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Dear Joanna

**Gas Distribution Price Control Review (GDPCR) Initial Proposals
Document: Consultation**

energywatch welcomes the opportunity to respond to the issues in the consultation. This response is non-confidential and we are happy for it to be published on the Ofgem website.

Executive summary

- We fully support proposals simplifying the service obligations on gas distribution networks (DNs) to ensure consumers get real improvements in quality of service
- Ofgem must work with energywatch and its successor to further develop and maintain high quality and standards of service, working from enhanced consumer feedback, and effectively monitor and enforce all service obligations
- Consumers expect the DN's to deliver safe, secure and reliable gas supplies in an efficient and economic manner. Ofgem must set future allowances recognising the high starting point (2007-08 price control allowances) and seek to drive down costs, reflecting real value for money for consumers
- No further increases are justified as consumers have already received hefty increases as a result of the one year control. Ofgem must minimise further changes to allowed revenues before the end of the review and, indeed, identify further efficiencies and price re-openers should be used very exceptionally
- We support the use of enhanced cost reporting to monitor progress on the DN's' future expenditure, to streamline the process of future reviews, and support the wider use of benchmarking within and across sectors to derive comparable efficiently incurred costs on which to base future revenue allowances
- Innovation and discretionary rewards can help deliver network extensions but consumer bodies must help set robust criteria for these schemes, ensuring that real innovation and the needs of the fuel poor drive future network development
- There must be rigorous and challenging targets for DN's to reduce shrinkage
- Whatever xoserve's future funding structure, the core service must deliver an

effective value for money enquiry service for the benefit of consumers

Service outputs

As a package, the initial proposals on quality of service outputs are a significant improvement on the current practice. We believe that the gas DNs must deliver high standards of customer service alongside efficiently and effectively run networks. The two must go hand in hand. The results of Ofgem's customer research indicate how highly consumers value both good communication and timely and effective action by their DN when they are affected by planned/unplanned interruptions to their supply.

It is also clear from the research that consumers are generally unaware of what DNs do and their role in consumers' supply. Improving consumer education in the form of more effective contact between the DNs and consumers will not just raise the DNs' profile but reduce delays in consumers contacting the right party when problems arise. The DNs must consider how to deliver that contact most effectively without adding to the cost burden on consumers.

We agree that using a simplified package of licence obligations and guaranteed standards of performance (GSoPs) creates a clear and measurable basis for DNs' performance and ensures a direct route for monitoring and enforcement action should the DNs fall below required standards. While compensation payments provides consumers with a remedy after the event, we believe that strengthening service outputs must encourage the DNs to have more effective preventative procedures in place so that poor performance does not occur.

However, despite enhancements to customer service there is a real concern that consumers will be less well-served in a post-energywatch world. The absence of a consumer advocate who can advise and act on behalf of consumers will be felt if a distance remains between consumers and DNs in certain areas. energywatch has identified scope for further obligations to be developed in light of consumer experience.

Consumers have told us about the lengthy delays that they experience in having work completed by DNs and their failure to provide any communication about completion timescales once works begin. Therefore, while the DN will observe the GSoP that ensures that consumers are told about when works will commence, there is no corresponding obligation on them to ensure the consumer is told when work will be completed, despite consumers often paying upfront for the work. There is also no clear remedy for the consumer when this situation arises.

In some cases, if the consumer fails to get satisfaction from the DN and applies to Ofgem for a regulatory determination, the consumer may be told that this is a time-limited remedy and they are too late. The consumer is therefore penalised for not knowing about a process which is not well-publicised in any case. There is scope for a further obligation on DNs to make sure that consumers get timely notice of any delays in works, how the DN proposes to tackle the delay, and of notice of estimated completion times. This obligation should be enforced rigorously with

clarity provided to the consumer about the process.

Consumers also tell us that any advanced payments they may have made sometimes do not cover the full extent of the work required – there may need to be a further intervention by a qualified engineer or non-DN party but no one communicates this fact to the consumer until additional costs need to be incurred. Without the DNs making the consumer aware of the full extent of the works, or their part in them, potential safety issues may arise. In such cases, consumers tell us they almost always have to initiate contact with the DN to progress matters rather than the other way round. It is important, therefore, that information about delays to works and any other necessary information are provided to consumers as a matter of routine and Ofgem must ensure DNs are clear on this if the only monitoring is to be through the customer satisfaction surveys.

