

NATIONAL GRID GDPCR2 OPEN LETTER RESPONSE

Dear Rachel

1. National Grid through our gas distribution business, distribute gas in the heart of England to approximately 11 million offices, schools and homes and owns and operates the gas transmission system throughout Great Britain. National Grid also owns and operates the high voltage electricity transmission system in England and Wales and as National Electricity Transmission System Operator (NETSO) operate the Scottish high voltage transmission system. The issues addressed in this consultation directly affect National Grid.
2. National Grid Gas Distribution (NG) welcomes the opportunity to respond to the GDPCR2 Open Letter dated 30th July 2010. The GDPCR2 process as outlined in the Open Letter is clearly building on the outcomes of the RPI-X@20 project and we support continued and active engagement with Ofgem as the recommendations are implemented.
3. This letter in response addresses the following areas as outlined in Ofgem's Open Letter: 1) Key issues for the review; 2) Outputs network companies should deliver; 3) Ofgem's approach to stakeholder engagement; 4) Business plan guidance and 5) timetable for the review and the principle of proportional treatment / fast track.

Key issues for the review

4. We believe the issues that have been highlighted for review are broadly the right ones. In particular, we recognise the importance of the HSE mains replacement programme in delivering network safety, but additionally in delivering emissions and leakage reduction benefits whilst fostering innovation. We note Ofgem's concerns in relation to the cost of the programme and agree that this and engagement with the HSE on the risks associated with ferrous mains should be addressed as part of this price control review. Any impact on the GDPCR2 timetable will clearly need to be assessed following a discussion of progress with relevant stakeholders
5. We understand Ofgem's concerns in relation to demand forecasts. However we believe that recent experience arising chiefly from recessionary effects is not a good indicator of future demand forecasting accuracy. We agree that recent studies and the direction of climate change policy suggest that demand for gas will fall gradually over the price control period and our forecasts reflect that view. We consider that there

remains a significant opportunity to incentivise accurate forecasting. This includes, importantly, alignment of capacity outputs incentives between Gas Distribution Networks (GDNs) and the National Transmission System (NTS) afforded by the concurrent price control reviews.

6. We are committed to playing our part in alleviating Fuel Poverty through Network extensions. We believe this success can be built upon and look forward to enhancing and improving future schemes through stakeholder engagement and the relevant GDPCR2 workstreams.
7. On Carbon Monoxide (CO), it should be recognised that in conjunction with Ofgem and key stakeholders, the GDNs carried out extensive and detailed work on how to raise awareness and reduce deaths and injuries during 2008 and 2009. Progress was made with a new CO leaflet and various GDN initiatives including National Grid's CO student campaign and formal proposals submitted to Ofgem for CO awareness schemes endorsed by the CO stakeholder working group. We consider the valuable work done by this group should be extended for GDPCR2. The GDN proposals remain with Ofgem for a decision within this price control.
8. We agree that financial issues will be significant factors during this price control review. New approaches to financing investment, regulatory commitments, cost of capital and asset lives, alongside longer price controls will be of considerable interest for networks and all stakeholders. Our views on financing networks are set out in more detail in the response to Ofgem's recent RPI-X@20 consultation. In addition, we look forward to engaging with Ofgem on the components and factors that will underpin Return on Regulated Equity analysis.
9. We note that Ofgem has recognised that loss of meter work and the impact of the Traffic Management Act gives issues to consider. We are currently experiencing the impact of loss of meterwork on the emergency workforce as Great Britain moves closer to smart metering implementation in 2012. In addition, we are now experiencing costs arising from implementation of the Traffic Management Act and activation of related obligations under the New Roads and Streetwork Act. We intend to highlight the issues arising in relation to the Income Adjustment Event provisions in the current price control with Ofgem. In the meantime we believe the costs in relation to permits, administration and productivity in the London Permit Scheme suggest this will be a major issue for GDPCR2. Whether there will be sufficient clarity on costs

across all networks by 2013 remains to be seen, given the variety of schemes and operating procedures that individual local authorities can apply. This is a higher priority issue for National Grid than currently framed in the Open Letter.

