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13 July 2007

Dear Joanna,

**National Grid UK Transmission's Response to Ofgem's GDPCR Initial Proposals Document  
Ref: 125/07**

Thank you for the opportunity to respond to Ofgem's Initial Proposals document on the Gas Distribution Price Control Review. Our response covers the areas which are relevant to our UK Transmission business. These are;

- 1) xoserve,
- 2) Independent Systems.

**xoserve**

Even though the issue of xoserve funding is being consulted on as part of the GDPCR, it is of course a very important issue for National Grid Transmission as we pay a significant contribution in funding xoserve's activities. An interim price control arrangement for the costs we incur in funding xoserve activities was put in place at the recent Transmission Price Control Review. This arrangement only covers the costs for the 2007/08 financial year. Hence it is critical as part of this process to define and agree an appropriate price control arrangement for Transmission for the forthcoming years. In order to do this, we look forward to working closely with Ofgem in defining appropriate arrangements for Transmission for 2008/09 onwards.

In relation to the enduring arrangements for funding xoserve's activities, we are supportive of the application of the 'user pays' principle where it promotes cost reflective charging and the efficient delivery of new or enhanced services. We are still concerned however firstly with how user pays addresses the funding of core services and secondly with ensuring adequate funding for the transporters from industry driven change. We believe that a practical arrangement for user pays approach to encompass both concerns is required to ensure an adequate funding mechanism is provided.

We respond to the specific questions as detailed below contained within 'Section 8 – Other Issues';

**Question 1:** *Do you agree with our proposed approach to the funding of xoserve?*

In principle we agree with Ofgem's proposed Option 2 which would potentially introduce a 'Core services plus user pays' approach. However, as iterated in our previous response we do not believe that this Option as currently expressed enhances the responsiveness of the market or indeed engages shippers to pay for additional services where they currently don't pay for the service (within the existing Core Services area). To ensure the appropriate incentives, it will be important to understand the 'governance' process to be applied to user pays services, e.g. correct allocation of costs of change, charging methodologies and the mechanism to recover cost of necessary changes to core services.

It is essential that the fixed costs that xoserve incurs in providing core services or user driven services are funded such that these services can be provided. We agree that some variable cost items could be funded through a usage charge on the user. However it will be important to ensure that any fixed costs incurred from user request driven services are recovered from users irrelevant of actual usage (perhaps via a commodity or capacity charge).

In addition, the funding arrangements should allow transporters to recover any costs that they incur through xoserve delivering service or systems change from industry developments that are triggered within a Price Control period and are not known at the outset. This will ensure that the Transporters incentives to work with xoserve to deliver the changes that the industry desire are fully aligned. This could be achieved by inclusion of an additional revenue driver term defined within the licences or by incorporation within the Income Adjusting Event mechanism for Industry Driven Change that is now included in the Transmission licence.

**Question 2:** *How should we address any benefits arising to xoserve from redundancy created from the replacement of UK Link?*

We do not currently believe that excessive 'redundancy', or from our interpretation what may be classed as 'spare capacity for storage and processing activities', will be built into the replacement of the UK Link system, therefore we do not anticipate that there will be commercial benefits provided within the scope of a replacement of a system that is being created on a like for like basis.

If the scope of the UK Link Replacement increases due to Industry demands (e.g. Shippers) for enhanced functionality then an appropriate mechanism would need to be in place either through user pays or through an adjustment to the Transporters allowance.

**Question 3:** *Do you agree with our approach of modifying SSC A15 to facilitate governance arrangements for user-pays?*

Standard Special Condition A15 defines the scope of the Agency services, and we agree that it may be appropriate to amend this to define the additional “user pays” service that the Agency will be required to provide.

It is essential that there is a full review of the existing arrangements currently in place, e.g. Licence Conditions, UNC and the Transmission and Distribution Charging Methodologies, to ensure that the new user pays and core services governance arrangements are adequately defined.

For example, the vast majority of the services that xoserve undertake in their role as the Agency for the collective Transporters are as defined within the Uniform Network Code (UNC). Hence we would expect that there will be a number of amendments to the UNC to define how the user pays principle is triggered.

If the intention is to implement this arrangement in April 2008, this review needs to be undertaken quickly as there are likely to be a number of consultation processes to go through.

In addition, there is currently no direct contractual link between xoserve and shippers for services. It seems logical that if a user pays model is agreed as the way forward, then the creation of a direct link for some (all) of these services should be explored to increase efficiency by remove unnecessary interactions and simplifying the process.

**Question 4:** *Do you think that the existing arrangements are adequate to ensure enforcement of the range of services and outputs delivered by xoserve in light of these proposals?*

xoserve undertakes the services to be provided to the Shippers on behalf of all Transporters.

Currently National Grid Transmission is obligated under licence to ensure that we deliver the responsibilities placed upon us by code to deliver the UNC services to the community via Standard Special Condition 15, which allowed the Transporters to enter into a contracting service agreement (the Agency Services Agreement) with an agent.

Therefore we believe that the existing obligations are adequate, although we think that they might be improved by implementing a more streamlined process, such as providing a mechanism for xoserve to contract directly with the Shippers for additional user pays services. However the costs of establishing this have to be assessed against the benefits.

**Response to Section 3, Operating expenditure analysis, paragraph 3.9:**

In response to Ofgem's question regarding the profit margin levied by xoserve in relation to ASA activities, we believe that it is appropriate for xoserve to charge a reasonable level of profit for their services.

With respect to National Grid, xoserve operate and are treated as an individual (arms-length) company. This requires them to demonstrate this and hence we understand a profit margin is required.

In terms of the proposal not to allow Transporters to directly recover any profit margin (currently 6%), it will be important to ensure that no Transporters are left in a position where they incur costs to fund xoserve that are not covered in their regulatory settlement as a result of the requirement on xoserve to levy the profit margin.

**Independent Systems; Section 8.20**

We believe that the current arrangements for the independent systems are satisfactory and that there should continue to be arrangements in place to protect the interests of consumers connected to independent systems.

We agree that it is appropriate to make adjustments to GDN allowances after the Secretary of State has made his decision on the future arrangements to apply to the independent systems, and anticipate that the appropriate modifications to the NTS licence will also be consulted upon at this time.

Yours sincerely

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National Grid Gas plc