In terms of providing effective customer service, there is no distinction between customer groups – a small business consumer who loses supply through any kind of interruption is no less inconvenienced than a domestic consumer in the same area. For priority consumers, where the need for action may be more acute, the DNs must have appropriate processes in place to recognise which consumers are impacted in their areas and keep registers updated to prevent real risk of detriment.

We have the following comments on the specific proposals:

- telephone calls – all the DNs must ensure that their contracts with National Grid reflect the level of service against which they will be judged. Consumers value prompt and efficient service;
- advanced notice of planned interruptions – it is not unreasonable for all consumers to receive adequate notice and the use of a GSoP sharpens the incentive on the DNs to meet the required standard;
- informing consumers about reconnection – we believe the enhanced customer satisfaction survey will assist but that stronger measures should be considered if DNs consistently fail to meet the standard. Consumers cannot take alternative action without proper communication;
- responses to complaints – the consumer research clearly highlights that poor communication creates detriment which can reach unacceptable levels. The DNs must be at least responsive within an adequate timescale and the use of a GSoP helps to focus their attention on more effective communication;
- gas emergencies – the use of a licence condition is an effective improvement on protection when performance falls below target and Ofgem must monitor this and any ensure any breaches are enforced vigorously – safety is paramount;
- supply restoration – consumers rightly expect restoration to take place in adequate timescales or at least effective communication about when supply may be restored. We believe that a tightly defined GSoP will assist;
- third party water ingress (TPWI) interruption – we agree that using the GSoP

will provide for adequate incentive on the DNs to minimise interruptions and compensate consumers effectively beyond a reasonable time;

- reinstatement works – we agree that tighter timescales to complete works should apply. It is for the DNs to manage their contracts effectively to ensure that reinstatement occurs within the required timescales;
- alternative heating and cooking facilities – energywatch has always believed that this GSoP should remain and the consumer research supports our view highlighting the value placed by consumers on access to these facilities. The DNs must also increase their efforts to hold up-to-date records of priority consumers to ensure that these consumers in particular are properly catered for;
- connections GSoP – the simplification of current standards should ensure clarity without reducing their impact. Consumers require an effective service when applying for a connection with timely resolution of problems regardless of the level of competition in gas connections.

We believe that more effective performance reporting is needed to ensure that the DNs increase their focus on areas where improvement is needed and to maintain existing standards. We welcome Ofgem's proposals, including more use of auditing and control processes to ensure data on service provision is recorded properly. We also support the use of an enhanced customer satisfaction survey so that consumers' views about the effectiveness of the DNs' performance is given full exposure and action can be recommended for improvement. We believe that Ofgem has achieved the correct balance with its proposed questions in Appendix 6 (and would refer Ofgem to our comments above on delays). Consumers need assurance that the DNs take performance targets seriously and that they record data accurately.

This is particularly the case with the accuracy of pipeline records as pipelines are the DNs' main assets. Effective asset management should be considered as an ordinary activity for the DNs with no additional financial incentives needed to meet the highest standards. The safety of gas pipelines is critical to ensure consumers are not put in danger. Comprehensive knowledge of the location of pipelines allows DNs to attend gas escapes, leakages and other potentially life-threatening incidents speedily, as well as preventing pipelines from falling into disrepair and ensuring their timely maintenance, replacement or additional connection where the network is extended. Should the reporting regime not provide sufficient incentive to DNs to improve performance then Ofgem should look to what action can be taken. This must not, however, include financial incentives – consumers must not be expected to meet the costs of a DN failing to carry out good housekeeping.

Cost efficiency issues

Consumers, especially the vulnerable, expect the delivery of safe, secure and reliable gas supplies in an economic and efficient manner. As a result of the sale of four of the DN networks by National Grid in May 2005, this price control review represents the first proper opportunity for the performance of the DNs to be assessed comparatively under different ownership. Ofgem must continue to

rigorously evaluate the DNs' updated estimates of future expenditure before the review is completed, placing consumers' expectations at the forefront of its eventual conclusions. We believe that Ofgem can set quite challenging but achievable targets for the DNs and has made a weak start through the initial proposals.

