



Gas transporters, customers and representatives and any other interested parties

Promoting choice and value for all customers

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Dear Colleague

Gas Distribution Price Control Review – Review of process

On 1 April 2008 the new price control applying to gas distribution networks (GDNs) came into effect. The new price control is the outcome of a two year review process. We are keen to understand stakeholders' views of how the Gas Distribution Price Control Review (GDPCR) process worked and to build on these experiences in undertaking the electricity distribution price control review¹ (DPCR5) and as part of RPI-X at 20², which will review incentive regulation in general.

The purpose of this letter is to seek responses from interested parties on how we conducted the GDPCR, with a view to understanding what elements of the review were perceived to have been conducted well, what could be improved and what should be done differently in future reviews.

Please note that it is not the intention of this review to identify whether the policies in the GDPCR final proposals document were appropriate. The focus of this review is on process. Attachment 1 provides an overview of the process followed during GDPCR.

Interested parties are invited to respond to this consultation. While we welcome views on any relevant issues, Attachment 2 suggests a list of questions for consideration. Responses should be received by 30 May 2008. They should be sent to:

Gas Distribution Price Control, Ofgem, 9 Millbank, London SW1P 3GE, or
gdpcr@ofgem.gov.uk

Unless marked as confidential, all responses will be published by placing them in Ofgem's library or on the website.

There will be a further opportunity to discuss the process that Ofgem uses to conduct its price controls during the DPCR5 workshops to be held in May 2008. We will look to use the findings of this assessment to inform the DPCR5 Policy Paper, due to be published in December 2008. It will also feed into the RPI-X at 20 Review.

¹ Electricity distribution price control review initial consultation document (32/08)

² Ofgem to review regulatory regime for energy networks (R/8)

Any questions on this letter should be directed to Nicola Cocks who can be contacted on 020 7901 7036 or by email at nicola.cocks@ofgem.gov.uk

Yours faithfully,

Rachel Fletcher,
Director, Distribution

Attachment 1 Overview of GDPCR process

Objectives and outputs of the review

Ofgem's duties and powers are defined by statute. Our principal objective under section 4AA of the Gas Act 1986 is to protect the interests of consumers, wherever appropriate by promoting effective competition. In addition (and without limitation), we identified the following general duties as being likely to have particular relevance to GDPCR:

- the need to secure that, so far as it is economical to meet them, all reasonable demands for gas conveyed through pipes are met,
- the need to secure that licence holders are able to finance their authorised activities,
- to promote efficiency and economy on the part of licence holders and the efficient use of gas conveyed through pipes,
- to be transparent, accountable, proportionate, consistent and target regulatory activities only in cases where action is needed, and
- to protect the public from dangers arising from the conveyance of gas through pipes or the use of such gas pipes, and to take into account any advice given by the Health and Safety Commission about any gas safety issue.

GDPCR determined the amount of revenue that may be recovered by a GDN from its customers during the period 1 April 2007 to 31 March 2013. As part of this, we sought to establish a framework that creates incentives for GDNs to invest and operate efficiently, to deliver an appropriate level of outputs and to meet their statutory obligations and licence conditions. We identified three key outputs for GDPCR:

- to extend the existing gas distribution price control for one year,
- to set revised gas distribution price controls from 2008-09, and
- to develop a cost reporting framework to apply from 2008-09 onwards.

Consultation process

Each price control review has unique features which must be taken into account when designing the process to be followed. GDPCR was the first price control to occur following National Grid's sales of four of the eight gas distribution networks, which meant that we faced a very different industry structure to previous reviews. These changes affected the quality of data available to us. We also needed to carry out a one year control in order to realign the price control timetable consistent with the outcome of the Developing Network Monopolies Price Control Consultation in 2003.

The main features of our consultation process were:

