

Legal & Regulatory

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21st September 2012

Dear James,

RIIO-GD1 Initial Proposals

1. Thank you for the opportunity to respond to Ofgem's latest consultation, RIIO-GD1 initial proposals, document 103/12. As a large integrated energy company in Great Britain that does not own any network interests, Centrica is in an ideal position to provide an unconflicted perspective on the business plans and offer our thoughts on the Gas Distribution Networks (GDNs) giving consumers' value for money.
2. This is a non-confidential response on behalf of the Centrica Group excluding Centrica Storage. Our response builds on our other RIIO letters and we have structured our comments as follows:
 - This letter gives our views on Ofgem's Initial Proposals;
 - With answers to Ofgem's questions in the appendices 1-3; and
 - GDNs' shrinkage performance in appendix 4.
 - Annex 1- Updated CEPA paper covering Cost of Equity
 - Annex 2- CEPA paper covering financeability
3. In summary:
 - We continue to believe that prices should be reducing, to reflect the downward pressure on required expenditure;
 - Financeability transition arrangements are over-stated;
 - Benchmarking and cost efficiency assessments are robust but ongoing efficiencies are not sufficiently challenging; and
 - there is considerable risk of price shocks, both from Final Proposals and within RIIO-GD1 that requires managing.

Overall package

4. Overall, despite there being much to commend in these proposals, we are disappointed to see GDN revenues, and so prices, expected to rise. As we have previously noted, we would expect GDN spending to be reducing when compared to the current price control. This is supported by Ofgem's review of the GDN business plan submissions, where expenditure has been scaled down by 17% in comparison to the submissions and 15% compared to the current price control. When taken in combination with the policy decision for replacement expenditure to be fully capitalised this should lead to significant reductions in revenues and price decreases. However, these proposals indicate GDNs will enjoy a 3.9% *increase* in revenues from April 2013.
5. In the current economic environment, with the strain on household incomes, we believe this threatens to be a missed opportunity to provide assistance to consumers. The benefit of the Ofgem scrutiny of spending plans has been offset by the financeability assessment, where most companies appear to be over-compensated.
6. It appears that the approach to implementation of full capitalisation of replacement expenditure is a main driver for higher prices, particularly in the early years of the price control period. The approach taken to this transition seems to be significantly more generous even than that generally requested by the GDNs. We believe the extent of any transition should be minimised, overall and for each network. We originally viewed the GDN proposals as 'worst case' and would ask why a more generous settlement has been offered. We estimate that the proposed transition is costing an additional £50 per household in this price control period.
7. When considered alongside the changes in depreciation, the GDNs appear to be 'cash positive' at the start of the price control period, which seems a bizarre outcome to result from a policy decision to increase the extent of capitalisation. Indeed, no transition to full capitalisation at all is applied from April 2013 and so the implementation of the policy has effectively been delayed for a year. This delay alone will mean customers' pay over £10 extra per household in first year of the price control.
8. We understand the networks need to be financeable, but do not accept that the extent of transition measures suggested is necessary. We attach a CEPA paper which concludes that financeability issues for the GDNs vary by network and are not as significant as implied by Initial Proposals. Although Repex capitalisation will introduce an additional source of pressure on some credit metrics in the short term, it is important to remember that companies will continue to benefit from the security of a stable UK regulatory regime providing index-linked returns. This will continue to be a key driver of investment grade GDN credit ratings and the appeal of this asset class to investors, as evidenced by the continued acquisition appetite.
9. For the majority of networks, the transition to 100% Repex capitalisation should begin in 2013/14 and could be completed more quickly than Ofgem has assumed. CEPA's analysis

suggests that a transition period of four years would be consistent with financeability. There is even evidence to suggest that Ofgem could go further, and that moving straight to 100% Repex capitalisation would be defensible – although this may result in some credit metrics moving outside target ranges. Overall, we would view a four year transition – reaching 100% Repex capitalisation at the midpoint of the control – as a balanced approach that would not impose an unnecessary burden on current consumers.

10. Ofgem’s proposed cost of equity, at 6.7%, is consistent with our view of the available evidence. We attach a further CEPA paper that updates its earlier view of the cost of equity based on Initial Proposals. It concludes that, based on available evidence, the cost of equity should fall in the range 6.0%-6.75%, and that an allowance of 6.7% is consistent with the relative risk of other electricity and gas networks.
11. There remains, however, a greater weight of evidence that Ofgem’s cost of capital allowance might be generous. Ofgem has used relatively high estimates for both the risk-free rate and the market risk premium. In combination, these two estimates do not appear a balanced reflection of the evidence. Market sentiment continues to suggest a widespread expectation of cost of capital outperformance, largely driven by a lower actual cost of capital for these low risk companies. Taking these factors into consideration, we suggest that a cost of equity of 6.5% would be more appropriate.

Total Expenditure Allowances

12. The approach taken by Ofgem to assessing work plans and benchmarking appears to be robust. Ofgem’s favoured approach is to use the simple average of historical and 2-year forecast models for both a bottom-up activity level model and a top-down Totex model, giving four efficiency estimates. The models provide consistent rankings of GDNs and the rationale for using a 2-year forecast is generally appropriate. Ofgem now needs to be strong in face of likely challenges from the GDNs, with an overall package that appears generous in terms of revenues.
13. A positive aspect from the Initial Proposals is the specified efficiency catch-up. Companies will be expected to close the efficiency gap to the upper quartile by 75%. We would expect for this to be in an initial (P0) adjustment, it is not wholly clear to us that this is the case. As part of an incentive package, attempts to improve the efficiency of companies and reduce costs to consumers are a positive step.
14. Our concerns over allowances for real price effects (RPEs) remain. With a high degree of uncertainty over the economy, it is clearly not sensible to set allowances for as far out as 2021, when there is no need to do so. The real price effect allowances given in GDPCR1 have proven to be over-generous, particularly for wage growth. We also note that considerable positive allowances were granted at DPCR5 which also appear very generous, with negative allowances appearing more appropriate. The lessons of recent price control settlements need to be learnt and extreme caution taken when considering RPE allowances.

