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Dear Kieran,

Gas Distribution Price Control Review Cost Reporting Consultation – WWU Response

This document is the formal response to the above consultation by Wales & West Utilities (WWU) Ltd.

For the avoidance of doubt this reply is not confidential and may be placed in the public domain. Appendix 1 is confidential.

Yours sincerely,



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24 hour gas escape number
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0800 111 999*

*calls will be recorded and may be monitored
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General

We support the introduction of the annual cost reporting/regulatory reporting pack (“RRP”) to Ofgem. This will provide Ofgem with an informed view of progress against the Price Control for 2008/9 – 2012/13 which they are currently setting during its life, rather than requiring a detailed ex-post review. This should ensure “no surprises” and give the opportunity for possible re-openers under the price control in the event of unexpected cost shocks. The aims of the RRP should be:

- to reduce the considerable peak demand placed on our resources at each Price Control review to produce historical data with supporting detailed commentary, by smoothing out the requirements over the quinquennium; and
- to reduce uncertainty over the definition and allocation of cost items by establishing common reporting guidelines.

However, the GDNs will incur additional costs to prepare such returns and we urge Ofgem to consider whether other reporting obligations could be dropped when RRP cost reporting is introduced. For the sake of clarity and to minimise the scope for errors, it is desirable to ensure that each data item only has to be collected and entered once (even if it is reported in several different tables). To avoid possible inconsistencies over timing and formats, we consider that the following returns should be abolished once cost reporting is introduced:

- A30 & Regulatory accounts,
- E2B,
- A37,
- Parts which are duplicated in the Annual RIGS Return, Tab 5 mains & service replacement, Tab 6 peak demand.
- Shrinkage data duplicated in the Revenue Reporting Pack and Outputs Reporting Pack.

It is our understanding that 2007/08 is the first year for which cost reporting is required, which is also the period of consultation and process development. We hope that this is taken into consideration when setting the timetable for 2007/08 returns and the ability to provide some data items that are still under consideration and/or yet to be defined.

There are a number of areas on the individual worksheets within the RRP where we consider further discussion is required with Ofgem. Included within these are:

- We understand that Ofgem may require greater clarity on the spend included within “Work Management”, however, we would request that Ofgem seek consultation with the GDNs on the level and nature of disaggregation in order to ensure appropriate and consistent analysis.
- The Cost Mapping worksheet is complex and in the light of the very high numbers of clarificatory Supplementary Questions received from Ofgem on the completion of the BPQs requires further consultation in order to ensure that it is consistently completed by all GDNs and provides the information which Ofgem anticipates
- The Labour Costs and FTEs sheet requires FTE type by work category. We require clarification on the basis of the FTEs to be reported to ensure consistent reporting. For example, direct labour costs are charged to activities based on time spent on

those activities. Logically, therefore, the direct labour FTEs to be reported should be the FTE equivalent based on the direct labour costs charged to the activity.

- Mains, within the BPQs used for reporting 2006/7 actual results the diameter band data was collapsed into above/below 180mm as Ofgem and/or their consultants found the data at a lower level of granularity not useful whilst the GDNs found completion difficult and based on estimates due to their systems only anticipating data at this collapsed level. Re-introducing this increased level of disaggregation without at least maintaining the accuracy of the data is not appropriate.
- For Governors, we would look to include the mechanical upgrades identified in the condition based Capex programme in table 3.4 under Renewal and the non-mechanical upgrades in Other Capex, table 3.6. Can you confirm whether this is the correct treatment?
- Other Capex, the categories included require rationalisation and simplification as during the completion of the BPQ we found that certain items of expenditure could be included in multiple categories.
- General, Ofgem requests a percentage breakdown of costs which relate to direct labour, contract labour, materials and other. We request that consideration is given to what constitutes “materials and other” costs in this respect as this may lead to future decisions on the impact of RPEs.
- Repex mains, there are LTS projects which could span more than one reporting period. Currently it is not possible to include these within the schedule as only within year spend is being captured rather than the full life.
- Para 1.4: To ensure consistency in the data and costs collected we believe that the guidance notes need to specify exactly what they should contain and not be open to interpretation by the GDNs. e.g. capitalised overheads, definition of materials.
- The Fixed Asset Disposals worksheet requires further discussion to clarify which assets should be included. Should this be in line with Licence Condition requirement A2?

