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## Gas Distribution Price Control Review - Initial Proposals Document

Dear Joanna,

RWE npower welcomes the opportunity to comment on the above consultation and does so on behalf of all its licensed gas businesses.

As previously, we have not commented in detail on financial issues or issues relating to GDN capex, repex and opex requirements (and any general incentive schemes relating to these) as we believe Ofgem are best placed to make appropriate judgements on these issues in the round. In making these judgements we expect Ofgem to draw on their experience of previous price controls and to carefully consider the extent to which GDNs face exposure to risk, along with the investment climate within which they operate.

Our comments below relate to specific questions raised in the consultation and to points where we have queries and/or concerns regarding Ofgem's initial proposals, as expressed in the consultation, its appendices and the recently published accompanying consultants reports.

### *CO measuring equipment*

We were not aware that GDNs Emergency Service personnel do not currently carry and use carbon monoxide measuring equipment when attending emergency investigations, and had assumed this would be a standard safety requirement. If the HSE are persuaded that there would be material safety benefits arising from such equipment being made available we consider it would be appropriate to try and quantify these benefits, such that they can be compared to the efficient costs of provision by GDNs in expectation that they would be included within GDNs capex and opex forecasts.

In the event the HSE are persuaded of the safety benefits, we would expect them to amend the relevant aspects of the safety procedures and/or legislation at the same time, so as to mandate the carrying of such equipment on Emergency Service visits.

### *Loss of meterwork*

We believe that the assumption contained in the PB Power consultant reports about GDNs loss of meterwork over the next price control is unduly optimistic. To suggest,

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for the purposes of calculating an efficient cost of GDNs providing a PRE service, that they will lose 55% of their 2005/06 meterwork over the period Apr 08 to Mar 2013 seems unrealistic when compared to the fact that incumbent GDN market share has reduced by less than 10% over the last 5 years. Whilst we accept that there may well be circumstances arising which lead to an increase in GDNs loss of meterwork over the period of the next price control, to assume the rate of acceleration will be over four times that experienced during the last five years is in our view highly questionable and if adopted will significantly over compensate GDNs for the provision of a PRE services.

#### *Quality of service*

We broadly support the rationalisation and updating of the standards of performance described in the Initial Proposals consultation subject to reviewing the licence and legislative drafting giving effect to the proposals later this year

The relatively modest allowances for quality of service arrangements do not seem unreasonable, provided that GDNs are not then permitted to recover compensation or insurance payments they may have had to make in excess of these allowances through other means (e.g. as a result of an Income Adjusting Event or post price control efficiency assessment). We believe this is a particular issue as the event cap has been reduced to 30,000 consumers.

#### *Accuracy of pipeline records and Mains Location Process (MLP)*

We believe that Ofgem are right to strengthen the incentives to encourage GDNs to improve their record keeping and to use new technology to locate PE pipelines in the ground. We hope that the proposed reporting requirements and the benchmarking of GDN performance against them will result in improved performance in this area. However, in the absence of any improvement in performance, or in the event performance deteriorates, Ofgem will need to consider how these incentives can be strengthened. This should not wait until the start of the following price control in 2013.

Having recently experienced the fiasco arising from our contractors attempting to locate a medium pressure gas main in order to supply gas to a major national supermarket, which extended over four months, we are well aware of the inadequacies that exist with certain GDN's interpretation and operation of the MLP. Whilst we welcome the steps proposed by Ofgem to improve the MLP, we do believe further investigation is required into individual GDN's performance and compliance with their MLP obligations, particular with regards to accountability and decision making.

#### *Network extensions*

We have previously indicated our support in principle for option 6 and stated that a modest cross subsidy may be consistent with Ofgem's broad duties. Now that further details of how option 6 would work have been made available we remain of the opinion that it is appropriate and is likely to provide the greatest benefit.

That said, the overall benefit of option 6 compared to the less risky (from a shipper perspective) option 5, and the extent to which option 6 results in cross subsidy, is heavily dependant on the actual level of take up by newly connected customers. If GDNs, or the agencies advising them, are overly optimistic about customer take up, in the absence of any incentive scheme or re-opener mechanism GDNs will not be exposed to the consequences of this.

Ofgem may wish to consider whether an incentive scheme or re-opener mechanism is appropriate at the outset of these arrangements. However, Ofgem should at least closely monitor the extent of any cross subsidies that arise through the operation of these arrangements, with a view to amending or terminating them during the course of the price control if the level of cross subsidy proves to be excessive.

