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Dear Ayesha

GDPCR: Initial Licence Drafting Consultation

You have invited views on the issues raised in the GDPCR – Initial Licence Drafting Consultation. Our comments and key concerns are set out in the Appendix to this letter, although we recognise that much of the detail cannot be finalised until the Final Proposals for the price control review.

Overall, we support the transparent process that has been adopted by Ofgem through the working group approach. We also broadly support the proposed presentational/ re-numbering modifications, which aid clarity.

We have a serious concern which we would highlight, with regard to the change of the one hour emergency response standard from an overall standard to an absolute standard within licence condition SSC D10. Events happen which are out of DNs control which can impact on the ability to meet this standard, for example major incidents, severe weather and industrial action. We strongly support the exclusion of such events from the measure of response to gas emergencies, as we understand to be the case in electricity distribution.

We are also concerned that as drafted, the Gas(Standards of Performance) Regulations are very complex and do not achieve Ofgem's stated aim in respect of payments to consumers on downstream networks where a loss of supply is a result of a failure on another GT's network.

Finally, we do not believe that a simple a re-opener for TMA costs is sufficient. In our view, an ex ante allowance is also required given that costs will start to be incurred from 1 April 2008, and these costs will be significant.

I hope the comments above are helpful, if you would like to discuss any of these issues further please call.

Yours sincerely

Paul Hemsley
Regulation Manager

Appendix

Scotia Gas Networks plc

<u>Response to Gas Distribution Price Control Review – Initial Licence Drafting Consultation</u>.

Our comments are set out below following the format of the questions raised in the Initial Licence Drafting Consultation.

<u>CHAPTER: One - Introduction</u>.

There are no specific questions in this chapter.

<u>CHAPTER: Two – Proposed modifications to the Special Conditions in Part E</u>.

Question 1: *Should shippers continue to raise Income Adjusting events to the exit incentive?*

No, we do not believe that shippers should continue to have the ability to raise Income Adjusting Events (IAEs) to the exit incentive. The exit incentive is an integral part of the price control which is a legal, regulatory "contract" between Ofgem and the licensee. It is therefore inappropriate for another party to have the potential ability to change this contract. Not only does it significantly increase the regulatory risk for the licensee, it could undermine the incentive principles established by Ofgem. It also has the potential to increase the regulatory burden for Ofgem in the event that a shipper should choose to exercise that right.

The existing IAE provision within the GDN licence was "copied" across from NGG's original licence through the GDN sales process. However, within the context of the original licence it referred to the NTS SO's incentive (in particular the term SOMRt) primarily associated with system balancing actions, the costs of which are mostly generated from NGG's actions within the commercial and competitive gas market and which have a direct and immediate impact on shippers' cost. Clearly, the use of the IAE in the GDN licence has no such direct impact on shippers since the GDNs have no SO role. Rather, the incentive to which the IAE relates is associated with a GDN's management of its capacity requirements which is immediately associated with one of the core price control building blocks (ie the capex requirements of the GDNs) and NOT the market mechanisms to which it referrs in the NTS licence. Therefore, while it may be appropriate for shippers to raise an IAE in respect of the NTS SO balancing role, we do not believe that it is appropriate for this potential to be retained within the GDN licence.

Notwithstanding the above, and although the IAE threshold was specifically reviewed by Ofgem in response to, and in light of, the GDNs exposure to the uncertainties associated with the exit capacity incentive, we still have a concern about the material amount for the exit performance measure. We believe the IAE should be proportionate to the GDN's performance target with an absolute lower limit. We therefore believe that this issue should be consulted upon in more detail as part of the enduring incentive arrangements. At the very least the current IAE threshold of £1m for the full formula year should be retained until the end of the next price control period and not increased to £1.5m in 2011/12 and £2m thereafter. Certainly, an IAE of £2m is disproportionately high for the GDNs and is a relic of NGG's licence prior to the GDN sales process which applied primarily to the NTS in this respect.

Question 2: *How should an IAE associated with TMA costs be constrained without limiting costs to permit costs?*

We agree with extending the TMA allowance to include other costs as well as permit costs. However, we do not believe that a simple a re-opener for TMA costs is sufficient. In our view, an ex ante allowance is also required given that costs will start to be incurred from 1 April 2008, and these costs will be significant. Pass-through of permit costs could also be considered.