Ofgem should recognise that the proper starting point for its current assessment is the interim price control for 2007-08, when it agreed to significant increases in the DNs' allowed revenues against the advice of most non-DN respondents. These increases are currently feeding into consumers' bills, providing justification to suppliers who may want to argue that recent reductions in wholesale gas prices are offset by higher gas distribution costs and stopping consumers' bills falling by as much as they could.

After the significant price rises of recent years which have created so much consumer detriment, particularly for the vulnerable, this is unacceptable. Ofgem estimates that the initial proposals will increase consumer bills in real terms by, on average, £1 per annum but is failing to acknowledge the wider context of the much bigger rises in consumers' bills due to the interim, one year price control. This increase masks the actual rise in bills which consumers will see through the initial proposals which is a nominal £16 over the 5 year period. Consumers are expected to continue to foot the bill for expenditure increases without having savings passed back in a timely manner. In our response to the one year control proposals we stated, very clearly, the situation consumers find themselves in and why. It is not reasonable for consumers to incur even more costs and Ofgem must address this now. It cannot be the case that a further price increase is viewed as acceptable because it can be, for example, offset against falling retail prices.

The outcome of the interim price control provided the DNs with additional revenues before any real comparative assessment had been undertaken of their expenditure. Now that such an assessment is possible, we believe that Ofgem is in a better position to determine more effectively where cost efficiencies lie. We note that analysis to date highlights that, other than for repex allowances, there is scope for reductions across the DNs. Even for repex, we are not entirely clear why allowances need to rise further after the significant increases in the interim price control. We believe that Ofgem has only begun to tackle what we have argued for since the start of the DN sales process, that there is room for real efficiency savings to be derived through the price control review and passed onto consumers. We believe Ofgem must continue to assess and identify these savings before the review process concludes and ensure these are passed through to consumers now and not deferred till later reviews.

We believe that use of a RPI-X price control remains appropriate and that cost efficiencies can be driven by using this price control formula. RPI-X has been an effective approach in the past for setting cost efficiency targets. We do not agree that DNs' costs always ought to be assessed to allow for the impact of specific price indices or regional factors other than where this approach is objectively justified. Users and consumers face similar cost pressures on labour, materials, etc. The regulated nature of the DNs and their relatively stable earnings and low risk should mean recovery of a reasonable rate of return on their assets rather than a

potentially inflated rate of return.

We note Ofgem's intention not to use revenue drivers because it is difficult to agree on which factors drive revenue without increasing complexity. We also note and agree that general use of price control re-openers creates uncertainty and fails to incentivise the DNs to reduce costs effectively over the price control period. Potential cost uncertainty arising from current or future legislation should be addressed separately. There should be objective justification for any resulting increase in allowances which facilitates the effective implementation of the legislation while still providing value for money to consumers.

Expenditure allowances and incentives - issues

We note the initial proposals on opex, capex and repex that each DN may recover over the price control period. We welcome the increased use of comparative benchmarking within and across sectors to determine what constitutes efficient expenditure. The competitively incurred costs of non-DN providers who provide services similar to those provided by the DNs are relevant for benchmarking. We believe that comparative benchmarking ensures that the most efficient methods of operating networks will be brought to light. The most efficient methods can then develop as the baseline for those DNs which use less efficient methods. The failure to adopt the baseline on their networks without objective justification ought to be taken into account in setting their allowances in future price controls.

We believe that Ofgem must use the best form of comparative benchmarking appropriate to a particular set of costs. This may mean a top-down approach for some costs and a bottom-up approach for others. Ofgem should also consider hybrid approaches where this is considered most effective in increasing the level of scrutiny, balanced against the need to keep assessment relatively simple. We appreciate that Ofgem does not yet have access to much comparative data for capex and that benchmarking will be refined over time. However, the lack of data points does not constitute a reason for not undertaking benchmarking.