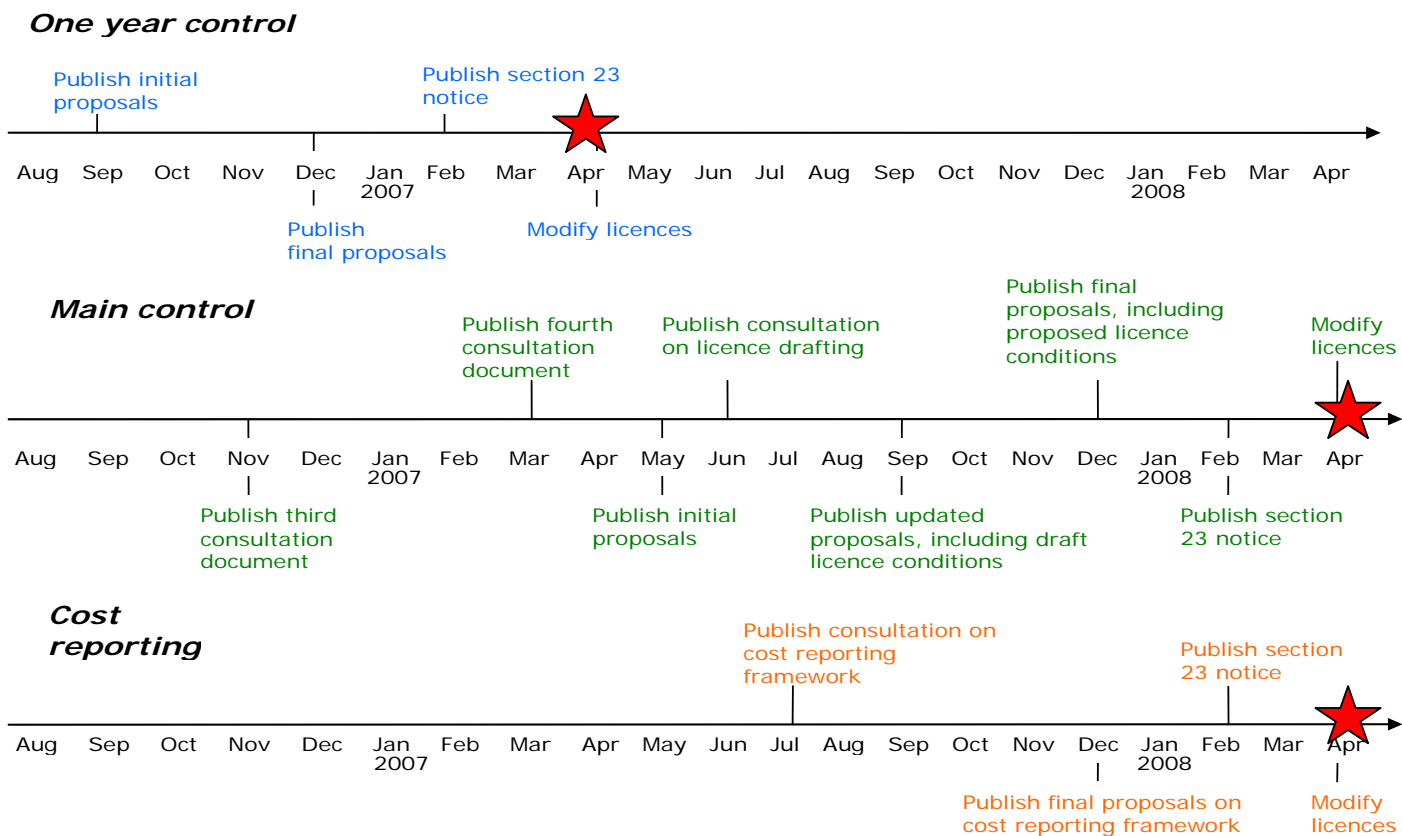
- **Consultation documents.** Over the course of two years, Ofgem issued four consultation documents, as well as initial proposals and final proposals for the one year control, and initial proposals, updated proposals and final proposals for the main control. We also issued documents relating to licence drafting and regulatory reporting.
- **Bilateral meetings.** Ofgem met regularly with the GDNs and with other stakeholders including the HSE, energywatch and other interested parties as appropriate.
- **Authority committee meetings with GDNs.** Senior GDN representatives met with a committee of the Authority prior to key decisions being taken. Three rounds of meetings were held during GDPCR – following the publication of the one year control and main review initial proposals, and prior to publishing the main control final proposals.
- **Working groups with GDNs.** The GDPCR working group provided an opportunity for GDNs and Ofgem to consider particular policies and approaches. It did not have any

decision making role. In addition, sub-groups were established to discuss individual strands of work such as financial issues, licence drafting and quality of supply.

- **External consultants.** Ofgem used external consultants to assist with the review and assessment of the historical and forecast costs of GDNs.
- **Seminars.** Ofgem conducted two seminars to discuss the issues set out in the consultation documents. These seminars were targeted at a broad range of stakeholders, including consumer, industry and City representatives.

GDPCR's timetable, as proposed in the second consultation document, is set out in Figure 1 below³.