Question 3: *Are there any other changes to SC Part E that are necessary to make the GDPCR effective?*

We note that there are issues still to be resolved in the price control review which will need to be reflected in the licence drafting after the Final Proposals. At this stage we would make the following comments, which we are also making in our response to the Update Proposals:

SC E3 – Pass through items.

- Rates. While we understand that Ofgem's aim is to incentivise the GDNs to minimise any potential increase in rates through the revaluation process, we do not believe that it is an acceptable regulatory risk, nor is it consistent with Ofgem's policy for the treatment of business rates, for the GDN's allowance for rates to default to zero from 1st April 2010. To the extent that the business rates increase, we firmly believe that the GDN's exposure should be limited to the difference between the pre- and post-revaluation rates and therefore that it is only this differential that should be subject to direction by Ofgem.

- LNG costs. As you will be aware, Scotland Gas Networks is required to pay a regulated price for the cost of LNG services at the Glenmavis LNG storage facility in order to meet its Independent Systems obligations. In the short and medium term we do not believe that there are viable alternatives to the use of Glenmavis and therefore this service is being provided on a monopoly basis. Given that Ofgem is currently consulting on the regulated price that will apply from 1st May 2008 the Scotland network is exposed to there being an uplift in this charge which we do not believe is acceptable. We therefore believe that for this network only, the regulated LNG charge associated with the Independent Systems should also be a pass through item;

- Emergency call handling service. We welcome Ofgem's proposal to increase its regulatory supervision of the emergency call handling arrangements provided by NGG. However, given the monopoly position NGG enjoys for the provision of this service we do not agree that it should be treated as an excluded service, rather we believe the charges should be price controlled, included as part of NGG's allowed revenue and be a pass-through item in our IDN licences.

SC E5 – Mains and services replacement. It would be unacceptable if Ofgem were to include the cap on the mains and services replacement as set out in this document. This would be inconsistent with the principle of the IQI mechanism. However, we do support the subsequent revision as consulted on in the Update Proposals.

SC E7 – Re-openers. DNs have raised significant concerns about potential large increases in Landfill Tax which may arise as a result of changes to the definition of hazardous waste. Due to the uncertainty over these potential costs, we believe there is a strong case for including this as a potential re-opener alongside TMA and other tax rules.

There is also significant uncertainty about when interruption and exit reform will come in. In our view, the incentives are not on the critical path for this price control review. However, we do consider it vital that any additional capex that is triggered by a move to firm access would need to be fully recoverable. Given the inherent uncertainty about how much this could be, we believe that either a specific capex re-opener or logging-up mechanism is required in regard of interruption reform.

SC E12 – Excluded Services. We note that Ofgem has proposed that the provision of emergency services to IGTs remains an excluded service, and we support this. However, we do not believe that these services are explicitly provided for in the draft licence condition. In our view, Para. 4(a) of the draft condition E12 (para 3(b) of existing Special Condition E4) needs to be extended to include these services (and similar services to private networks) as well as those provided under Standard Special Condition A41 (which specifically relates to arrangements in respect of a major loss of supply and ordinarily therefore, does not cover the IGT contracts).

Ofgem intends to introduce an incentive on the GDNs in respect of the loss of meter work. While we comment in detail on that proposal in the Updated Proposals we believe it is important that there is clarification in respect of the revenue treatment of any "filler" work associated with this incentive scheme. In our view, consistent with the treatment of the meter work to which the incentive relates and to ensure that the proposed incentive is not undermined, it will be important to ensure that revenue associated with any new "filler" contracts for the FCOs (irrespective of their nature) should be treated as excluded services and not counted against the de minimis cap.

Question 4: *Are there any changes to SC Part E that are inappropriate?*

We note that proposed changes will need to reflect the GDPCR Final Proposals, in particular we have not commented at this stage on the shrinkage incentive or exit/interruption incentives.

Question 5: *Are there any other changes to SC Part E that are desirable but not necessarily associated with GDPCR?*

SC E11 – Allocation of costs. In our view, this licence condition can be removed as the cost reporting process will provide transparency on cost allocation. In any event we believe that the requirement to have a statement in place should be sufficient i.e. there is no need for a report on compliance against the statement given that DNs have a licence obligation to comply with it. In addition, this statement could be moved to the Regulatory Accounts licence condition. We also believe that the requirement for independent audit is unnecessary given that the Regulatory Accounts are audited.

CHAPTER: Three – Other proposed modifications.

