



Consumers and their  
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Dear Colleague

## **National Grid Gas NTS price control allowance for xoserve**

### **Summary**

xoserve provides common commercial services to shippers and other industry participants on behalf of National Grid Gas the NTS operator (NGG NTS) and the gas distribution networks (GDNs). The gas distribution price control review (GDPCR) final proposals were published on 3 December 2007. These set out the funding model for xoserve and our assessment of the efficient level of xoserve costs that the GDNs can recover through their price controls.

As part of the Transmission Price Control Review (TPCR), which was completed in December 2006, we confirmed that we would assess NGG NTS' share of the efficient costs for xoserve as part of GDPCR. Given the timing of GDPCR, for 2007-08 we used xoserve's forecast of charges to NGG NTS to set the value for this term at £6.6 million (04/05 prices). We did not assess the efficiency of this forecast but committed to an ex-post assessment of these costs and set the remaining four years to zero. Having carried out our analysis our proposed approach is to set allowed revenues over the remaining four years of the price control to £39.5 million compared to the £53.3 million NGG NTS asked for. On average this equates to £9.9 million pa, an increase of 50 per cent over the amount included in the NGG NTS price control in 2007-08.

The purpose of this open letter is to consult on these proposals. We intend to publish our final decision at the end of February 2008 and at the same time undertake the statutory consultation on the necessary licence amendments.

### **Background**

The costs of xoserve were not reviewed in TPCR and it was agreed that as part of GDPCR we would assess the efficiency of xoserve's costs and apply our findings to the share of costs borne by NGG NTS. In GDPCR final proposals we have detailed the efficiency assumptions that we intend to apply to the GDNs in respect of xoserve.

In addition as part of GDPCR we have reviewed the funding arrangements and proposed a core services plus user pays funding model. The purpose of this change is to improve the incentives for gas transporters to be proactive with users in the services they offer via xoserve and to encourage users to consider more carefully the costs they impose.

We have identified a number of existing service lines that will be treated as user pays from 1 April 2008 but expect that the number and value of these services will increase over time during the price control period. The costs of providing core services will be funded through price controlled revenue while the costs of the user pays service lines will be funded directly by shippers and customers who want and use the particular service lines. This user pays income will be treated as excluded services and has been removed from the GDNs' price control allowances.

In September 2007 NGG NTS wrote to us detailing their forecast costs for the remaining four years. This submission can be found on our website as an attachment to this letter. In addition xoserve provided forecast cost submissions as part of GDPCR.

The planned expenditure over the price control period is a mix between capital and operating expenditure. Non-operational capex is treated as operating expenditure within TPCR and therefore all costs will form an operating expenditure allowance. There is an existing term in NGG NTS' special condition C8B Part 2 which details the revenue restriction conditions for the NTS system operation activity which we intend to modify as part of this process.

### **Key Issues**

NGG NTS forecast costs are detailed in Annex 1 along with our assessment of these costs and proposed allowances for NGG NTS for the remaining four years.

#### *Efficiency assessment*

xoserve operating expenditure was reviewed as part of GDPCR. We identified £1.3 million per annum (2004/05 prices) of efficiency savings through benchmarking with the GDNs. In line with the share of xoserve's charges, 89 per cent of these savings have been treated as attributable to the GDNs with the remaining 11 per cent attributable to NGG NTS.

In addition we have reviewed the forecast spend on IT upgrades and replacement. We have found these costs to be efficient and allowed the forecast capital costs. There are a number of xoserve costs predominantly around the Gemini IT system that are only funded by NGG NTS (no share is borne by the GDNs). We propose to allow the costs for this work.

#### *User pays*

The costs of the existing service lines that have been identified as user pays services will be funded directly by shippers who use the particular services. In line with our approach for the GDNs, NGG NTS' share of this income (11 per cent) will be treated as excluded services income and it is proposed to remove this revenue from the price control allowance.

