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Dear Rachel

**Gas Distribution Price Control Review – Review of process.**

We welcome the opportunity to comment on the process followed during the Gas Distribution Price Control Review (GDPCR). We strongly agree that such a review is appropriate and that building on the “lessons learnt” is valuable for future price control reviews.

We are pleased to set out below the views of Scotia Gas Networks (SGN). As requested, we have focused on the process followed during GDPCR and have tried to avoid commenting on policies.

It was always recognised that GDPCR would be challenging given that it followed soon after DN sales, that the new businesses were therefore being established at the same time as carrying out the review and therefore that data quality and availability would be an issue and that it was clearly too early to assess the impact of the new management teams. Also, there were a number of significant legacy issues to be addressed, such as the NGG capex overspends, pension scheme deficits and the exposure to rising shrinkage costs and lower volume growth. These issues needed to be addressed before looking ahead to the next price control period and considering the new issues DNs would be facing going forward.

Overall, we consider that GDPCR was carried out in an open and transparent way, and that the decision to have a one-year review followed by a main review was successful. The overall positive to us was the open and transparent way in which the review was carried out. In particular, the key members of the Ofgem price control review team were usually readily available to discuss and resolve issues as they arose.

However, we do believe that the data issues were underestimated, particularly with regard to the transition year 2005/06 and despite being flagged by DNs beforehand.

The comments we have are summarised below under each of the main constituent parts of the consultation process. More detailed comments are included in the Appendix to this letter, addressing each of the questions in turn set out in Appendix 2 to the consultation letter.

Consultation documents. In our view, the number of consultation documents was broadly appropriate, although consolidation of the Second and Third Consultations may have freed up more time to better understand the outputs from the benchmarking. In addition, we believe that the September [2007] Update was critical to our process, in taking into account 2006/07 outturns, and should be considered for future reviews.

Bilateral meetings. We greatly appreciated the bi-lateral meetings ahead of the publication of each consultation document and consider that these significantly aided the transparency of the review.

Authority committee meetings with GDNs. We believe that the Authority meetings are vital to the process. However, given their importance and that we always tried to focus on the key issues for us at the time, in our view they were too short at an hour and a quarter each and we felt did not allow sufficient time for us to get over all our points. Provided that dates are agreed and in diaries as early as possible, it should be possible to arrange for at least two hours for each DN.

Working groups with GDNs. We continue to support DN's meeting together face to face with Ofgem through the working groups. In GDPCR these were well managed, open and constructive and allowed through the discussions an understanding of all parties views.

External consultants. In our view, the external consultants were engaged [and re-engaged] too late in the process and this may have added to, we believe, the excessive number of supplementary questions raised following submission of the BPQs. We also suggest that additional DN visits by the external consultants would have been a more efficient and coordinated way of managing the large number of supplementary questions.

We would also observe that it was often not easy to draw the key conclusions and underlying numbers from the consultants' reports. These would have benefited, and been more helpful to us, from better summary information.

We would also question the willingness of certain consultants to take on board new and innovative approaches being taken by the new management teams which were expected as part of DN sales.

In addition, too much reliance was placed by Ofgem on "scientific" analysis/ benchmarking carried out by external consultants. The outputs of the benchmarking left many unexplained differences, perhaps due to data issues but also perhaps due to insufficient recognition of regional differences and real price effects, and in certain areas lacked an overall "felt fair" sense check. We would encourage Ofgem to restrict the reliance on external consultants to specific technical areas and instead to develop the expertise and knowledge in-house. The annual cost reporting process will be valuable here.

Seminars. We note that the open seminars were not widely attended and that one had to be cancelled through lack of interest. Stakeholders written responses were far more comprehensive and considered than was evident at the seminars. We question therefore whether these serve a useful purpose or are simply "due process". We do however believe that it is appropriate for DN's to present and explain their business plans to stakeholders early in a price control review and note that DPCR5 includes such stakeholder consultation.

I hope our comments above are helpful. If you would like to discuss any of the points raised, please call.