Question 1: *Are our proposed changes to SSC in Part A and D appropriate?*

We comment on SSC D5, D7 and A40 and SC 4B further below. In addition, we have the following further comments on Parts A and D:

SSC A19 - Provision of services to vulnerable customers. We do not support an enduring password register as not only would it be unnecessary but there would in our view be significant administrative costs in maintaining such a database. While we continue to support the password scheme for accessing the premises of a vulnerable customer, it should be on a job specific basis.

Also, currently DNs only have to provide facilities for the blind, partially sighted, deaf or hearing impaired customers free of charge "on request". We do not understand why, as currently drafted, the words "on request" have been left out.

SSC A30 – Regulatory Accounts. As we set out in our response to Ofgem's consultation on the cost reporting framework, we do not believe that the regulatory accounts add any significant value where statutory accounts exist which mirror the GDN structure. Any additional information contained in the regulatory accounts can be collected through the cost reporting process.

A55 – Enduring Offtake Arrangements and D8 – Reform of Distribution Network interruption arrangements. We agree with Ofgem that these two licence conditions should be deleted

SSC D9 – Performance reporting. We have not commented on this licence condition at this stage, and are feeding in our comments to the discussions that are taking place through the quality of service workshop.

SSC D10 – Quality of service standards. We have serious concerns with this licence condition, in particular the change of the one hour emergency response standard from an

overall standard to an absolute standard within this licence condition. Events happen which are out of DNs control which can impact on the ability to meet this standard, for example major incidents, severe weather and industrial action. We strongly support the addition of words such that a DN is only required to use "reasonable endeavours" in meeting this standard, also exemptions from counting the response to gas emergencies in such events, as we understand to be the case in electricity distribution. Without such exemption in major incidents we believe that there is a disincentive to cooperate or provide resource in major incidents to other DNs, for fear of adverse impact on this standard. We also believe that, by excluding major incidents, this will add to the transparency of how DNs perform in such events.

Finally, it appears that the reporting requirements under paragraph 6 duplicate the GS performance reporting required under SSC A22?

Gas (Standards of Performance) Regulations.

- Regulation 7 - Supply restoration. We are concerned that the proposed drafting of this regulation is unclear and we are unsure that the current drafting of Para. 3(e) achieves Ofgem's stated aim. We believe that the exemption should only apply where the upstream transporter has been notified and accepted that it is responsible for the failure of supply.

  We are also concerned that even where a notification has been given to the upstream transporter they remain exposed to standard failures associated with tardy supply restoration by the downstream transporter.

  To ensure that all GT parties are fully aware of their obligations in a timely manner, we believe that a specific timeframe within which a notification from one GT to another associated with the exemption described in Para. (3)(e) of Regulation 7 should be included. This may be provided for by additional drafting within Regulation 7 or by amending the proposed definition of "relevant gas transporter" under Regulation 3(1).

- Regulation 10A. Notice of Planned Interruptions. We welcome the constructive dialogue Ofgem has held with the GDNs on this proposed standard. However, we continue to believe that the standard should only apply to the period of notice that is given and, for the reasons discussed at the recent quality of service workshop, should not include the period within which the work will be undertaken.

- Regulation 10B – Responding to complaints. We believe that telephone complaints should be received via a number notified by the GT and that Para. 1 should be amended accordingly. In our view, this would ensure that all potential complaints are easily captured and monitored and would avoid any "unofficial" channels being used by a customer to lodge a complaint. In our view this would be in the customer's interest and would minimise any potential disputes as to whether a verbal complaint had been made.

  We are also concerned that there is a certain amount of subjectivity around this Regulation. For example, what is a substantive response? Furthermore, there is scope for differences in interpretation of what may be considered to be a vexatious or frivolous complaint.

  We are concerned that the GT could be subject to a standard failure if, despite contacting the customer or a third party in a timely manner, a response has not been forthcoming and the GT remains unable to provide a substantive response within the prescribed period. We therefore believe that Para. 4(b) should include circumstances where information from the customer/third parties has not been received within the prescribed period to enable the GT to meet the standard.

  For clarity, rather than referencing frivolous and vexatious complaints in Para. 1, the

exemptions should be listed in Para. 4 and should also include repetitive complaints that have been addressed and those that are based upon incorrect information.