### *Discretionary reward scheme*

We are still not fully convinced of the need for GDNs to have a discretionary reward scheme, particularly as the areas where Ofgem have highlighted rewards may be applicable seem to be ones being covered by specific initiatives and incentives. To this extent we are concerned that a discretionary reward scheme may result in opportunities for GDNs being rewarded twice for initiatives they have taken which, in themselves, are likely to enhance their reputation for corporate social responsibility and enhance their brand image. A discretionary reward scheme could also become a vehicle for government to promote initiatives that are inconsistent with the collective views of suppliers and shippers.

We draw some encouragement from the fact that the extent of the proposed scheme is relatively modest and would expect this to remain so during the course of the price control period. If such a scheme were to go ahead we believe it would be appropriate for shippers to be represented collectively on the panel set up to decide rewards, as this would provide a partial check against the concerns we have about how the scheme may operate.

### *Gas shrinkage arrangements*

Bearing in mind the considerable impact GDN leakage has on GB's greenhouse gas emissions we believe Ofgem are right to consider strengthening the current shrinkage incentive and to focus their attention on the adequacy of the current leakage model. In the event there is a case for strengthening the shrinkage incentive it is important that the leakage element of the incentive uses as a starting assumption the projected reductions in leakage contained in the PB Power report.

In our opinion such debate should be conducted at the existing Shrinkage Forum. However, we are not aware of any plans afoot for this group to consider the issues Ofgem have identified within the timescales referred to.

As previously stated, we do not think it appropriate for a discretionary reward scheme to attempt to incentivise leakage reduction whilst at the same time strengthening the shrinkage incentive as this may result in GDNs being rewarded twice. We also doubt whether the extent of the discretionary reward scheme that is being proposed will be sufficient in its own right to incentivise GDNs to make the investments necessary to accurately measure leakage, or to improve the robustness of the data collection used in calculating leakage.

### *Funding of xoserve*

Whilst we accept that it is right for Ofgem to keep an open mind on the issue of xoserve funding, particularly bearing in mind the large capital investment xoserve propose to make in re-writing the UK Link systems, we do not believe it is right to actively pursue a user pays approach at this time.

We are glad that Ofgem have recognised there is limited scope for user pays service lines at present and as such have not undertaken any funding split for the purposes of GDN revenue allowances. We support fully including xoserve efficient costs in the allowance and would hope this approach is maintained in Ofgem's final proposals.

Similarly we are glad that Ofgem have recognised the difficulty of valuing any spare capacity inherent in any UK link re-write, and the complexity of introducing a mechanism to share this benefit with consumers. We too believe that this issue should be addressed ex post as part of Ofgem's periodic assessment of whether investment has been efficiently incurred.

Ofgem highlight the considerable amount of work that is necessary for the industry to establish

appropriate governance arrangements for user pays, and the very challenging timescales to implement these arrangements for 1<sup>st</sup> April 2008. We sense there is little appetite from shippers and xoserve to commit resource to this work at this time and do not believe 1<sup>st</sup> April is a realistic, or necessary, deadline. Bearing in mind the limited scope for user pays service lines in the first instance we believe new governance arrangements, to the extent they are necessary at all, can be developed during the course of the next price control rather than having to be put in place at the outset.

We are surprised that Ofgem's Impact Assessment on the funding of xoserve is said to be final bearing in mind the sparsity of shipper cost data upon which it is based. We do not think the Impact Assessment is sufficiently robust to justify a decision of this magnitude and hope that if Ofgem do persist with the user pays funding regime they revisit their Impact Assessment making a more thorough attempt to establish shipper costs, or to better understand those costs provided to them.

With regard to Ofgem's concerns about the adequacy of the licence condition requiring GDNs to provide agency services collectively (SSC A15), we share these concerns. Despite being discussed at the time of GDN sales we do not believe that the scope of the agency services is laid out in the UNC currently. Whilst specific obligations and processes that transporters are required to provide collectively are laid out in the UNC, and replicated at a high level in the form of service lines within the Agency Services Agreement (which we understand is not an Ofgem designated document), the licence requires GDNs only to ensure that an Agency Services Agreement and an agent are in place. Breach of the UNC and/or the Agency Services Agreement is not in itself a licence breach therefore, and we believe that the licence condition should be strengthened to place more emphasis on GDNs securing performance of agency services (which cannot be withdrawn at will) by their agent.

We also agree with the comments made in the PB Power report that consideration should be given to GDNs requiring xoserve to put in place more formal cost reduction targets.

Should you wish to discuss our response in more detail please do not hesitate to contact me.

Yours sincerely,

Steve Rose  
Economic Regulation

Sent by e-mail and therefore not signed