10. In addition we consider real price effects to be an important consideration including assumptions around levels and volatility of materials costs and trends in contractor and other service costs.
11. We also believe that the review should consider the essential role the gas network will play in providing a cost effective and secure solution to supporting the Government in their climate change targets, and gas networks central role in creating the low carbon economy. The networks through the ENA Gas Futures Group have developed future scenarios which will be shared with stakeholders.
12. We do not agree with the views set out on the value for money of xoserve services, but agree that the services provided, governance and funding option for xoserve should be reviewed. In addition, xoserve's role in smart meter roll-out will be a key part of stakeholder engagement.

Outputs network companies should deliver

13. As outlined in National Grid's response to the RPI-X@20 recommendations letter dated 6th September 2010, we strongly support Ofgem's proposal to establish a more clearly articulated "regulatory contract" at price reviews. We believe the six output categories broadly capture what network companies deliver. However, we believe that the activities also mentioned by Ofgem such as the role of xoserve and sub deducts networks could usefully be encompassed within a seventh output category - "making the industry work better". During our preliminary consultation, other industry related activities for example:- interruptions regime; responsibility of the emergency contact register and the industry impacts of the roll out of smart metering, have also been raised. These and other activities could be rolled into a separate seventh industry theme, so that they are not lost.
14. We fully support the approach of a series of working groups consisting of the GDNs, Ofgem and interested stakeholders to develop primary output measures. It should be recognised that the length of time to collect information (including stakeholder views) to inform the appropriate performance levels for output and incentive measures will

mean that discussions may not be complete in the time prior to the publication of Ofgem's initial strategy document in December.

15. There is a high degree of interdependency between the output categories as, for example, the mains replacement programme can deliver benefits in Safety and Reliability categories, as well as Environment. We need to ensure that there is an appropriate point in the discussion to consider interdependencies and verify the overriding logic for the weighting across the overall outputs and incentives package.
16. We believe that due consideration is required around the HSE ten-year review and the interaction with their timeline and implications.
17. We would welcome a view from Ofgem on the characteristics and potential application of the innovation stimulus fund at the earliest opportunity. It would be useful if this could describe how Ofgem propose that it will interact with or be differentiated from the six outputs and innovation associated with them.

Ofgem approach to stakeholder engagement

18. NG fully supports giving stakeholders more opportunity to influence the design and development of price controls. We recognise that there is a balance between early discussion and engagement with stakeholders and maturity of development of output and incentive measures such that a full and informed debate can be held. We also recognise that consideration of the balance of stakeholder views is an important factor, for example balancing local and national views. Calibrating and acting on views where they may differ should not be under-estimated.
19. To avoid duplication of effort and potential burden on stakeholders, National Grid are keen to discuss Ofgem's detail plans for stakeholder engagement as these develop.

GDPCR2 business plan initial guidance

20. NG welcomes the business plan guidance outlined in the letter and believes it is a good "best practice" framework.

Timetable for the review and the principle of proportionate treatment / fast track

21. NG notes the timetable of the review being shaped around a desire to make a fast track decision by December 2011, therefore the need to provide networks with sufficiently worked guidelines in the Ofgem GDPCR2 Final Strategy document in

March 2011 for detailed business plan guidance. We see the benefits of the fast track process in focusing management teams on developing high quality business plans. . However, the trade-off is sufficient time to fully engage with stakeholders and the time to ensure a rigorous set of agreed output and incentive measures.

22. A more pragmatic approach would be to apply certain principles of the new RIIO recommendations in the first price control reviews and ensure other elements of the “tool-kit” are applied at a later stage. The fast track mechanism would appear to be an appropriate candidate for introduction at future price control reviews.

23. We fully support the early and open dialogue with Ofgem on the key issues and process around GDPCR2 and are very happy to expand on any of the points raised in the letter above.

Yours sincerely

Helen Campbell
GDPCR2 Programme Manager