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Ofgem
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Dear James,

Initial Assessment of RIIO-GD1 Business Plans

Thank you for the opportunity to comment on this initial assessment.

NGN is disappointed that our business plan was not considered suitable for the fast-track process. As the frontier performer during GDPCR1, we believe our plan contained the key elements necessary for fast-tracking. As we explained during our meeting with GEMA we believe the issues raised in the initial assessment could have been resolved within a short time frame.

We welcome the subsequent discussions and further feedback on our plan and we hope to resolve the concerns you have raised when our plan is resubmitted at the end of April.

The attached appendix provides further comment on the detailed areas of the assessment. Please do not hesitate to contact me if you wish to discuss any aspect of this response. Our response is non-confidential.

Yours sincerely



Stephen Parker
Regulation Director

APPENDIX

Chapter 2 Summary Assessment

Assessment Process

The initial assessment process did not function as effectively as it could from the GDN, stakeholder and we believe, Ofgem's perspective. We do, however, recognise that this is a new process for all parties and that the learning gained will be used to improve future assessments.

From our perspective the process could be improved significantly by scheduling face to face review sessions with each company much earlier in the process and certainly prior to completion of the initial assessment. At these sessions Ofgem staff (and other stakeholders) undertaking the assessment could clarify, question and challenge elements of the plan on a much more interactive basis.

Process

We welcome the positive comments regarding our commitment to the RIIO process, our stakeholder engagement activities and the content of our plan.

Your assessment states that no company submitted detailed cost benefit analysis (CBA) to support any of their assessment investment plans. This was incorrect. NGN submitted a detailed cost benefit analysis including the underlying detailed model to support our holder demolition programme. We also set out in our plan how we used CBA to develop our repex programme under the three tier approach.

Outputs

We were very disappointed that the initial assessment process did not identify how extensively we have revised our approach to the repex programme compared to the indicative forecast submitted in 2010. We are fully utilising the additional flexibility and wider criteria that can be used under the three tier approach. Following subsequent assessment we believe this has now been recognised.

We note the comments regarding common approaches across the GDNs to particular output areas notably asset health. There is a limitation as to the extent individual companies can ensure this occurs, but NGN will contribute in a positive manner to industry discussions on these areas.

Resources – Value for Money in delivering Outputs

The assessment has highlighted that a much greater depth of information is required in this area than we included in our plan. We will seek to rectify this in our April plan resubmission.

Resources – Efficient Financial costs

We note Ofgem comments regarding cost of equity for the sector but would again highlight the uncertainty over future demand for the gas distribution network, removal of any headroom from the cost of debt, the limited uncertainty mechanisms and the limited overall incentive package as reasons why the cost of equity should be at the top end of Ofgem's published range.

Uncertainty and Risk

NGN accepted Ofgem's proposals in this area and will manage any risks outside of the proposed incentive mechanisms. On charging volatility we believe the correct approach is to take this forward on an industry wide basis as proposed by Ofgem rather than as components of individual company business plans.

Chapter 3 Key issues

Repex and approach to CBA

NGN was not aware of the requirement to use an industry wide common CBA model when we submitted our business plan. NGN will use the newly developed common CBA models in our revised business plan submission. We do not expect these to generate any significant changes to our plan as the core principles of the common model are consistent with the CBA models used in our business plan particularly with regard to assessment/discount period and assumed deterioration rates.

The tier 2 threshold drives less than 2% of the total repex workload. We note the comments regarding a common methodology and will continue to contribute to resolving this issue such that the end result will be accepted by the HSE. However, we feel this is clearly an area where the RIIO principle of proportionality has not been applied.

Asset Health, Criticality and Risk Data

NGN submitted a fully detailed asset health assessment across all the asset categories and clearly set out in a detailed appendix the link between this assessment and the proposed workload.

Smart Metering and Loss of Metering

We believe the correct approach is to have a common approach based on an ex-ante allowance and an uncertainty mechanism as proposed by Ofgem.

Street works

We welcome further discussion on the treatment of street works costs.

Low Pressure Gasholders

We believe the holder demolition programme provides significant benefits to customers as demonstrated by our detailed CBA. Since our business plan submission we have undertaken further engineering studies allowing us to further develop our previously proposed approach.

Comparative Efficiency Modelling

The range of assessment models Ofgem have developed are appropriate and fit for purpose. We believe greater emphasis should be placed on the Totex models and the top down regressions in reaching an overall efficiency assessment.

Social Outputs

It is noticeable in the area of carbon monoxide detection and awareness individual GDNs have proposed different approaches and initiatives. This is a welcome development as it shows a willingness of the sector to innovate and try different approaches consistent with the RIIO principles. It would be a disappointing outcome if Ofgem were to force all companies to adopt a standard approach in this area.

Chapter 5 Assessment of NGN's Business Plan

Overall Assessment

NGN is disappointed that we were not retained within the fast-track process. We believe the key issues raised by Ofgem could have been resolved in a short time frame.

We welcome the recognition by Ofgem of our frontier efficiency position and the efficiency of our financial proposals within the business plan (notwithstanding Ofgem's view on the cost of equity).

In relation to the key issues raised in the initial assessment we believe the following factors should be noted:

- Repex volumes – NGN submitted the lowest volume of non-mandated repex work as a proportion of our total iron mains population of any GDN.
- Tier 2 threshold – mandated tier 2 work driven by this threshold accounts for less than 2% of the repex workload.
- Real price effects – NGN submitted independent analysis based on long term averages consistent with the approach proposed in the RIIO strategy document.
- Total costs relative to GDPCR1 – this simplistic comparison takes no account of the lumpy nature of capex spend, relative cost efficiency or the new costs included in the RIIO-GD1 period (e.g. holder demolition, smart metering etc).

Assessment of Process

We welcome the positive assessment of the structure of our business plan and the stakeholder engagement which fed into its development.

Assessment of Outputs

NGN submitted detailed output forecasts alongside the historic performance to enable Ofgem and other stakeholders to understand and assess the suitability of our proposals.

It is our understanding from the initial assessment and subsequent discussions that no significant additional information is required in our resubmission.

Assessment of Efficient Expenditure

To carry out the initial assessment Ofgem only carried out a simplistic comparison between historic and forecast costs which took no account relative cost efficiency, the lumpy nature of capex spend or new costs in the RIIO-GD1 period.

We note Ofgem's comments on the level of justification required and will seek to address this in our business plan resubmission.

Assessment of Efficient Financial Costs

We welcome Ofgem's positive comments on our financial proposals and will address the fixed capitalisation point raised.

We note Ofgem comments regarding cost of equity for the sector but would again highlight the uncertainty over future demand for the gas distribution network, removal of any headroom from the cost of debt, the limited uncertainty mechanisms and the limited overall incentive package as reasons why the cost of equity should be at the top end of Ofgem's range.

Assessment of Uncertainty and Risk

We support Ofgem's proposals in this area.