Yours sincerely

Rob McDonald  
Director of Regulation

**Detailed response to Gas Distribution Price Control Review – Review of Process**

• **General principles and objectives**

- *Were the objectives of GDPCR appropriate?*
- *Did our process conform to the principles of better regulation?*

The objectives of GDPCR were appropriate and, overall, we consider that GDPCR was carried out in an open and transparent way.

• **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?*

The consultation process was useful. However, we do believe that the data issues were underestimated, particularly with regard to the transition year 2005/06 and despite being flagged by DNs beforehand.

• **Communication**

- *How effective were the channels and methods of communication?*
- *Would it be possible to make more use of electronic communication compared to face to face meetings?*
- *Were the appropriate people 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?*

We comment in more detail below on the channels of communication, but, overall, we were satisfied with the channels and methods of communication, which were effective.

However, there were still “surprises”. In particular, the switch to a post-tax cost of capital during the review for the one-year control was not flagged and, in addition, was not consistent with the principle of a “roll-over” review.

We note that the open seminars were not widely attended and that one had to be cancelled through lack of interest. Stakeholders’ (other than DNs) written responses were often far more comprehensive and considered than was evident at the seminars. We question therefore whether these seminars serve a useful purpose or are simply “due process”. We do however believe that it is appropriate for DNs to present and explain their business plans to stakeholders early in a price control review, and the seminar where this was addressed was probably the most useful. We note that DPCR5 includes such stakeholder consultation.

• **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?*

Bilateral meetings. We greatly appreciated the bi-lateral meetings ahead of the publication of each consultation document, which also seems the appropriate frequency. Face to face meetings are helpful and, given the welcome openness in which they were conducted, we consider that these significantly aided the transparency of the review.

Working groups with GDNs. We continue to support DNs meeting together face to face with Ofgem through the working groups. In GDPCR these were well managed, open and constructive and allowed, through discussion at an appropriate level of detail, an understanding of all parties' views. This, we believe, is fundamental to achieving a successful price control review outcome.

We also consider that keeping the frequency of working group meetings flexible avoided overlap and duplication and enabled each meeting to focus on a clear agenda.

- **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?*

The decision to have a one-year review followed by a main review was, in our view, broadly successful. It was always recognised that GDPCR would be challenging given that it followed soon after DN sales, that the new businesses were therefore being established at the same time as carrying out the review and therefore that data quality and availability would be an issue and that it was clearly too early to assess the impact of the new management teams. Also, there were a number of significant legacy issues to be addressed, such as the NGG capex overspends, pension scheme deficits and the exposure to rising shrinkage costs and lower volume growth. These issues needed to be addressed before looking ahead to the next price control period and considering the new issues DNs would be facing going forward.

- **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 work in-house?*

External consultants. Overall, the external consultants were probably engaged in the right areas, and with a range of relevant experience and knowledge, however, in our view, they were engaged [and re-engaged] too late in the process and this may have added to, we believe, the excessive number of supplementary questions raised following submission of the BPQs. We also suggest that additional DN visits by the external consultants would have been a more efficient and coordinated way of managing the large number of supplementary questions.

We would also question the willingness of certain consultants to take on board new and innovative approaches being taken by the new management teams, which were expected as part of DN sales, instead too much reliance being placed on possibly out of date experience.

Finally, in our view, too much reliance was placed by Ofgem on "scientific" analysis/ benchmarking carried out by external consultants. The outputs of the benchmarking left many unexplained differences, perhaps due to data issues but also perhaps due to insufficient recognition of regional differences and real price effects, and in certain areas lacked an overall "felt fair" sense check. In our view, the consultants should have spent more time on trying to understand the differences rather than relying on the mechanistic approach. We would encourage Ofgem to restrict the reliance on external consultants to specific technical areas and instead to develop, as far as possible, the expertise and knowledge in-house. The annual cost reporting process will be valuable here.

- **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?*

In our view, the number of consultation documents was broadly appropriate, although consolidation of the Second and Third Consultations may have freed up more time to better understand the outputs from the benchmarking.

