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Dear Joanna,

xoserve's response to Ofgem's GDPGR Updated Proposals Document, ref 226/07

Thank you for the opportunity to respond to Ofgem's Updated Proposals document on the Gas Distribution Price Control Review. We will be limiting our response to cover only those issues raised that relate to xoserve.

Opex

The conclusions drawn by your consultants, LECG, on the efficiency of xoserve's property and IS support costs are still based on invalid comparisons between xoserve and the GDNs. xoserve's property costs, for a single town centre office block, are compared with the full range of the GDNs' property portfolios, including industrial and office properties. This is not a valid comparison and the conclusions drawn should be set aside. A comparison of our total property costs against the TOCS benchmark prepared by Actium Consult demonstrates that our property costs are more efficient than suggested by the comparison with GDNs undertaken by LECG.

xoserve's IS costs are compared to a single GDN, NGG. In the Updated Proposals NGG's IS support costs are shown at benchmark (Table A7.3) yet an efficiency saving is proposed for xoserve. We haven't received any explanation for this anomaly. The benchmark metric used for IS support is the ratio of support costs to revenue. For GDNs this is in the range 1.5% to 2.38%. For xoserve the equivalent ratio is 26%, clearly demonstrating the different nature of the two businesses and the invalidity of the comparison. For these two reasons, the conclusions drawn should be set aside.

The reduction in opex for user pays is consistent with the information provided to Ofgem. We have undertaken a review of the scope of the user pays services and provided updated information which we assume will be reflected in your final proposals.

Capex

We assume that the capex element of xoserve's costs is included in the non-operational capex allowances for GDNs. You have separately confirmed that Ofgem propose no efficiency savings to the operational capex element of xoserve's costs. However, the PB Power capex report shows for all GDNs a capex reduction of £12.7m in normalisation adjustments (26% of the original figure). If this was due to a change in definition of capex we would expect to see a corresponding increase in opex, which has not been reflected in the Updated Proposals. At the time of submitting this response we have not been provided with an explanation for the adjustments.

Demand Forecasting

We note your comments concerning xoserve's peak day demand forecasts (4.21). Our forecasts utilise a well established methodology based on historical trends and economic indicators.

Funding of xoserve

We are actively participating in the User Pays Implementation Group established to introduce user pays arrangements for a set of existing services from the start of the period. The Group will also be considering the application of user pays to change and new services. Arguably, under a User Pays model, the potential for key developments being delayed or opportunities missed through lack of clarity of funding and governance arrangements will be significant. It will be critical to ensure that the governance arrangements are consistent with the funding arrangements and we are very happy to work with the Group to develop arrangements that mitigate this risk.

We welcome your continued view that quantifying any additional value obtained from UK Link should be undertaken ex post. However, we do not understand how efficiently funding UK Link Replacement could be interpreted as a "windfall". This is a complete misunderstanding of the situation and to believe that further services could be provided at no cost is unrealistic.

We receive high customer satisfaction scores from shippers and welcome the general view of respondents that existing arrangements are sufficient to ensure continued performance by xoserve.

We look forward to discussing these important topics with you and your team at the earliest opportunity. In the meantime, if you have any questions or comments about what we have raised in this letter please do not hesitate to contact either myself or Nick Salter. We are happy for you to publish this letter as part of the consultation process.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Jon Carlton', is centered within a light blue rectangular box.

Jon Carlton