

Kieran Donoghue
Head of Gas Distribution Regulation
Ofgem
9 Millbank
London
SW1P 3GE

Paul Rogers
Regulatory Manager

paul.s.rogers@uk.ngrid.com
Direct tel +44 (0)1926 655584

www.nationalgrid.com

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Dear Kieran,

Reporting arrangements applying to gas distribution networks

1. This is National Grid Gas's (NGG's) response to the Gas Distribution Network (GDN) reporting arrangements published on 7 March 2008 by Ofgem. Each of the three documents:
 - Price Control Review Reporting Rules (Cost Reporting);
 - Revenue Reporting Regulatory Instructions and Guidance;
 - Quality of Service Regulatory Instructions and Guidance;

are dealt with in turn within this response and should be self explanatory.

Price Control Review Reporting Rules (Cost Reporting)

Section 1: Summary

2. We recognise that the Cost Reporting consultation document is still "work in progress" and we will continue to liaise with Ofgem through further working groups in April to finalise the Regulatory Reporting Pack (RRP) for the reporting year 2007/8.
3. Section 2 contains our responses to the specific questions raised by Ofgem in the consultation document. Section 3 contains our "points of detail" on the data tables, completion instructions and definitions. Our main "points of principle" are as follows:
4. The guidance notes for the RRP state that all costs are to be entered on a cash typical costs basis i.e. not on an accounting basis. Whilst we understand the requirement to report actual data on a consistent basis with the price control review settlement, we do not accept that it is necessary, or even

helpful, to make adjustments on a detailed line by line basis. Doing this would make it difficult to maintain visibility between the company's accounts and the regulatory reporting information.

5. We believe a better approach would be to include, within the operating cost schedule (below the total controllable costs sub-total), a limited number of additional free format rows where Gas Distribution Networks (GDNs) would be able to detail the cash and atypical adjustments across the activities. This method is more in line with the approach taken by Ofgem in the NGG Transmission schedules and would:

- Enable simpler reconciliation of costs to internal accounts
- Reduce the work required to complete the schedules for the GDNs
- Enable Ofgem to compare actual controllable opex with allowances

It would also ensure the starting point for indirect costs were on a consistent basis with the NGG Transmission schedules. All other supporting opex schedules would be completed on an accounting basis.

6. Furthermore, the usefulness of schedule 2.6 (cost mapping to operating costs) will be reduced if cash typical adjustments are required. We understand that Ofgem intends to use this schedule to review the budget holders' costs/cost centre allocations to activities and the basis of the allocation. Completing schedule 2.6 on an accounting basis would maintain visibility to the company's accounting records thereby aiding Ofgem's compliance checks.

7. We acknowledge that under normal circumstances the information requested under Standard Special Condition A40 (Price Control Review Information) should be submitted to Ofgem no later than 31 July following the end of the financial year to which the information relates. However, Ofgem has indicated during the course of GDN discussions and working group meetings that submissions for the first year of reporting may be staggered in order to allow GDNs time to put processes in place this year. This is a helpful approach and we confirm that:

- Information provided via NGG Transmission will be submitted no later than 31 July 2008. As Ofgem has stated on page 5 of the Regulatory Instructions and Guidance (RIGS) this submission will include the schedules for debt analysis, tax computations and capital allowances, related party margins and pensions. The Transmission RRP will also include Distribution indirect costs, although these will be presented on an internal organisation basis in accordance with Transmission RRP requirements, but with no line by line analysis. It would be helpful if Ofgem could develop a process

whereby questions will only be submitted once for these common Transmission and Distribution areas.

- We propose that some further RRP data tables (the extent of which has still to be agreed with Ofgem) will be submitted by 19 September 2008 with the remaining data tables and other information submitted by 30 September 2008.

8. For NGG, indirect activities are undertaken by a shared services organisation with costs allocated to Transmission and Distribution on the basis of a methodology which has been agreed with Ofgem. As agreed during discussions with Ofgem, NGG will submit detailed data for indirect activities at a total level (i.e. combined Transmission and Distribution) with bottom line summaries of the amounts of each department allocated to Transmission and Distribution based on the agreed allocation methodology. In order to populate the full detail required under schedule 2.1 for Distribution, NGG will simply apply the percentage allocation of the total departmental cost to each individual line item.
9. This approach could have implications for explaining year-on-year movements in costs on a line by line basis (for example, changes in gross materials costs may be as a result of changes in Transmission activity, but would also flow through to Distribution on an expense heading basis). We believe that any analysis and explanation of costs on a line by line basis should be made before allocations using the information provided for indirect costs as part of the Transmission RRP.
10. It is important that the formats and definitions are subject to a change control process in order that consistency and comparability of data across GDNs and against allowances is not compromised. However, based on NGG's experience with the Transmission RRP last year, we believe that the volume of issues/errors/problems identified during the first year is likely to be higher than normal. Taking this into account, and the fact that the data table spreadsheet has not yet been tested, we would recommend some flexibility of approach in the change control process for the first year. Our recommendation would be to lock worksheet structures (e.g. inserting rows and columns), but allow GDNs to correct any formula errors. These errors would be separately logged with Ofgem for subsequent correction in master file versions. If this flexibility is not available, the timely submission of data tables may be jeopardised.
11. We have not tested the excel spreadsheet, but any formula errors that we have come across as part of our review of the data table formats are noted within section 3. However, our assumption is that the spreadsheet will have been comprehensively tested by Ofgem before the final version is released to GDNs.