As stated in our previous responses, we believe that consumers should only bear a level of pensions costs that are efficiently incurred (and are therefore reasonable) based on actuarial assessments. We cannot agree with a funding liability beyond that level which ought to be borne by the DN owners. We look forward to Ofgem's review of the stranded pension surplus before commenting further.

We will provide comments on the appropriate allowances which should be provided to the DNs in relation to riser replacement when we see the updated proposals in September. energywatch agrees that alternative solutions should be sought but great care must be taken over the social and environmental impacts of these solutions. We would expect to see an efficient level of costs attributed to this activity which keeps costs to consumers low while maximising the benefit to consumers who are affected by the replacement work. This may mean providing consumers with access to electrical appliances for heating and cooking if riser replacement costs are disproportionately high. More environmentally efficient solutions should be considered, including community-based CHP generation or some other

environmentally friendly option if an electricity solution is preferable which should provide affected residents with both a social and cost benefit.

We believe that the use of enhanced cost reporting by the DNs between price control reviews should assist in two ways: to provide a more effective platform for assessing how well the DNs are performing against their allowable revenues – are they keeping costs low and are they using innovative approaches to limit costs; and to streamline the reporting process for the next review. Ofgem should consider the most appropriate parameters to apply and against which the DNs are to report to ensure that consumers are best served by the reporting regime. Simplicity and transparency are the key objectives in implementing such an approach. Provision of better access to this data to allow objective assessment should be a further aim.

We agree that appropriate incentives can help to ensure that the DNs do not ‘game’ the price control by timing over and under recovery of revenues to maximise the benefit of any potential savings to them but not to consumers. By developing an overarching framework for incentives that encourages (or, alternatively, penalises where they fail to do so) the DNs to provide better quality information would be helpful. However, the use of cost reporting and benchmarking within the framework is equally important as it allows Ofgem’s consultants to use the more detailed data provided for more objective assessment of whether the overall incentive matches up realistically with detailed costs. Incentives need to be set carefully to ensure that savings are identified as early as possible and realised for the benefit of consumers, balanced against appropriate rewards for the DNs.

Network extensions

We note Ofgem’s preference for a hybrid solution to encourage more network extensions, including the use of a discretionary reward scheme and the application of a revised economic test for extension projects aimed at the fuel poor. We also note Ofgem’s intention to apply the schemes for off gas fuel poor communities only based on a definition of fuel poverty reflected in the Government’s Index of Multiple Deprivation (IMD). Whilst we believe that the IMD can provide a helpful measure of the level of fuel poverty amongst different communities we have the following concerns about using this measure:

- rural fuel poverty tends not to show up using IMD which is predominantly high in urban areas. Our analysis comparing the distribution of fuel poverty using the IMD measure and the separate Fuel Poverty Indicator for England highlights a number of differences which may mean some of the rural poor miss out on network extensions;
- the level of the calculation of the IMD indicator which uses the local authority level to determine the distribution of fuel poverty may hide pockets of real fuel poverty. Using the Lower Super Output Area (LSOA) level may provide a better answer; and
- Ofgem’s suggests that all areas with a score over 20 should qualify. energywatch believes that the trigger level should be dependent upon the area for which the

score is calculated (e.g. LSOA, Ward level, 'neighbourhood) so would prefer that the area is selected such that small pockets of fuel poverty are not eliminated by the scale of aggregation. For example using a general score of 20 would result in over 30% of the LSOAs in the country being included which would then provide scope to target 'easier to connect' areas rather than targeting actual fuel poverty.

We believe that network extensions provide different benefits:

- there is the social benefit of connecting off gas communities to a fuel which can meet their heating and cooking needs relatively cheaply. As many off gas communities are not too far from an existing gas supply, there is a sensible economic and social argument for connecting them. There should also be a willingness to consider how to bring gas economically to more remote (largely rural) areas. Many off gas consumers have an associated level of fuel poverty. We welcome Ofgem's willingness to promote a solution which helps some of the most disadvantaged consumers. However, the extensions must be cost effective and provide wider benefits to all consumers through the efficient use of networks; and
- there is the environmental benefit of using network extensions to develop gas supplies - a more environmentally friendly fuel source - and accelerate the development of community-based schemes which serve a larger number of deprived communities than would be the case with one-off connections. We believe that maximising the benefit of network extensions in this way must be one criterion for additional funding through government or discretionary reward schemes.

