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Your ref

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Dear Keiran

Gas Distribution Price Control Review: Cost Reporting Consultation

I am pleased to provide a response to your recent consultation on Cost Reporting arrangements for gas DNs. We already have several years' experience of the developing cost reporting framework for electricity distributors and are pleased to see that your proposals build on the work already completed elsewhere in Ofgem's Networks Division. I will address the issues raised under the section headings used in your paper.

Consistency with other RRP's

We agree that you should aim for the maximum consistency, with variations from other models clearly justified by differences in the operations of the licensees. However this should not imply any restriction on innovation. Over time we would expect fine tuning of all RRP's to reflect emerging best practice. You particularly highlight the question of indirect costs. Whilst common classification of costs is important, we would put as much emphasis on the mechanism for ensuring that indirect costs are suitably treated in price controls. The example of DPCR4 is not a good one. Because of difficulties in identifying indirect costs, their estimation within the price control setting process was somewhat arbitrary with no clear linkage between forecast direct costs and associated indirects, especially in the capital expenditure area. We accept that accurate and reliable reporting is a precursor to an improved approach, but it is not sufficient if price controls are not then set in a way that reflects the basis of costs.

Data from related parties and contractors

Your proposals here appear to be a significant improvement on the electricity RRP, since you recognise the need for consistency of treatment of activity costs regardless of their source. We accept that there will be issues about materiality that will need to be reflected in a DNO's

contracts with its service providers, but in principle we support consistent treatment of costs between direct and indirect categories regardless of their source.

Auditing the information

We see value in the approach adopted for the electricity distribution RRP, where data is linked back to audited accounts, but the RRP itself is subject only to internal review, prior to submission. We believe the Ofgem visits to be valuable to both parties as they provide an opportunity to discuss performance and to allow more detailed exploration of specific issues. At the same time, senior management in all utility companies have been influenced by MD209 and similar recent concerns over the accuracy of regulatory reporting. We have submitted Board assurance notes with our last two RRP.

Interaction with regulatory accounts and other regulatory financial statements

The success of the RRP in electricity distribution is itself making the Regulatory Accounts less useful. It would be wrong to remove the obligation to produce such accounts before a robust RRP has been established, but beyond that there is a danger of duplication and the production of redundant documents. This would also apply to other reports that were specified in a pre-RRP world.

Avoidance of unnecessary duplication

We agree that regulatory requirements should not be duplicated. Information can be, and often is, extracted from one regulatory return and included in another Ofgem publication. This is a more efficient approach than requesting the same data more than once.

There are a number of other issues not specifically covered by your consultation where experience from electricity distribution may usefully be applied.

Specifying accuracy standards

Whilst accuracy of reporting is of paramount importance, there is a danger that an early emphasis on accuracy may discourage parties from disclosure. It would be better to have initial discussions around what kinds of information would be helpful, before introducing concerns over accuracy levels. In our experience, debates around definitions are unhelpfully constrained once companies begin to think of the implications of certain accuracy standards on their internal systems. It would be better for the discussion on changes to accounting systems to come once the ideal RRP structure had been determined.

Capex unit costs

You suggest that capex data should be collected in a way that will facilitate the calculation of unit costs. Whilst this appears attractive, particularly when thinking of the building blocks for

price controls, there are dangers that numbers compiled from within-year cash expenditure will prove unreliable indicators of unit costs for many categories of capex. There is also a linkage back to our previous observation on indirect costs. Total delivered costs for capex items are in part a function of attributed indirect costs, making comparison across companies all the more difficult.

Publication

Although publication of full RRP data is superficially attractive, there are practical limits to this option. Some items are subject to commercial sensitivity of available data e.g. tax, debt, related party transactions. We recognise, however, that publication of a sub-set of data would be desirable. One improvement recently introduced into the DNO process that could usefully be rolled forward into other RRP's is the inclusion within the pack of a table populated with those data that will ultimately be published. This would ensure that licensees have full visibility of data to be published prior to it entering the public domain. We would also advocate the establishment of a data share of appropriate tables across the GDNs. The equivalent for DNOs has proved invaluable in identifying areas of inconsistency of cost allocation.

Finally, we have a number of more detailed observations on your proposals:

- We expect that your proposal to require FTE breakdown by salary cost component will prove onerous and are unsure what purpose the disaggregated data would serve.
- We would encourage you to review the proposed inclusion of statutory Net Book Value details within your asset disposals sheet. These may cause confusion when combined with information on a regulatory basis.
- We are interested to note that your proposed atypical sheet is much simpler than the one used for reporting DNO costs. We would be very interested in understanding how this table develops as it may assist in the development of a simplified table for DNO use.

Should you have any questions regarding this please do not hesitate to contact me or a member of my team.

Yours sincerely,

Paul Bircham
Regulation Director Designate