly, if we know we will want to collect certain data through cost reporting, we may be able to relax the requirements of other licence conditions. For example, the price control information condition (E6) includes details of the revenue and costs involved in providing emergency services to other gas transporters. Since allowed revenue is not dependent on this information, it might be better collected through the RRP.

Grid plc however, voluntarily prepares a report for its group accounts that covers most of the areas required under the gas transporters' licences

Appendices

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Appendix 1 - Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document. In particular, we would like to hear from gas consumers and their representatives, gas distribution networks and any other interested parties.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.3. Responses should be received by 21 September 2007 and should be sent to:

- Kieran Donoghue
- Gas Distribution
- Ofgem, 9 Millbank, London, SW1P 3GE
- Tel: 020 7901 7458
- Email: kieran.donoghue@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Next steps: Having considered the responses to this consultation, Ofgem intends to take forward the development of the RRP and the RIGs in consultation with the GDNs. The final versions will be made available on the Ofgem website. Any questions on this document should, in the first instance, be directed to:

- Kieran Donoghue
- Gas Distribution
- Ofgem, 9 Millbank, London, SW1P 3GE
- Tel: 020 7901 7458
- Email: kieran.donoghue@ofgem.gov.uk

1.7. The remainder of this appendix restates the consultation questions for convenience.

CHAPTER: One

There are no questions in this chapter

CHAPTER: Two

- **Question 1:** Are the proposed contents of the annual report appropriate?
- **Question 2:** Are there any reasons why, consistent with our desire to promote transparency, we would not publish RRP data?
- **Question 3:** Do you have views on the annual timetable including deadlines for submission of information to Ofgem?

CHAPTER: Three

- **Question 1:** Is it realistic to seek to create benchmarking opportunities across sectors for generic cost types, such as indirect costs?
- **Question 2:** How should we determine the criteria for requiring details of cost information from GDNs' service providers whether they are classified as related parties or not? What practical issues are there in requiring detailed third party cost information?
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Appendix 2 – Commentary on draft RRP

1.1 Summary data

This sheet is yet to be designed but will draw some high level data from other sheets. It is likely to give an indication of the data that will be published in the annual report.

1.2 Regulatory accounts reconciliation

This sheet allows GDNs to explain the differences in key figures from the audited regulatory accounts and the figures reported in the RRP and so will act as a sense check on the cost reporting data. To the extent that during the next price control we relax the regulatory accounts requirement (see paragraph 3.10), it will be replaced by a statutory accounts reconciliation.

1.3 Debt analysis

This sheet sets out details of the licensee's external and intercompany loans and finance costs. We use this to monitor how licensees finance themselves and also to determine if we need to make an adjustment at the end of the price control for excess debt tax shield³. This data will be collected on a statutory basis - for NGG, this data is therefore also being collected in the NTS RRP. Since their debt schedule was developed specifically with National Grid in mind it is different from the GDPCR draft schedule and may not be appropriate for the other GDNs. However, it creates additional work for NGG to complete two different debt schedules, so we will consider how they can be conformed or whether it is simpler to exempt NGG's GDNs from completing this schedule and collect the data via the NTS RRP.

1.4 Licensee tax computations

This sheet sets out details of the licensee's tax computations. It helps us to understand the factors affecting their effective tax rate and if HMRC treatment of any of their expenditure has changed.

1.5 Licensee capital allowances

This sheet is complementary to the previous sheet and provides more details of the capital allowances claimed by the licensee.

³ As outlined in GDPCR Initial Proposals, Ref 125/07, May 2007, page 91, para 9.22.

1.6 RAV

This schedule sets out the indicative RAV for the GDN for the duration of the price control, based on actual capex. The return on the RAV is determined ex ante as part of the price control, and so any additional expenditure over and above that allowed for will not earn a return in this price control. Nevertheless, it will eventually earn a return equal to a fixed percentage of the capex costs, and so interested parties may wish to consider it as included in the RAV⁴. A symmetric approach is taken to the treatment of underspend. We will look to build in adjustments to capex spend for any non-qualifying amounts, such as related party margins or DN sales-related expenditure. Note that the RAV figures are only indicative, that is they will not be confirmed until the next price control is set.