During the GDPCR BPQ process both Ofgem and its consultants raised a very significant number of supplementary questions against the GDNs asking for clarification in the treatment and presentation of items within the BPQs. In order to avoid the need for such detailed follow up after submission of the RRP is important that the lessons from the BPQ process are incorporated into the RRP process. In particular to ensure that the RRP are completed on a consistent basis by the GDNs and that they are also comparable year on year. This upfront quality improvement should ensure that the proposed annual reporting visits by Ofgem to the GDNs are more focused and therefore more beneficial in understanding issues and concerns rather than in ensuring data comparability. We have provided a list of specific supplementary questions in appendix 1. The majority of these questions are in relation to providing detailed activity analysis for indirect and direct opex costs. Further discussion is required on whether this information will be required as part of the annual RRP and if so what is the most appropriate format.

In respect of the following paragraphs we have the following comments/queries:-

- 2.1 the RRP for all GDNs should be identical not “essentially the same”
- 2.3 refers to a “cash typical basis” – can you please clarify what is meant by this?
- 2.3 Can you please clarify what an atypical accrual/provision is, as defined by Ofgem?

Chapter Two

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

In relation to the commentary included within Appendix 2 to the Consultation, we consider the proposed contents to be appropriate. However, in the context of the detailed Excel model we encourage Ofgem to include only requests for data that it will need rather than data that could be useful or merely informative as this can be costly to provide and increases the administrative burden on GDNs. There is obviously a licence condition on Ofgem to only request data which they need namely Standard Special Condition A40 due to be activated as part of the GDPR.

We have separately provided initial comments to Ofgem on their proposed model which have not yet been incorporated and urge them to consider those comments during their review process. These comments were provided in advance of a conference call held on 11 July, some two weeks before the RRP was published on Ofgem's website.

In addition we would like the following specific items to be considered:

The draft table 3.14 for 'Mains and Governor Asset data' requests the number of meter points in multiple occupancy buildings collected from LC21 or other surveys to date. The LC21 survey only applies to buildings of 6 storeys and above and there is currently no other procedure in place to collate data from buildings of up to 6 storeys. In addition to this the LC21 survey does not specify the collection of meter points. We would like to question the usefulness of having this information. However, for 2007/08 actual figures we are able to provide meter point numbers after interrogation of the Xoserve Meter Point Reference Number database. For the up to 6 storey buildings we can provide details of those picked up in the replacement programme as a result of operational visits and for the above 6 storey those surveyed as part of LC21, please advise.

Further clarification is required on the definitions of district, service and non domestic governors to enable accurate and consistent population of governor data requested on tables 3.4, 3.5 and 3.14. The requirement on table 3.14 to provide governor numbers by capacity is not possible at present as it is not a parameter we can report on but we can provide governor numbers by category. We feel that additional categories are required on table 3.4 to distinguish the IP/MP District Governor Renewal and Growth numbers.

On table 3.8 for 'Analysis of Capital expenditure by type of expenditure' we would like to question the benefit of requesting the percentage split of 'Other' activities by direct/contract labour and materials. We believe that 100% of these activities is represented by purchases of goods and services, so it would be classified as 100% other in all cases. If this expectation is incorrect, Ofgem should clarify the definition of the "Materials and Other" category.

As has previously been advised financial information for Capex and Repex mains laid is not held by the requested diameter bandwidth split. Although systems are being updated to hold this data, it is unlikely to be available in respect of the 2007/08 year.

'Other domestic' and 'other non-domestic' are categories contained on table 3.11 for Services Replacement. We would like further clarification on the job types that could make up these categories. In addition, we require further clarity on how Ofgem define domestic

and non domestic services. There are a number of differing definitions using threshold or predominant use of the service which causes problems operationally which can subsequently affect our records. We welcome further discussion on this point.

A requirement of the July 2007 BPQ submission was to provide aggregated cost information for LTS & Storage projects in each category costing less than £0.5m split by LDZ. This split has not been requested on table 3.2 of the RRP. We would like confirmation that this breakdown will not be required in future, but rather that the total of all projects costing less than £0.5m in each work category for the GDN will be requested.

We do hold riser information on our core system but at present we do not have it in an easily reportable way, this makes population of the relevant sections of table 3.11 difficult. We have started the process to address the changes required to the output reports in order to capture the information.

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

There may be commercial reasons for not disclosing certain information. Some third party information will simply not be available to the GDNs, whilst publishing some GDN information about third party transactions would be undesirable. Problems would arise particularly over margins charged by third parties for work they undertake on behalf of the GDNs, should these requirements form part of the final cost reporting pack. We would like assurance that proper regard will be given to any legitimate claims of commercial sensitivity and/or confidentiality.

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

We would expect that the timetable for submitting this data is in line with Ofgem's current reporting deadlines for financial data. That is 31 July in the year following the year of the data. However for the first report on the 2007/8 year, given the precise requirements of the data have not yet been agreed, we would expect additional time to extract and report the data on this occasion.