Section 2: National Grid's response to specific questions raised.

Are the reporting arrangements set at an appropriate level of detail?

12. There have been a number of GDN working group meetings with Ofgem to discuss and agree the content of the Distribution RRP. Our view is that the level of detail requested is appropriate subject to the concern raised in paragraphs 4 and 5 above regarding Ofgem's proposed method for removing non-cash and atypical costs from operating costs on a detailed line by line basis.

Is the scope of the reporting arrangements appropriate?

13. We believe that the scope of the reporting arrangements is broadly appropriate.

Do the reporting arrangements omit any relevant categories of information?

14. We do not believe that the reporting arrangements omit any relevant categories of information.

Section 3: Detail Points

Data tables and associated table instructions

15. Para 1.17 – there appear to be some words missing at the end of this paragraph.
16. Check and balance report – we would recommend that some tolerance level is applied to any cross checks to avoid spurious "errors" being highlighted, with cross-checks performed to the nearest £0.1m.
17. Table 1.1 Summary – in the section which calculates overs and unders entitled "DB pension contribution rate variance" there is also a row for "Group schemes where reallocated to GDN". Further explanation for this row is requested as the final proposals for NGG only included an assumed contribution rate for the DB scheme.
18. Table 2.1 row 11 states that activity costs should be net of related party margins. However, the completion instructions for this table state that costs should be inclusive of related party margins - this is our preferred treatment for related party margins which was agreed with Ofgem at working group meetings.
19. In the reconciliation to the regulatory accounts schedule, the table heading for the capex reconciliation has been referenced incorrectly as "A8 Reconciliation to Regulatory Accounts: Capex" – it should be "1.2 Reconciliation to Regulatory Accounts: Capex"

20. Table 1.7 RAV roll forward - is the referencing in the spreadsheet correct? Net proceeds on sale of assets for the reporting year (2007/8) are being referenced into cell F46 which relates to the previous year.
21. Table 1.7 RAV roll forward – we recommend that the row for LTS Repex is renamed "variance from non-matrix allowances". All variances from non-matrix allowances are dealt with via the RAV and cover the repex categories for LTS repex, relay after escape, other domestic services and multi-occupancy buildings. There will need to be a separate table of allowances (pre-populated by Ofgem) and actual costs to calculate this number.
22. Table 2.1 Total Cost Matrix – spurious row entitled "Shared Service Cost from Table XXX" should be removed.
23. Table 2.1 Total Cost Matrix – the row called TMA should be renamed to TMA/NRSWA, consistent with the approach taken in table 2.13.
24. Table 2.1 Total Cost Matrix – we note that an additional column (metering) has been added into the analysis of non formula costs compared to the BPQ submission. We assume that this is only to capture the costs incurred by the GDN on behalf of the metering business (mainly the repair, exchange and installation of meters) – confirmation that this is the correct treatment is requested.
25. Table 2.7 Analysis of Labour Costs – we understood that the columns for non formula costs would be shown in full (to mirror the columns in the total cost matrix i.e. de minimis, excluded services, metering and consented), so that net staff costs could then be cross referenced into table 2.1.
26. Table 2.11 Accruals – the table instructions refer to rows which do not exist – e.g. "utilised" and "cash payments on utilisation of provisions". Either the table instructions or the spreadsheet need to be amended.
27. Table 2.12 Shrinkage - average system pressure is required “as at” date. Average system pressure is calculated over a period, currently calendar year, so it would be more meaningful for this to be “for the period”.
28. Capex and repex - some words seem to be missing from the introductory paragraph (page 25 of RIGS).