2.1 Operating costs

This sheet collects details of the operating expenses incurred by the main activities within GDNs. We do this to facilitate benchmarking between GDNs (and possibly with other companies for certain activity types). We do not know at this stage whether top-down or bottom-up benchmarking (or some combination of the two) will be the most useful comparative methodology for the next price control so it is important to collect costs at a consistent, disaggregated level.

The current activity analysis is taken from the BPO, however we may modify this. Firstly, there may be merit in splitting the work management category into a greater range of cost types. Secondly, we will look to align our indirect activity analysis with those used in the transmission and electricity distribution RRs. This is not to say that they will be exactly the same, but a minimum aim will be to have a set of high-level categories to which each RR's indirect cost analysis can be clearly mapped. This will allow benchmarking across all network operators.

2.2 Year on year cost operating cost movements

This sheet uses the same cost activity analysis as in the previous sheet and allows licensees to explain what they believe are the main variances to the prior years' data (adjusted for inflation). This will help us to understand the key trends driving changes in costs, and where the GDNs are making operating efficiencies.

2.3 Cost mapping

This sheet has been taken from the electricity distribution RRP and seeks to provide an audit trail back to primary accounting records, including an explanation of where

⁴ This is linked to the implementation of Ofgem's proposal to adopt capex rolling incentives - see GDPCR Initial Proposals, Ref 125/07, May 2007, page 65

and how costs have been allocated across different activities. This enables us to robustly check that costs have been attributed or allocated to the correct activity and understand where allocations are being used and the basis of allocation. The format of this sheet may need modifying, bearing in mind that NGG has a multiple-stage allocation process for shared costs, which will be difficult to replicate in this format.

2.4 Labour costs

This sheet collects details specifically of labour costs and also the number of FTEs involved in each key cost activity, as well as a cost per FTE for each activity. This allows us to monitor labour trends in gas distribution.

2.5 Pension data

This sheet collects pension data relating to cash costs of funding pension obligations, and the costs of meeting current service obligations as charged to the profit and loss account. In conjunction with the labour costs schedule it will allow us to calculate any under/over funding adjustment to be applied at the next price control.

2.6 Atypicals and provisions

This sheet collects details of atypical events and movements on provisions or accruals. By identifying movements in provisions it allow us to differentiate between costs arising due to those movements and the underlying cash costs. It will also form an important part of the reconciliation to the accounts.

2.7 Shrinkage

This sheet collects the components of shrinkage in terms of volume and factors by LDZ. This allows us to monitor trends in shrinkage. We may use this sheet to collect additional information on performance against the shrinkage incentive, to the extent that we do not collect this information through the revenue RRP.

3.1 Capex Summary

This sheet is simply a summary of the information contained in the capex sheets 3.2-3.6. No input is required.

3.2 LTS & Storage

This sheet collects capex for LTS reinforcement and new storage, by individual project. These investments may take place over a number of years so we can only evaluate them in the context of the total cost of the project. We have therefore included costs in previous years and future forecast costs for all projects in which expenditure is incurred in the current year.

3.3 Mains

This sheet collects data on general and specific mains reinforcement, both by pipeline diameter band and by project. We collect the information by diameter band in order to understand how unit costs vary by pipeline size.

3.4 Governors

This sheet collects expenditure data for district governor investment. Data is collected for growth driven general reinforcement as well as for any other renewal of district governors, split by pressure tier to support a meaningful comparison of unit costs between activities and companies.

3.5 Connections

This sheet collects expenditure and activity data for mains, governors and service connections activities that are directly customer driven. Disaggregation of mains data is required in order to separately identify the unit costs for each mains pipe size for existing housing, new housing, non-domestic, off-site (feeder) and specific reinforcement mains activities.

