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30th May 2008

Dear Rachel

Gas Distribution Price Control Review – Review of Process

Thank you for your letter of 24 April inviting views on the recent price review process. We welcome the opportunity to give feedback from the WWU perspective and trust that the comments in this summary are viewed in a constructive light. You will be aware from our discussion at your recent visit that we had some major concerns about the process, and we repeat these here with the aim of an improved process next time round.

We have attempted to keep our comments as brief and succinct as possible in this letter, and to support this aim the various pieces of correspondence referred to are referenced at the end of the letter. These detail the specific concerns outlined here should you wish to explore further.

The overall process

The timetable for this review was clearly a challenging one, with an extra stage added to the process (Updated Proposals) compared to previous reviews. In principle, the Updated Proposal stage could have been very useful, but with hindsight we believe that this added considerably to the work and time pressure, and certainly resulted in less meaningful consultation as opposed to what may have been the original Ofgem intent.

Diligent adherence to the timetable in our view resulted in a lack of realistic time to review both Ofgem and DN documentation, and a lack of real meaningful consultation on critical issues. A prime example of this was the fact that our detailed response to the 4th Consultation Document (25th April)¹ and the associated independent analysis were clearly not given consideration by Ofgem before publishing their Initial Proposals (IPs). Indeed the Ofgem team confirmed in the bilateral meeting at the time that they hadn't fully read our response prior to the publication of the IPs. This did not constitute an effective consultation or proper process. We made specific reference to these process points in the executive

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summary of our response to the IPs on 13th July (section 9, page 23)². The letter from our Chairman Duncan Whyte to Sir John Mogg on 18th September³ also made specific reference to these important process issues.

We would certainly advocate more time is allowed for effective and meaningful consultation between Ofgem and the companies, and to facilitate this we would propose reducing the number of consultations and leaving more time for consideration and response between major publications. We note this approach seems to have been taken on board for DPCR5.

With reference to your specific question concerning adherence to the principles of better regulation, we note that Ofgem document 109/04b (24 May 2004) states, *“From January 2005, we will aim to set a minimum consultation period of 6 weeks”*.

A number of Ofgem’s consultation papers in this review allowed less than six weeks to respond, a factor compounded by the late issue of associated workbooks, without which detailed and meaningful analysis could not be undertaken. On one occasion only 3 of the proposed 6 weeks were allowed to analyse and understand how the proposals had been calculated before the required response deadline.

Balance between one year and five year reviews

The overlap of the one year review with the main five year review clearly caused major resource stress for both GDNs and Ofgem, adding further time pressure on proper consideration of certain evidence. Having agreed a one year review this was to some extent unavoidable, however in retrospect the decision to collect forward looking cost information beyond 2007/8 early for the main review was certainly not helpful.

The engagement process

Working group meetings were probably the most helpful and productive part of the whole review process. They were frequent enough to be effective without creating a resource strain, but also sufficient time was allowed at these for meaningful discussion and debate.

By contrast, the meetings with the Authority certainly felt more like compliance with process rather than a meaningful engagement. By way of illustration the time allowed on each occasion, a maximum of 1.5 hours, dictated that only superficial coverage of a wide and complex range of issues could be afforded.

More meaningful engagement of the GEMA non-executive directors would certainly be valuable given their wider industry experience, but this would inevitably require an increased time commitment by them in the overall process. We fully appreciate that given the breadth of issues a price control embraces, it is not practical for non-executives to be fully conversant with every issue. However, for them to add

increased value to both Ofgem and the consumers they serve, a greater level of engagement would we believe be very valuable.

Methodology

There was strong reaction from all GDNs about the lack of robustness of both the top down and bottom up analysis undertaken by Ofgem and its consultants, as well as criticism of the actual cost drivers used. Given the seriousness of our concerns at the time, WWU commissioned a number of respected independent external organisations to review the Ofgem analysis, and where appropriate to propose credible alternative views.