29. Table 3.1 Capital Expenditure Summary – is the subjective split required on this page (shown on table 3.9)? If so, the split currently does not cover all the rows in the table 3.1; also waste management should be renamed as reinstatement and TMA renamed as TMA/NRSWA.
30. Table 3.2 LTS Capex - during the development phase of the regulatory reporting pack we understood that it was Ofgem's intention to request LTS capex data for the whole period to 2012/13 each year. The guidance notes do not make this clear and confirmation is requested.
31. Table 3.6 Other Capex - Aggregated Expenditure Categories – The text states that additional notes should be provided in those categories marked “*”. The column containing the asterisks has been deleted from the current draft templates and therefore it is not clear which categories require further information.
32. Table 3.8 – Capital expenditure by type of expenditure - TMA should be renamed as TMA/NRSWA.
33. Table 3.9 Replacement Expenditure Summary - the Waste Management column should be retitled Reinstatement and TMA retitled TMA/NRSWA consistent with opex and capex.
34. Table 3.15 Additional Data – the number of actioned "repairs" by mains diameter band should be the number of actioned reports, consistent with HSE reporting. The instructions for this table should make this clear.

Comments on definitions

35. We note that the published consultation version of the RIGS does not contain the latest work management activity definitions issued by Wales & West Utilities (WWU) on behalf of all the GDNs; presumably because this was released after the deadline for consultation document publication. We agree with the WWU definitions and would recommend they be included within the final version of the RIGS.
36. Abandoned mains – mains are abandoned for other reasons apart from the mains replacement programme (e.g. mains diversions).
37. Audit, Finance & Regulation – amend "Time sheet processing" to "Time sheet evaluation where not part of the payroll process". Payroll management and operation is defined as being within HR
38. Capital expenditure – include additional sub-bullets after (a) - "replacement of an existing asset" and "the expenditure represents the restoration of asset benefits which have been consumed by the entity" – in line the UK GAAP definition.

39. De minimis activity – replace the definition of de minimis contained in the RIGS with "Activities undertaken by the licensee which are not within the definitions of the gas transportation, metering, meter reading or LNG storage businesses and for which the Authority has not given specific consent and which are subject to the limitation provided for in Standard Special Condition A36 (Restriction on Activity and Financial Ring Fencing) of the gas transporter's licence applicable to the GDNs and the National Transmission System (NTS)"
40. Depreciation – replace with "The measure of the amount of the benefits of a fixed asset consumed during the period".
41. Excluded Services – amend to "Any activities or engagements undertaken by the licensee or any affiliate or related undertaking of the licensee as part of the transportation business, but which are not remunerated through formula revenues. Include services that have been determined by the Authority to be Excluded Services in line with the principles outlined in Special Condition E18 (Supplementary provisions of the revenue restrictions in respect of the Distribution Network) of the gas transporter's licence applicable to the GDNs. Also include the provision of meter work services by the GDN to the licensee's metering business".
42. IT & Telecoms – amend definition to exclude cost of mobiles (rental/call charges) where charged directly to user departments.
43. Maintenance: Storage – the definition refers to "Maintenance job records"; we would expect job records to be included within the work management activities.
44. Operating expenditure – replace with "The operating costs of the GDN other than replacement expenditure, depreciation, amortisation, profit on sale of assets, release of deferred contributions and charges/releases of provisions".
45. Non Routine Maintenance - "Typically the requirement to carry out this work on any individual site may arise only once in a ten to twenty year period" - suggest the time frame should be amended to a once in every five years or more e.g. On Line Inspection runs occur around every seven years.
46. Post-vesting asset/vesting asset/vesting asset lives – we believe these to be electricity network concepts and therefore the definitions should be removed from the gas distribution RIGS.
47. Share options – the correct terminology is share based payments which covers awards of shares as well as share options.

Other Information

48. Page 51 of the Appendices indicates that capex scheme papers for the LTS projects listed in Table 3.2 should be provided. Such papers will only be available for approved schemes i.e. not for planned projects still to be approved.

Revenue Reporting Regulatory Instructions and Guidance

Timetable for Reporting in 2008

49. There is some cross-over between items to be reported in the cost reporting pack and the RRP e.g. repex costs, formula rates, licence fees and non-formula costs, and there needs to be absolute consistency in these areas. Given the need to establish the required new processes, Ofgem has agreed that for 2008 the data tables contained in the cost reporting pack are not due to be submitted until mid-September, with narratives following on at the end of September. The benefit of this extra time is reduced if certain areas of the costs have to be submitted by 31st July via the revenue pack. We consider that, for consistency and in order to establish robust procedures for both revenue and cost reporting, it would be beneficial to agree the same submission date for the revenue reporting pack, covering historical revenues, as for cost reporting. This would not impact the timing of the forecast returns of the RRP.