3.6 Other Capex

This sheet collects high level data for other operational plant, equipment land & buildings and Non-Operational Capex. The worksheet makes provision to capture both named projects over £0.5m, aggregated smaller projects and non-project related expenditure. Certain known projects have been pre-populated in the worksheet.

3.7 Breakdown of Capitalised Overheads

This sheet collects summary level data on the amount of capitalised overheads included in each capex activity. In the BPOs, this data was collected within the capex activity sheets. We will need to build in a reconciliation to the opex analysis of overheads.

3.8 Expenditure analysis

This sheet analyses total capex expenditure by activity into the cost categories of direct labour, contractors, materials and other. This analysis is useful for understanding the impact of different real price effects for different inputs. In the BPOs, this data was collected within the capex activity sheets.

3.9 Repex Summary

This sheet is simply a summary of the information contained in the capex sheets 3.10-3.11. No input is required.

3.10 Repex Mains

This sheet contains details of costs incurred in replacing mains pipelines. Mains data is collected by installed pipe size in 8 ranges (from less than 75mm to more than 630mm) and for decommissioned pipes (workload only) from <3" to more than 24". Data is collected for each category of mains replacement - such as the HSE - mandated replacement programme. We will also need to collect data on abandoned mains as part of revenue reporting, but not by replacement reason. LTS pipelines are also analysed by project. This data enables us to understand the cost of each replacement programme, and the relationship between the size of pipe abandoned, and the replacement pipe.

3.11 Repex Services

This sheet collects details of costs incurred in replacing service pipes and risers (vertical pipes in multi-occupancy buildings of over 20m in length). The costs are intended to include the cost of replacing service connections and restoring supplies, but not the cost of any meter work carried out on behalf of others.

3.12 LTS Asset Data

This sheet collects non-financial data on movements in total length of pipelines (by diameter and operating pressure) during the period. It also includes sundry other LTS population data. We collect this data to understand changes in the pipeline assets and the changes that investment makes to the pressure tiers over time.

3.13 Capacity & Storage Asset Data

This sheet collects non-financial data on movements in the amount of storage capacity (by storage type) during the period. We collect this data to understand the changes in the volume of any contracted seasonal storage and the (contracted or planned) capacity of supplies into the LTS.

3.14 Mains & Governors Asset Data

This sheet collects non-financial data on movements in the length of mains pipelines (by material type) and governors (by type) during the period. It also collects details of the target population of the mains replacement programme and the surveyed number of risers. We collect this data to understand the profile of pipelines and other assets and the changes that investment is making to that profile.

3.15 Additional Data

This sheet collects non-financial data on the incidence of publicly reported escapes (PREs) and repairs carried out. We collect this data to understand the trend in PREs and the overall system condition.

3.16 Capacity & Demand Data

This sheet collects planning data by exit zone for the current year and four years forward, based on three key planning scenarios. We collect this data to understand the basis on which capacity-based investment is judged to be required on the GDN.

3.17 Fixed asset disposals

This schedule sets out details of assets disposed of by the licensee. This allows us to adjust the RAV in line with Ofgem's regulatory principles.

Appendix 3 – The Authority's Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority ("the Authority"), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Act 2004, as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.⁵

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly⁶.

1.4. The Authority's principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of consumers, present and future, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.5. The Authority must when carrying out those functions have regard to:

- The need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- The need to secure that all reasonable demands for electricity are met;
- The need to secure that licence holders are able to finance the activities which are the subject of obligations on them⁷; and
- The interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.⁸

⁵ Entitled "Gas Supply" and "Electricity Supply" respectively.

⁶ However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

⁷ Under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.

⁸ The Authority may have regard to other descriptions of consumers.

1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

- Promote efficiency and economy on the part of those licensed⁹ under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- Protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity;
- Contribute to the achievement of sustainable development; and
- Secure a diverse and viable long-term energy supply.

1.7. In carrying out the functions referred to, the Authority must also have regard, to:

- The effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- The principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- Certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.8. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation¹⁰ and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

⁹ Or persons authorised by exemptions to carry on any activity.