We had a number of major concerns with the methodology used, and these were laid out in detail in the executive summary of our response to the Updated Proposals (22nd October, section 2, pages 4-8)⁴. In the final proposals Ofgem clearly recognised some of the flaws in their consultants' analysis.

Quality of information

The quality and accuracy of Ofgem documentation did not meet the standard we would expect on a number of occasions. A contributory factor was probably the time and volume pressure of the workload involved, with mistakes in spreadsheets and working documents meaning a number had to be reissued by Ofgem. My letter to Joanna Whittington on 28th August⁵ stressed the impact of these issues.

External consultants

Ofgem's consultants did not always demonstrate rigorous analysis, and consequently it appeared that some of the assumptions made were no more than suppositions with no supporting rationale. One consultant report actually had to be re-issued twice.

WWU consistently sought the underlying analysis and rationale for assumptions made by Ofgem and its consultants but in a number of instances nothing was provided. As we state previously in this letter, these issues were of such concern to us that we had our own analysis undertaken independently by external organisations.

Our final comment in relation to the quality of work by Ofgem and its consultants is the possible influence of restrictions placed by Ofgem on the consultants in terms of scope of work. Evidence at the time clearly suggested that Ofgem placed some restrictions on the scope of work, a factor which may restrict their ability to explore all explanations for variances in the data supplied by the GDNs. An example of this is in the LECG report of 31st July which stated;

"Having reviewed the GDNs comments relating to our Phase 1 Reports, Ofgem believes our methodology is robust. Consequently, we were asked to focus on updating our analysis for the new data, rather than carry out a significant methodology change"

These comments highlighted our concerns that Ofgem were restricting the scope of the consultants work in such a way as to compromise their ability to fully explore and properly analyse the data provided by the GDNs. In our view this led to analysis and conclusions by both Ofgem and its consultants which lacked sufficient robustness and transparency. This key point was stressed in our Chairman's letter to Sir John Mogg on 18th September⁶.

We would make a final point on the general issue of transparency and openness, which relates to a specific issue right at the final stage of the review process. The final allowances actually given for Real Price Effects (RPEs) were based on calculations in the detailed workbooks circulated after the Final Proposals (FPs) - but differed from the way they were described very clearly in the FPs themselves. Despite the wording in the FPs being very specific about how RPEs would be treated it was evident that a different approach was being taken, which ultimately cost WWU £4.7m in lost allowances. Despite representations by all GDNs at the time Ofgem refused to modify the approach in line with the FPs, even though they openly recognised the difference in treatment. My letters to Joanna Whittington⁷ and Chris Watts⁸ respectively outlined this issue in detail.

This refusal to accept such obvious discrepancy in approach was a final disappointment for us and further reinforced our serious concerns about the integrity and transparency of the review process generally.

As I stated at the start of this letter we have attempted to keep our comments as brief as possible. You will recognise from both this letter and the discussion during your visit that we had real issues with the review process and its lack of what we considered to be proper consultation and transparency of process. We trust however that our comments will be viewed as constructive and valuable in reflecting on future reviews.

On a final note Rachel we look forward to working with you and your team, and building on the open relationship we have always had with Ofgem since setting up this business.

Yours sincerely



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References in the letter to specific price review correspondence

1. WWU response to GDPCR 4th Consultation Document, dated 25th April 2007
2. WWU response to GDPCR Initial Proposals, dated 13th July 2007
3. Letter to Sir John Mogg from WWU Chairman Duncan Whyte, dated 18th September 2007
4. WWU response to GDPCR Updated Proposals, dated 22nd October 2007
5. Letter to Joanna Whittington from Bob Westlake on 'Timing of issuing supporting workbooks', dated 28th August 2007
6. Letter to Sir John Mogg from WWU Chairman Duncan Whyte, dated 18th September 2007
7. Letter to Joanna Whittington from Bob Westlake on treatment of Real Price Effects, dated 20th December 2007
8. Letter to Chris Watts from Bob Westlake on treatment of Real Price Effects, dated 21st December 2007