Accounts Reconciliation

50. Further consideration needs to be given to the issue of reconciliation to the statutory accounts. For NGG it is not possible to reconcile revenue numbers by network to the statutory accounts, where only an overall analysis is available. Two options are possible: to reconcile to the regulatory accounts, where the Distribution business numbers are split by network (and a separate overall reconciliation of the regulatory and statutory accounts is already provided) or to reconcile overall reported revenue, across all our Distribution networks, to the statutory accounts. If consistency of the reporting of Other Revenue with other Licence holders is sought, the latter approach may be more appropriate. In this case it would be appropriate to report overall Other Revenue rather than by network. Given the different business structures of the Distribution Licensees, it may be appropriate to develop separate versions of the revenue reporting RIGs for National Grid Gas and for other Licensees. The need to resolve the reconciliation reporting requirement is further reason to delay the date for reporting in 2008.

Reporting of Other Revenue

51. The decision on the type of accounts reconciliation will impact on the revenue to be reported under Other Revenue. For example, the Distribution networks provide metering services to National Grid Metering, the income from which is initially coded to revenue, but which is eliminated on consolidation, being an intra-group transaction, to avoid overstating group revenues. The figures to be reported in the RRP thus depend upon the type of reconciliation sought. Whatever reconciliation is intended, we

consider that further clarity is required on the revenue to be reported for some items, such as Metering and Meter Reading revenue, to establish the scope of the services covered by the reported revenue. Services providing de minimis and consented income are not undertaken on a network basis in NGG and so it would be more appropriate to report these on an overall basis.

Forecast Return

52. Both the detailed and forecast returns of the RRP contain signed off sheets, however the level of sign-off is not specified. We consider that sign-off at Director level is appropriate for the historical reporting, consistent with current requirements, whereas for the revenue forecasts sub-Director level sign-off, by the Pricing Manager as at present, is appropriate. Introducing a higher level sign-off for the forecasts would introduce an extra internal step that could lead to earlier forecasts needing to be used.

Reporting for the Innovation Funding Incentive

53. The further guidance sets out the information requirements to be provided by 1 March of each reporting year. Our understanding is that this would need to be provided by 1 March 2009 in respect of reporting year 2008/9, and similarly for later years. It would be useful for Ofgem to clarify the timescale for Innovation Funding reporting.

54. The guidance also states that Ofgem will inform the GDN of any deficiencies in the information. It would be beneficial to have further information on the level of detail which Ofgem is seeking on the project schedule and other items. Similarly, further information on the level of detail required in the year end reporting would be valuable, for example whether all projects need to be published within the report or whether some may be kept confidential.

Audit Requirements

55. We note that further details of the audit requirements relating to revenue reporting were discussed at the network audit workshop held on 12 March. We consider that the discussed requirements need further development. It would be beneficial for further details of the requirements to be included within the RIGS once they are agreed.

Reporting Template

56. The Forecast Return sheet of the template contains duplicate information blocks for information calculated within the spreadsheet and data manually entered. Whilst either approach would provide appropriate forecasts if used throughout, it is likely that the forecasts provided will be a mix of calculated items and manually-input items. In this case the cells calculating the Maximum Distribution Revenue will not give the correct forecast within either block.

57. It may be better to allow data to be entered manually directly in the automatic-calculation cells, so as to over-ride the calculation, and to adopt a convention to clearly show where data is manually input as

opposed to calculated. This would enable a single forecast revenue block to be shown and signed-off and for the Maximum Distribution Revenue to be calculated properly in every case.

58. Whilst we have been able to undertake some testing of the template, to check whether its calculations properly reflect the licence conditions, we have not been able to test every option and calculation within the template. It would be beneficial for Ofgem to provide a version of the template with the licence condition values for all years to facilitate further testing.

Quality of Service Regulatory Instructions and Guidance

59. We have no substantive comments in relation to the Quality of Service (QoS) RIGS as most of the issues arising have been addressed through the QoS work-stream process. Our remarks are referenced to the relevant paragraph number/section within the QoS RIGS document.
60. Table of Contents – The page numbering is wrong from section 3. “Customer satisfaction surveys” onwards. It should be page 11 rather than 12 and this follows on for the remainder of the Table of Contents.
61. Paragraph 2.34 - This paragraph states that “the number and duration of interruptions must be 95 per cent complete.” We understand from Ofgem that this will apply from the formula year commencing 1 April 2009, to enable GDN systems and processes to be introduced and thoroughly tested in the first year of this Price Control. While the requirement is stated in the December 2007 QoS report, it may be appropriate to make this clear within the QoS RIGS.
62. Paragraph 3.8 – The content of paragraph 3.9 is repeated as the last sentence of paragraph 3.8.
63. Paragraph 4.6 – Insert “a” between “of “and “licensee”.

I hope the comments provided are sufficiently clear, but should you wish to discuss any aspects of our response, please contact me at your convenience.

Yours sincerely

Paul Rogers

By email