¹⁰ Council Regulation (EC) 1/2003

Appendix 4 - Glossary

A

Agreed Upon Procedures (AUPs)

Procedures to be followed by auditors in preparing audit reports of regulatory reporting.

B

Business Plan Questionnaire (BPQ)

Expenditure information requested by Ofgem from the GDNs to inform decisions about setting the price control.

C

Capacity (Gas)

The amount of natural gas that can be produced, transported, stored, distributed or utilized in a given period of time under design conditions.

D

Direct activities (operating expenditure)

Direct activities are the core activities carried out by GDNs e.g. repair and maintenance of pipelines, provision of emergency service response to reported gas leaks, etc.

Distribution Network Operator (DNO)

DNOs are holders of electricity distribution licences. Licences are granted for specified geographical areas. Currently in Great Britain there are seven companies who own the fourteen licensed distribution areas.

Distribution Price Control Review 4 (DPCR4)

The price control review for the electricity distribution network operators which covers the five years from 1 April 2005 to 31 March 2010.

G

Gas Distribution Network (GDN)

GDNs transport gas from the NTS to final consumers and to connected system exit points. There are currently eight GDNs in Great Britain which comprise twelve LDZs.

Gas Distribution Price Control Review (GDPCR)

The review of the price control applying to gas distribution networks. The review will extend the existing price control for the year 2007-8 and reset the control for the period commencing 1 April 2008.

I

Indirect activities (operating expenditure)

Indirect activities are activities that are not part of the core services of a GDN but which are undertaken to support those activities e.g. human resources.

L

Local Distribution Zones (LDZs)

LDZs are low pressure pipeline systems which deliver gas to final users and Independent Gas Transporters. There are twelve LDZs which take gas from the high pressure transmission system for onward distribution at lower pressures.

Local Transmission System (LTS)

The pipeline system operating at >7barg that transports gas from NTS offtakes to distribution systems. Some large users may take their gas direct from the LTS.

N

National Grid Gas (NGG)

The GT licence holder for the North West, West Midlands, East England and London GDNs. NGG also hold the GT licence for the gas national transmission system (NTS). Prior to 10 October 2005, NGG was known as Transco.

National Transmission System (NTS)

National Grid's high pressure gas transmission system. It consists of more than 6,400 km of pipe carrying gas at pressures of up to 85 bar (85 times normal atmospheric pressure).

Northern Gas Networks (NGN)

The GT licence holder for Northern GDN.

R

Regulatory Asset Value (RAV)

The value ascribed by Ofgem to the capital employed in the licensee's regulated distribution business (the 'regulated asset base'). The RAV is calculated by summing an estimate of the initial market value of each licensee's regulated asset base at

privatisation and all subsequent allowed additions to it at historical cost, and deducting annual depreciation amounts calculated in accordance with established regulatory methods. These vary between classes of licensee. A deduction is also made in certain cases to reflect the value realised from the disposal of assets comprised in the regulatory asset base. The RAV is indexed to RPI in order to allow for the effects of inflation on the licensee's capital allowances for the regulatory depreciation and also for the return investors are estimated to require to provide the capital.

Regulatory Information Guidance (RIGs)

The instructions to be followed by the GDNs when preparing regulatory returns, such as the RRP.

Regulatory Reporting Pack (RRP)

An annual return of information required from network operators, primarily relating to costs incurred within the licensees, and related information.

S

Shrinkage

Shrinkage gas is gas lost from the network through leakage, theft or own use gas.

T

Transmission Price Control Review (TPCR)

The TPCR will establish the price controls for the transmission licensees which will take effect in April 2007 for a 5-year period. The review applies to the three electricity transmission licensees, National Grid Electricity Transmission, Scottish Power Transmission Limited, Scottish Hydro-Electric Transmission Limited and to the licensed gas transporter responsible for the gas transmission system, NGG.

X

xoserve

A transporter agency which provides a single, uniform interface between the IT systems of relevant GTs and shippers.

Appendix 5 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

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