We believe that discretionary reward schemes appear attractive and may be viewed as an effective way of incentivising the DNs to push forward with more network extensions. Indeed we are aware that the similar scheme in electricity has brought benefits. However, there seems to be multiple aims outlined by Ofgem (not just network extensions) for the proposed reward scheme which may need more careful scrutiny. For instance, does Ofgem believe that the schemes are appropriate vehicles for more innovation and improved customer service in general?

We believe that Ofgem must involve consumer bodies in the activity of the panel which will oversee the reward scheme. This will ensure effective consumer input so that there is development of appropriate criteria and scrutiny of projects eligible for funding to ensure that these projects maximise the benefits for consumers, particularly the fuel poor and vulnerable. We are wary of schemes which have too wide a scope and end up not achieving real benefits in any efficient or effective way. We also believe that the benefits may be unevenly spread if one DN takes a more pro-active stance and others do not follow. What will Ofgem do to incentivise other DNs to adopt a similar approach, which has proved to be effective, in their network areas? The recovery of the reward amount from the consumers in the successful DN's area must be balanced against any long-term benefits for those consumers otherwise they will simply pay for a scheme with limited value.

Shrinkage

For consumers, incentives which encourage the DNs to tackle shrinkage effectively are necessary. There are not just environmental benefits of reduced loss of gas from the system but the associated costs are also minimised and savings can be passed back to consumers. However, rigorous and challenging incentives should be based on robust data collection by the DNs highlighting the size of the problem. A target volume-related incentive will be limited until this is achieved. Robust processes, including an effective governance process which ensures the industry is united in its approach to tackling the issue, must be in place allaying the suspicions of consumers that the DNs may be contributing to the problem rather than resolving it.

Xoserve funding arrangements

We note Ofgem's impact assessment regarding the xoserve funding arrangements. We believe that there are more fundamental issues affecting consumers about the type of core service currently provided by xoserve. A number of issues have been identified by our Consumer Advisors when they access the service:

- the online database is slow and inadequate for dealing with consumer queries. A single query may take some minutes to run, inconveniencing a customer at the other end of the phone line;
- the details which appear onscreen can be limited, for instance the lack of a full supply history which allows customer advisers to identify start and end dates every time a transfer takes place. There may need to be verification from xoserve by telephone of the correct details which is clearly a time-consuming and inefficient process for dealing with a consumer query;
- xoserve online only shows the last meter reading obtained and the date of that reading; and
- the information also sits on several pages rather than a single page, meaning that dealing with a simple query may require time-consuming navigation through the xoserve website.

Our Consumer Advisors have found that the service provided by the electricity online enquiry service ECOES is much more suited to answering consumer queries. After energywatch's closure, any service that deals with consumers' queries will need to access appropriate information on a timely basis. Any upgrade of xoserve's core service should reflect best practice, including delivering access to a full (or fuller) supply history for a premises, which incorporates any forthcoming transfers and any objections to transfers, and access to a number of the most recent meter readings if a more extensive meter reading history is not feasibly deliverable.

Whether this approach would then impact on the preferred option for xoserve funding is a matter which we leave open. We note that there are advantages to xoserve fully and efficiently utilising upgraded systems by offering a 'user pays' service. However, until the basic service is working effectively for consumers, any

benefits of 'user pays' and the potential for cost savings passed through to consumers as a reduction in allowable revenues, will be lost.

We are concerned that Ofgem wishes to leave it to industry parties to fully determine how to proceed with xoserve funding. Ofgem should at least facilitate discussions that ought to lead to an efficient solution for the services provided and the costs involved. Consumers will ultimately pay for xoserve funding. Consumers expect Ofgem to, if necessary, lead the industry towards a solution which minimises the pass through of costs to consumers.

Going forward, we will continue to keep these issues under review as and when they are raised, always considering the possible impact on consumers. We look forward to seeing Ofgem's updated proposals in September and would appreciate being kept informed of the progress of the review and any related issues to enable us to comment as the need arises.

If you do wish to discuss our response further please do not hesitate to contact me on 0191 2212072.

Yours sincerely

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