- Regulation 12 – Payments. When Para. 1A and 3A are read in conjunction with the drafting of Regulation 7, it is unclear whether the relevant transporter is obliged to make the payment to the customers connected to a downstream network directly, via their shipper or via the downstream GT.

  Furthermore, as currently drafted, under Para. 3A the relevant transporter would be penalised if the downstream transporter has not provided all the information to enable the upstream transporter to make the payment within the prescribed period from the applicable date. This is because the definition of "applicable date" in this scenario means the date that the downstream GT has notified the upstream GT. However, there does not appear to be any requirement for that notice (referred to in the Para. (b) of the definition of relevant transporter) to contain all of the relevant customer details to enable the upstream GT to make the payments within the prescribed period. Therefore, unless the requirements of the notice are amended to include all relevant customer details, the applicable date in this scenario should mean the date that the relevant transporter has received all the information it requires from the other GT to enable payments to be made.

  We believe that each instance of the use of "relevant transporter" within this regulation needs to be reviewed. In our view there are circumstances where we believe the reference is incorrect for example in Para. 2(b) is it not the relevant transporter that is passing the payment on to the other GT? Furthermore, we believe that there need to be two versions of Para. 4 one each for the scenarios under Paras. 2(a) and (b) of this Regulation.

  Para. 6 (c) should make reference to payments from a relevant transporter to another transporter.

Question 2: *Is the information provided by the GDNs under SSC D5 – licensee's procurement and use of system management services, useful? Is there any specific additional information that GDNs can provide to increase transparency in the use of their constraint management tools?*

We continue to believe that the requirements of Standard Special Condition D5 are unnecessarily onerous for the DNs and are more reflective of the requirements placed upon NGG NTS in its system balancing role prior to the disaggregation of the DNs from the NTS during the DN sales process. Accordingly, we believe that this licence condition could be removed given Ofgem's proposal to remove the shrinkage element of the current condition, which we support, and the proposed exit and interruptions incentives.

Failing that, however, we believe that the condition can be further simplified such that the GDNs are only required to prepare one statement that describes the tools that they may use to manage constraints and the basis on which they will do so. Given that the GDNs will have other reporting requirements under the new interruption arrangements and the capacity output incentive, we question whether it is necessary to include further reporting requirements in this licence condition and believe it would be sufficient for the GDNs to be obliged simply to comply with the statement. To the extent that Ofgem does believe that a report is necessary, we do not believe that the current audit requirement provides any additional benefit and, therefore, should be removed. Finally, we only believe that the GDNs should consult on the statement where they propose to make changes. This would be consistent with other consultation requirements contained within the licence and significantly reduce the burden of the current annual consultation process.

Question 3: *Is it appropriate to remove D7 – exit code statement? If so why?*

We note that the intention is that the requirement for an exit code statement will expire on 1 April 2011. However, in our view, this requirement should be removed now for the IDNs. All we currently report are services provided under NSAs which are currently covered by the de minimis exemption, and now would be in excluded services. The exit code statement is only relevant to NGG's RDNs as NGG also has NTS TO and NTS SO.

Question 4: *How should the scope of A40 – Price Control information, be defined to capture information from GDN affiliates or related undertakings?*

As a principle, the licence should only cover the licensee. In addition, we do not believe that affiliated third parties should be treated differently to external third parties. This risks creating perverse incentives to outsource whether the most efficient solution or not.

Question 5: *Do respondents believe that the powers of the Authority should be similar to those that exist in respect of connection charges on other categories of gas and electricity network?*

Ofgem have previously noted that competition is significantly more advanced in gas connections than in electricity. Therefore, Ofgem should be looking to reduce regulation not increase it. We note also that Ofgem already have significant powers of determination.

Question 6: *Do respondents believe that the need to consult prior to amending the charging methodology is unduly onerous?*

We do believe that a requirement to consult on changes is unduly onerous. The consultation process adds further delay to the introduction of revised charges. The longer lag will also lead to significant re-quoting/ administrative costs. It could also lead to undercharging of customers, which was criticised by Ofgem's consultants PB Power during the price control review. In any event, in future Ofgem will have to approve the methodology and it is in their power to consult if deemed necessary. We also understand that there is no consultation requirement in electricity.

CHAPTER: Four – Next steps.

Question 1: *Is the timetable set out in this chapter appropriate?*

The timetable does seem appropriate. In addition, we support the transparent process to date through the licence drafting working group and consider that further working group meetings would be helpful to consider detailed licence drafting comments.