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Dear Paul

Proposed process for the determination of re-opener applications in respect of a Traffic Management Act income adjusting event under the first gas distribution price control review

As one of the Gas Distribution Networks that has submitted an application under Special Condition E7 of the Gas Transporter licence in respect of the North London Network, National Grid Gas has a particular interest in the approach and methodology proposed by Ofgem. In general, we agree that the approach and timetable are pragmatic and broadly in accordance with the provisions of the licence. We do however, have a number of observations in relation to the methodology.

Throughout development of the Traffic Management Act (TMA) and its associated regulations, National Grid Gas has expended considerable effort in attempting to influence and once finalised, shape the implementation of policies and systems associated with the legislation. This has been particularly important in London where the first schemes have been approved and implemented, creating the basis upon which all other highways authorities might proceed. As highway authorities across the country begin to consider their own TMA policies, National Grid Gas will continue to respond in each case to minimise the inevitable cost increases to gas customers associated with each new scheme. In this respect National Grid Gas believes Ofgem has a key role, consistent with its duty to protect the interests of current and future energy consumers, to draw attention to the impact on consumers, notwithstanding the benefits the legislation may bring in minimising congestion.

As Ofgem makes clear, at the time of agreeing the current price control, the exact terms and policies associated with the TMA were not fully understood and hence the inclusion of an Income Adjusting Event within the licence was agreed. In particular, due to wide ranging potential of future TMA regulations, the Authority recognised the need for a clause to address other costs which at the time could not be specified with any degree of certainty. In providing for a TMA Income Adjusting Event, there was a presumption of scheme stability and hence the requirement to provide 6 months of actual cost data which would form the basis of not only remunerating efficient costs incurred to date, but also setting allowances for the remainder of the price control. In practice, National Grid Gas' experience has been different to that envisaged at the time. The London Permit Scheme has continued to evolve and those participating highway authorities have applied the rules in accordance with their own policies and procedures, leading to differing levels of rigour and working practices. As the London Permit Scheme matures, it is likely that application of the rules will continue to change as local authorities learn from each other and scheme rules themselves are modified or added to. Furthermore, not all London Boroughs are currently participating in the London Permit Scheme, although a significant number have signalled their intention to do so within the current price control period. This will inevitably increase the costs of working in the highway beyond that currently experienced within the London Network. Associated with the permit schemes there are plans from 2012 to increase over-stay charges where

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engineering works exceed planned completion dates and to introduce lane rental charges for occupying the highway. As outlined above National Grid Gas will continue to engage with Government and Local Authorities to try to minimise the impact of these costs and will adapt working practices to optimise efficient delivery of street-works. However, it is clear that despite these measures, more permit schemes, working restrictions, penalties and lane rental charges will further reduce operational flexibility and drive costs into maintaining, replacing and connecting to the gas network.

Throughout the implementation of the TMA, National Grid Gas has endeavoured to keep Ofgem informed of developments and has written specifically to highlight potential costs and how they should be treated for price control purposes. In December 2009 National Grid Gas proposed how permit fees for connections customers should be treated and in October 2010 provided indicative cost estimates of the impact of TMA with subsequent updates and proposals for revenue treatment in March 2011. During this period National Grid Gas has been one of two Gas Networks Operators to experience the implementation of the TMA at first hand and consequently has needed to develop new approaches and adapt working practices in real time. There has been no template or framework to operate against and to an extent utilities and highway authorities have been discovering new ways of inter-acting and working in a new and changing environment.

Following the submission of National Grid Gas' Income Adjusting Event claim on 30 June 2011, Ofgem has sought to develop a cost template to enable benchmark comparison between National Grid Gas and Scotia Gas Networks. As the TMA schemes are novel, each network had captured data in different ways and categories reflecting their unique operating models, processes and different permit schemes or interpretation of such schemes by highway authorities. While we agree that it is important to benchmark where direct and clear comparisons can be made, we are concerned that misleading conclusions could be drawn by attempting to re-constitute data that was captured and expressed differently to that now required. Equally, we would be concerned if Ofgem considered that an inability to provide evidence to a previously undefined level of granularity or precision was reasonable grounds to disallow such costs. It is National Grid Gas' view that the principle submission of the 30 June has been provided in accordance with Special Condition E7 and assessment should rely primarily on this document. As part of the work undertaken to develop the TMA submission, National Grid Gas appointed an independent assessor to audit the methodology used to calculate the additional costs incurred. As part of this work, attempts were made to benchmark costs with other utilities, but no meaningful data could be obtained to assess National Grid Gas directly in comparison with water or electricity networks

National Grid Gas agrees with Ofgem that Productivity is an important component of the Income Adjusting Event and represents a significant proportion of the costs incurred. In compiling the Productivity costs, National Grid Gas has been careful to ensure it has only included the incremental costs associated with TMA and not those associated with existing New Roads and Street-works Act (NRSWA) obligations. Due to the difficulties of assessing these costs on a job by job basis, which would be prohibitively expensive and prone to distortion through job specific factors (each job is unique and will encounter different physical and permit conditions), National Grid Gas has utilised an aggregate top down approach which has been compared against non-permit scheme London Boroughs. We believe this to be the most pragmatic and most reliable means to assess the overall impact of the TMA on Productivity. It also ensures that NRSWA costs as they apply to non permit scheme boroughs are excluded from the assessment of TMA costs. Having developed this approach, National Grid Gas appointed Currie and Brown Ltd to review the methodology and we would recommend that Ofgem considers their report as a material part of the evidence in support of the submission.

National Grid Gas considers its Income Adjusting Event submission and the methodology adopted to compile it, is an accurate and conservative assessment of the efficient costs incurred in meeting its TMA obligations. There remains considerable risk that our assessment of future costs within the current price control period could turn out to be under or over forecast for the reasons explained earlier, and as such National Grid Gas would, as suggested in our letter to Ofgem of 2 March 2011, be open to recovering efficient costs as they are incurred in order to avoid windfall gains or losses. We look forward to dialogue on our submission over the coming months in order to ensure a fair and balanced minded to position is reached in October 2011.

If you wish to discuss any of the points raised in this response, please contact David Chalmers on 01926 655830.

Yours sincerely

Paul Rogers
By email