#### *Industry framework changes*

In addition NGG NTS are seeking an allowance to cover the cost of future industry framework change. Two of these proposed changes are for licence obligations placed on NGG NTS as part of TPCR and are associated with transmission exit reform and entry capacity arrangements. We propose to fund the costs for these changes (£4 million over the four years).

The remaining costs are speculative in nature, particularly later in the price control period, and we do not consider it is appropriate to make any allowance at this time for these costs. We would expect a similar process to be followed for changes to Gemini as proposed for UK Link whereby parties who place greatest value on the change bear the costs. We consider it is more likely that change will be driven by the industry in gas distribution compared to transmission and expect that NGG NTS will, more generally, put forward changes to the Gemini system. With this in mind we would expect proportionally more of the costs of change for the Gemini system to be recovered through gas transportation charges levied by

NGG NTS. In circumstances where the changes have a significant cost and NGG NTS consider they have not been funded we will consider whether it is appropriate for an ex-ante allowance to be set at the time of a proposal or whether the change costs should be logged up with an ex-post review.

#### *2007-08 costs*

We are not proposing any adjustment to the allowance for 07-08 costs.

#### *Other issues*

We note the recent failure of the Gemini system and industry concern over the robustness of the system and service quality. We consider that the proposals we have set out in this letter for the funding of xoserve are appropriate. We note that if users consider the existing standards of service are not appropriate then they can seek to amend them through modifications to the Uniform Network Code. We will however continue to monitor this situation.

#### **Timetable**

The term in the NTS licence is set to zero for the four years from 2008-09 to 2011-12. We intend to modify this term before 1 April 2008 as detailed above which will require a 28 day statutory consultation on the licence amendments. Our proposed timetable is set out below:

Open letter consultation	20 December 2007
Consultation close	25 January 2008
Publish decision and statutory consultation	End of February 2008

#### **Responding to this letter**

Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this letter. In particular, we would like to have views on the following question:

- Do you agree with our approach for setting opex allowances for the funding of xoserve and the proposed allowances we have derived using this approach?

Unless marked confidential, all responses will be published by placing them in Ofgem's library and on our website [www.ofgem.gov.uk](http://www.ofgem.gov.uk). Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000. Respondents who wish to have their responses remain confidential should clearly mark the document to that effect and include the reasons for confidentiality.

If you have any questions on this consultation please contact either Mike Begley on 0207 901 7048 or Paul O'Donovan on 0207 901 7414.

Yours faithfully



Bob Hull  
Director, Transmission

## Annex 1 – NGG forecast costs and our assessment

### Forecast of xoserve charges to Transmission (NGG NTS letter 25.09.07)

04/05 prices	UKT sharing factor (%)	2008/9 (£m)	2009/10 (£m)	2010/11 (£m)	2011/12 (£m)	total
Operating costs	11%	5.0	5.0	5.0	5.0	20.0
UK Link developments	11%	2.0	0.2	1.9	1.5	5.6
GEMINI infrastructure upgrades	100%	0.4	8.3	2.0		10.7
GEMINI maintenance releases	100%	0.3	0.3	0.3	0.3	1.1
Industry Framework change allowance	100%	3.6	3.5	4.5	4.4	16.0
<b>Total allowance (IX)</b>		<b>11.3</b>	<b>17.2</b>	<b>13.7</b>	<b>11.2</b>	<b>53.3</b>

### Ofgem proposed allowance

04/05 prices	UKT sharing factor (%)	2008/9 (£m)	2009/10 (£m)	2010/11 (£m)	2011/12 (£m)	total
Operating costs	11%	4.5	4.5	4.5	4.5	18.2
UK Link developments	11%	2.0	0.2	1.9	1.5	5.6
GEMINI infrastructure upgrades	100%	0.4	8.3	2.0		10.7
GEMINI maintenance releases	100%	0.3	0.3	0.3	0.3	1.1
Industry Framework change allowance	100%	1.9	1.2	0.6	0.3	4.0
<b>Total allowance (IX)</b>		<b>9.1</b>	<b>14.5</b>	<b>9.3</b>	<b>6.6</b>	<b>39.5</b>