Given that the RRP includes data in excess of that currently provided to Ofgem on an annual basis, achieving a 31 July deadline will be challenging. There will be the added inconvenience and delay caused by the data being audited, should Ofgem decide on this route. The cost of auditing the Regulatory Accounts is currently some £40k. Should the level of audit work which Ofgem requires to be undertaken on the RRP be similar, then it is likely that a similar further cost will be incurred. Should Ofgem require that the RRP be audited, then we will require that the associated additional costs be allowed by Ofgem.

The provision of LTS capacity and demand data forecasts and project forecast information by the 31 July deadline is extremely challenging. The planning process is reliant on receiving the Demand Supply statements which are not normally received until late May; an earlier submission by National Grid would ensure the appropriate level of diligence was applied to the process in order to meet the deadline. The GDNs are currently in discussion with National Grid and Ofgem as part of the "Transporting Britain's Energy" consultation and that this issue has been raised.



The wide movement between the capacity forecasts provided for the 2006/7 year and for the 2007/8 year demonstrates the need for significant review of the forecasts to understand them in advance of submitting data to Ofgem.

The possibility of having several demand scenarios defined by Ofgem to analyse and subsequently to plan investment against is also a concern and early indication of these scenarios would assist in achieving the deadline. The forecast information is based on planning parameters requested from National Grid as the final Offtake Capacity Statement (OCS) agreement from National Grid is not received until the end of September.

Chapter Three

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

It is anticipated that Ofgem will look to benchmark data, both between the GDNs and against information which they receive from other regulated and non-regulated industries. However, we counsel caution in blindly comparing submitted data without the detailed understanding of how comparable that data is.

In particular we recommend that independent external benchmarking should be used where concerns exist as to the comparability of the data. Any benchmarks chosen need to have a strong correlation to the actual cost drivers involved.

Adjusting such comparisons for differences between firms must take account of all relevant cost drivers, but such comparisons are fraught with difficulty. The results should be viewed as a means of identifying cases for further investigation and never as providing a definitive view of allowable costs.

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?

Third party service providers have no obligation to provide information on their costs or margins. If GDNs demand such information, it will come at a cost – possibly a substantial one. Imposing an obligation on suppliers to divulge commercially sensitive information will drive some out of the market, diminish competition and drive up costs across the board. Moreover, there is no guarantee that such information submitted by third party suppliers will be accurate, unless it is extensively audited. Accounting standards do not normally operate at the level of individual contracts, so it is not clear what kind of audit could be demanded. Any information collected in this way is unlikely to be comparable or consistent between firms.

Moreover, we cannot identify any reason why Ofgem would need information on the margins or costs of third party suppliers. If Ofgem has concerns about procurement policies, the focus should be on those policies, not on the internal accounts of companies that fall outside its jurisdiction. It may be easier to obtain information on the costs and margins of related third parties. However, in our view, it would still be better for Ofgem to focus on procurement policies rather than trying to define after the fact the results of those policies for GDN costs.

To the extent to which Ofgem wishes to review such information, we consider that it should be requested for related third parties only.

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

Our preference is for such data to be provided directly by xoserve.

Whilst the charges which an individual GDN receives from xoserve will be included within that GDNs' RRP, there may be undue delays in obtaining the underlying supporting data from xoserve and incorporating into the RRP.

In addition, the charges to each GDN should be derived on similar bases.

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?

We advocate the abolition of the Regulatory Accounts and their associated audit as part of the introduction of the RRP as a means of minimising the cost impact of completing the return. Consequently, Ofgem will not receive audited financial data from the GDNs unless some or all of the RRP is audited. Such an audit may be required to give Ofgem confidence in the data and to remove the need for ad hoc adjustments for consistency.

Auditing the RRP will be a time consuming and therefore expensive task, due to the number of schedules included and the disaggregated level of detail provided.

Currently the electricity distribution reporting pack is unaudited and the Water reporting pack is only partially audited each year, with a rotation on the part subject to audit.

We would support the RRP cost data being audited, utilising Agreed Upon Procedures and over a limited number of the schedules.

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

We do not know if these accounts provide value to stakeholders as we have not received any comment or query on the accounts.

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

We note that there is little consistency in regulatory policy on audit of regulated accounts. Ofgem does not require audited regulatory accounts for electricity distribution using i) the statutory accounts and ii) other information within the RRP.

Taking into account the above, we would wish to ensure that any new auditing requirement imposed on the RRP of GDNs is consistent with – and not more onerous than – the obligations imposed on electricity distribution networks and water/sewerage companies.

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?

We are not aware how much weight Ofgem places upon these statements. We would advocate a statement within the RRP stating that we have applied the methodology as set out within the RRP as input by each GDN.