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Dear Kieran,

Response to the Gas Distribution Price Control Review – Cost Reporting Consultation

You have invited views on the issues raised in the GDPCR – Cost Reporting Consultation. Our overall views are summarised in this covering letter, and our detailed comments are set out in the Appendix to this letter.

We continue to support the introduction of a cost reporting framework in Gas Distribution, however, we have a few areas we would like to highlight as the process is developed over the next few months:-

Form and Content

With the increasing volume of data that is supplied to Ofgem on an annual basis our general desire is that Ofgem critically review what information is potentially duplicated and question their need for the level of detail in some sections of the Regulatory Reporting Pack (RRP). To this end, we welcome the fact that Ofgem are reviewing the potential relaxing of some reporting areas.

One area of data that has been suggested is the capture of cost reporting information for third party suppliers. We believe this will be commercially sensitive to the third party and hence limit the ability to extend cost reporting into this area.

Cost

We believe that the costs and time to produce the RRP will be significantly increased if there was a requirement for external audit. We strongly support the process adopted in Electricity Distribution whereby an Ofgem team carries out annual visits.

Use and Publication of Benchmarking Data

Whilst we support the introduction of benchmarking between the GDN's in the future, we have consistently raised concerns about the consistency and comparability of detailed cost data in the early years following DN sales. Until the cost reporting process has become established and all parties are comfortable with the consistency of this information, we believe that the publication of data should be kept to a high level in line with the annual report produced for Electricity Distribution.

Only once the process has become established in Gas Distribution can we consider opportunities to benchmark across sectors. However, it is unclear without further work whether the drivers of costs (including indirect costs) will be consistent to allow comparisons.

I hope that our comments are helpful. If you have any questions please call.

Yours sincerely

Mike Bedford
Director of Regulatory Finance

Scotia Gas Networks plc

Response to GDPCR Cost Reporting Consultation

Chapter 2

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

The high level description of the annual report¹ does not detail the contents of the annual report, but in principle SGN has no objections to the publishing of an annual report comparing the GDNs' and would support a report along the lines of that currently issued for the electricity distribution businesses.

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

We believe the level of information published in the Electricity Distribution annual report is at an appropriate level to promote transparency and we would support its publication. We do not support the publishing of any further information, particularly as we are still in the process of ensuring consistency and comparability at a more detailed level. We would also not support the publication of any data which we regard as commercially sensitive. This would include, for example, the publication of information consistent with the statement of charges and apportionments which is currently redacted from the published regulatory accounts².

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

The proposed deadline for submission of the completed RRP of July 31 mirrors the timing of various other reporting requirements and we would support this timetable for the vast majority of information in the RRP. One exception is the Investment forecasts - the existing process is well established to produce our annual ten year statement at the end of October and any advancement of this date would involve changes to the existing process which is in part out with our control - This is discussed by detailed return later in this response.

We do not believe it would be feasible to bring the deadline forward from 31 July.

If there was to be a requirement for external audit of the RRP, we believe the 31st July deadline would potentially be unrealistic.

In the first year of completing the RRP (i.e. 31st July 2008), we would request that Ofgem provide the DN's more time to produce this information. This request is based on the fact that it is the first year the DN's have produced the pack and the information is not time critical for the price control process.

¹ GDPCR Cost Reporting Consultation, p5 para 2.8

² In accordance with Standard Special Condition A30

Chapter 3

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

SGN support the principle of benchmarking as a guide to relative performance across the GDNs', however as noted throughout the PCR process and in our response to various consultants reports we have some concerns over the application of benchmarking to date, particularly bottom up. The main areas which have caused concern are;

- Data quality – consistency of data in the early years following Network sale
- Different operating models – the differing operating models adopted by the GDNs' mean that achieving direct comparability for benchmarks may not always be possible at a detailed level – this is particularly relevant across sectors
- Appropriateness of benchmarks – SGN have some concerns over the appropriateness of some of the benchmarks selected. Again as the RRP process develops through time the most appropriate benchmarks should be able to be determined.

In the longer term, once the above issues have been resolved, there may be opportunities for benchmarking across sectors, particularly indirect costs. However, the gas distribution business does not necessarily lend itself to benchmarking against companies in other industries sectors and a detailed examination of drivers would need to be undertaken prior to any comparisons.

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?

The availability of information from a third party supplier that will be provided to GDN's will be severely limited by considerations of commercial confidentiality with the third party.

We also believe that the requirements for related parties should be no more than from a third party supplier.

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

As noted in the Consultation the resource requirement for xoserve is likely to be equivalent whether the requested information is provided direct to Ofgem, or to the GDNs' for inclusion in their RRP return to Ofgem. We believe it is more appropriate for the DN's to see information from xoserve in advance but for xoserve to submit their own 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?

Any additional external work will have a significant associated cost to the GDNs' and could compromise the 31st July reporting deadline. The cost may be partially offset if audit requirements for various other regulatory returns are removed.

We would support an alternative approach whereby reconciliations are carried out to other available information which has been audited. This is already allowed for in the RRP with the reconciliation to the regulatory accounts and hence statutory accounts, both of which are audited documents. This and the proposed review of the RRP, which we envisage as being similar to the supplementary question process carried out during the PCR, should provide Ofgem with sufficient assurance as to the contents of the RRP submission.

Whilst we do not support the need for an external audit, if Ofgem were to pursue this approach, the existing process for audit of regulatory returns, whereby the GDNs' statutory auditors are engaged to perform AUPs, works well. One advantage of engaging the statutory auditors is that they are able to rely on their existing documentation of systems and processes and on testing already carried out for the statutory audit, thus avoiding duplication of effort, and increased cost.

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

The only significant additional information available in the regulatory accounts, over and above that contained in the statutory accounts, is the segmental analysis³. We do not believe that the existing regulatory accounts provide any significant value to stakeholders over and above that available in the statutory accounts of Scotland Gas Networks plc and of Southern Gas Networks plc. Any reporting differences could easily be picked up in the RRP process.

However, we accept that for some ownership groups, their structure and / or statutory reporting deadlines may provide a requirement over and above the RRP to provide some form of accounting report by GDN. This additional information could form part of a disclosure published as part of the cost reporting report.

We therefore conclude that the current regulatory accounts do not add a significant amount of value to stakeholders over and above the statutory accounts and there is likely to be scope in the RRP's to accommodate any additional information required.

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

As noted above we do not believe the regulatory accounts add any significant added value to stakeholders and as such should not require to be published. This is only the

³ Analysis of the reported results by Transportation, Metering, De Minimis, Other Activities

case where statutory accounts exist which mirror the GDN structure and Ofgem are happy that they can obtain sufficient assurances for any additional data in the Regulatory Accounts that would be collected in the RRP process.

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?

There is clearly a requirement to ensure, as far as possible, comparability between the financial information submitted by the GDNs'. Going forward we believe that the cost reporting schedules could provide the transparency required which could remove Ofgem's requirements to submit a statement of allocation of costs and revenues.