In addition, the due dates for responses to the one-year control initial proposals and the submission of the BPQ for the main control were within a week of each other. This put considerable pressure on our resources at the time and it would have helped if the BPQ could have been submitted [say] two weeks later. We suggest that such potential "pinch points" need to be considered and avoided when drafting timetables for future reviews.

Finally, we believe that the September [2007] Update was critical to our process, in taking into account 2006/07 outturns, and should be considered for future reviews.

- ***Use of impact assessments***

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

The impact assessments were useful. The number also seemed appropriate and targeted in the right areas.

- ***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?*

The consultation on the Business Planning Questionnaire (BPQ) was useful, and resulted in a BPQ which was broadly appropriate in the level of detail requested. As we have said above, if the consultants had been more involved in the process of drafting the BPQ and in particular the request for written commentary, it may have avoided the excessive number of supplementary questions. Subsequent to submission of the BPQs, there could have been better oversight and coordination of supplementary questions to avoid duplication.

The opportunity to re-submit forecasts with the 2006/07 actuals we found helpful.

- ***Timeline***

- *Were the timelines for the various workstreams appropriate?*
- *Which issues were addressed too soon/ too late in the process?*

As we have said above, it was always recognised that GDPCR would be challenging given the number of issues on the table. The timelines were pressured, and it was inevitable that there would be issues not finalised during the review, such as network extensions into fuel poor areas and improving CO awareness. In our view, it was appropriate to defer these for proper consideration, with appropriate reassurances about funding, rather than arrive at a rushed conclusion.

We do, however, remain concerned that the key issues of the appropriate cost of capital and financeability were still left so late in the review. We are still not sure that the link between this workstream and the “building blocks” approach to GDPCR has been clearly defined.

- **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?*

Regulatory consistency should be a key aim. We remain of the view that the decision to switch to a post-tax cost of capital in the review for the one-year control did not help regulatory consistency and was not consistent with the principle of a “roll-over” review..

- **Transparency**

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

As we have said above, in our view, too much reliance was placed by Ofgem on “scientific” analysis/ benchmarking carried out by external consultants. The outputs of the benchmarking left many unexplained differences, perhaps due to data issues but also perhaps due to insufficient recognition of regional differences and real price effects, and in certain areas lacked an overall “felt fair” sense check..

We would also observe that it was often not easy to draw the key conclusions and underlying numbers from the consultants’ reports. These would have benefited, and been more helpful to us, from better summary information. Transparency was also not helped, and considerable pressure put on the timetable, by the delays in DNs receiving the background analysis to the reports.

- **Access to Ofgem and 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?*

We believe that the Authority meetings are vital to the process. However, given their importance and that we always tried to focus on the key issues for us at the time, in our view they were too short at an hour and a quarter each and we felt did not allow sufficient time for us to get over all our points. Provided that dates are agreed and in diaries as early as possible, it should be possible to arrange for at least two hours for each DN.

- **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?*

Overall, the process worked. We would note that there were issues of sufficient resource on both Ofgem’s and DNs’ parts, but that this is inevitable in a price control review. It is vital that where “pinch points” happen, then Ofgem and the DNs must remain in close contact to manage priorities..

- **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?*

The overall positive to us was the open and transparent way in which the review was carried out. In particular, the key members of the Ofgem price control review team were usually readily available to discuss and resolve issues as they arose.

The early start to the licence drafting process worked well. This process often aids clarity on Ofgem's policy proposals and how they will be implemented.

- **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?*

The biggest issues were, in our view, the availability of reliable data and the sheer number of issues on the table. The former was flagged up by us early in the review, however this should be resolved going forward through the cost reporting process. The latter would have benefited from, but this may not have been feasible given that DN sales had only just taken place, by an early attempt to get all the issues "on the table". Inevitably, though, issues would have arisen as the review went on.

- **Other issues**

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

As we have said above, we would encourage Ofgem to restrict the reliance on external consultants to specific technical areas and instead to develop, as far as possible, expertise and knowledge in-house. Specifically, work done now to improve the robustness of the benchmarking for GDPCR2 would be of value. The annual cost reporting process will be helpful here.