Figure 1 GDPCR timeline



GDPCR's timetable diverged from previous Ofgem price control processes in a number of respects. Since we anticipated problems with data quality, we commenced our review of costs early, and completed our review of costs at a later stage in the process than would ordinarily be the case. We also started work on the cost reporting framework and the legal drafting changes required to give effect to GDPCR at a relatively early stage in the process. These changes were intended to address specific issues arising in the context of GDPCR and to build on Ofgem's experience of carrying out price control reviews.

³ In practice, this timetable was slightly amended as we published a second licence drafting consultation document in December 2007 and did not include licence conditions in the updated proposals document. Final proposals on cost reporting were not published in December 2007, but a document covering cost, revenue and quality of service reporting was published in March 2008. We also published two additional consultations, on capacity incentives and leakage rates, in October 2007.

Attachment 2 Consultation questions

The questions below are intended as a guide to the types of issue that interested parties may wish to address in their response to the open letter.

- *General principles and objectives*
 - Were the objectives of GDPCR appropriate?
 - Did our process conform to the principles of better regulation?
- *Preparatory work*
 - Was our consultation on the process during the early stages of GDPCR useful?
 - Was there anything else that should have been done at the planning stage?
- *Communication*
 - How effective were the channels and methods of communication?
 - Would it have been possible to make more use of electronic communication compared to face to face meetings?
 - Were the appropriate individuals with responsibility for work areas within Ofgem clearly identified to interested parties?
 - Were we open and receptive to comment and criticism?
 - Did stakeholders have access to the appropriate levels of seniority within Ofgem to resolve issues as they arose?
- *Meetings and working groups*
 - Did participants find our meetings and working groups useful?
 - Were the right people invited?
 - Were there too many/too few meetings?
 - Were meetings focused on the right issues?
 - Were they held at appropriate stages of the process?
 - Were the discussions in meetings sufficiently transparent?
- *Balance between one year control/main control*
 - Did we spend too much time, too little time or about the right amount of time focussing on the one year control?
 - Did any problems arise during the period when the two controls overlapped?
 - Did our strategy of dealing with certain issues as part of the one year control work well?
 - Did our strategy of explicitly rolling over the previous control in some areas work well?
- *Use of consultants*
 - Did we use consultants in an appropriate manner?
 - Were consultants employed at the right time?
 - Was the output from our consultants fair and unbiased?
 - Should we be doing more or less of the work in-house?

- *Consultation documents*
 - Was the overall consultation process too lengthy, about right or too short?
 - Did we produce the right amount and level of information so that all interested parties could understand the GDPCR?
 - Were there too many/too few consultation documents? Were all relevant issues consulted on?
 - Were the response periods for these documents sufficient? Was there any conflict in timescales with any other consultations?
 - Did our documents give a fair and balanced account when respondents had contrary or conflicting views?

- *Use of impact assessments*
 - Were our impact assessments useful?
 - Did we produce too many, too few or the right number of impact assessments?

- *Requests for and use of information*
 - Were our requests for information reasonable and proportionate?
 - Was the consultation on draft information requests useful?
 - Were consultants sufficiently integrated in the drafting of information requests?
 - Did we give appropriate explanation and justification for our information requests?
 - Did regulated companies have sufficient time to meet our information requests?
 - Could we have avoided some of the initial information requests / follow-up information requests?

- *Timeline*
 - Were the timelines for the various work streams appropriate?
 - Which issues were addressed to soon/too late in the process?

- *Regulatory consistency*
 - Were there any unexplained changes in regulatory policy during the course of GDPCR?
 - Was the process followed during GDPCR consistent with your expectations?

- *Transparency*
 - Were the processes and analyses conducted by us and our consultants sufficiently transparent?
 - Was the underlying data provided by GDNs sufficiently transparent?

- *Access to Ofgem & the Authority*
 - Were interested parties satisfied with the extent that they were able to meet with Ofgem and/or the Authority during the GDPCR process?
 - Was Ofgem properly represented at such meetings?
 - Were Authority members willing to engage at appropriate stages of the process?
 - Were these meetings productive?

- *Process delivery*
 - Overall did the process work?
 - Did we deploy sufficient resource, too much or too little and at the right time in the process?
 - Were our teams comprised of the correct range of competencies to deliver an effective price control?

- *Positive points*
 - What parts of the process worked well?
 - Which elements added the most value to the process? What aspects should be retained for future reviews?

- *Potential improvements*
 - How could the overall process be improved?
 - What were the biggest problems with the GDPCR process?
 - What changes should be made to the process to avoid a repetition of these problems?

- *Other issues*
 - Are there any other observations that should be made regarding the GDPCR?
 - Are there other issues we should be addressing in 2008 and 2009 as early preparation for GDPCR2?