15. RPEs should only be set for the first 4 years of the price control and then be included for review at the midpoint when it is hoped there will be more certainty over future values. Due to current negative RPEs it is likely the allowance will be close to zero. With the recent ONS announcement of potential changes to the RPI calculation, a midpoint review may well be needed in any case to capture any impact of this.
16. We do not believe that the ongoing efficiency assumptions are sufficiently challenging. This is effectively the first price control with GDNs under multiple ownership. We believe that comparative analysis will drive down the costs of all GDNs, in addition to allowing benchmarking between networks. It is highly unlikely that all of this benefit has been realized in a single price control period. The implied productivity gains in the early price controls for Electricity Distributors were higher than suggested here and still stood at 1.5% per annum at the *fourth* Price Control Review.
17. For companies in a competitive environment, particularly in the current economic climate, there is pressure to reduce costs in *nominal* terms (hence even greater reductions in real terms), therefore the GDNs should be challenged to reduce controllable costs and outperform inflation.

Incentives

18. Incentives should be symmetrical with mirrored penalties for each reward. For example, we do not understand a one-sided stakeholder engagement reward. Stakeholder engagement should be part of the everyday activity and not a discretionary activity that requires promoting. We must also take care to ensure incentives do not turn stakeholder engagement into a tick-box exercise.
19. During the current price control, GDNs have consistently and significantly beaten their shrinkage targets. In the last 2 years, GDNs have beaten their target by an average of 13%, which we estimate has cost consumers £9m per annum in incentive payments. This may well demonstrate the incentive working effectively and to the benefit of customers. However, to ensure this is transparent we believe GDNs should be required to report on the incremental investment they have committed to reduce shrinkage. Network users will then be able to assess this against incentive returns to see if the incentive scheme is providing true value for money.
20. Any improvements required to the Shrinkage model should be implemented prior to the agreement of targets. Any changes thereafter will require the targets also to be changed to ensure the output of the shrinkage model remains consistent.
21. Without having evidence on the impact of the IQI on revenue across GDPCR, it is very difficult to evaluate how the new IQI mechanism will work. A key objective of the introduction of the IQI is 'truth telling' by companies in their business plans (alongside the equalisation of Capex and Opex incentive rates) – a review of performance to date would

cast light on whether or not this is happening and it is unfortunate that Ofgem has chosen not to review evidence from the IQI at this stage.

Pricing Volatility

22. During the next price control period, April 2013 – March 2021, we have concerns over the process, number and transparency of revenue reviews with the pensions deficit update, mid-point review, IRM etc. Suppliers need significant notice for significant price changes. We note that Ofgem has consulted in this area and hope that our concerns are addressed when the decision is published.
23. We further note that Final Proposals for RIIO-GD1 (and T1) are not due until the end of the year, for application from the following April. These Initial Proposals will have naturally have informed suppliers' expectations of future prices and formed the basis for supply contracts: it is therefore essential that significant price disturbance between Initial and Final Proposals is avoided. An acceptable solution may be to set revenues for the first year as per Initial Proposals and adjust in subsequent years.
24. In summary, we still expect the GDNs to be able to deliver over GD1, whilst lowering gas distribution prices to consumers.
25. We hope you find the comments useful and would be happy to discuss further if helpful.

Yours sincerely,

Andy Manning
Head of Network Regulation, Forecasting and Settlements
British Gas
[Via email]

Appendix 1: Finance & Uncertainty Initial Proposals

1. Do you agree with approach [Asset lives and RAV] of using the profile for the release of backlog depreciation as a mechanism to smooth revenues and reduce their volatility through the RIIO-GD1 period?
 - a. We agree that the approach is practical and can have a smoothing effect on revenues. However, we do not believe that this flexibility is currently being used to best effect. Total GDN revenues are highest in the first year of GD1 which we do not believe is sensible in the current economic climate.

2. Do you have any comments on our relative risk assessment [in allowed revenue]?
 - a. We support Ofgem's view of relative risk. As part of its analysis of the cost of equity in support of our response, CEPA has looked at this issue in detail. In its 19 June paper¹, CEPA compared the riskiness of GD1 with GDPCR, DPCR5 and the fast-tracked T1 companies. It has reconsidered this analysis based on Initial Proposals, and reached the same conclusions.
 - b. In our view GD1 is less risky than GDPCR and T1, and of comparable risk to DPCR5. As a result, Ofgem's proposed cost of equity allowance of 6.7% appears consistent with its other decisions purely from the perspective of relative risk.

3. Do you agree with our proposed elements of allowed return?
 - a. Ofgem's proposed cost of equity, at 6.7%, is broadly consistent with our view of the available evidence. We note, however, that there is further evidence to suggest that a lower cost of equity would be appropriate.
 - b. In particular, Ofgem has combined estimates of 2.0% for the risk free rate and 5.25% for the market risk premium (MRP). Combining two upper end estimates in this way is arguably not a balanced approach. CEPA has provided a supporting paper which revisits the evidence on the components of the cost of equity. They note that while Ofgem's component estimates are, individually, supportable by the evidence, the implied total of 7.25% very likely exceeds required market returns. In CEPA's view, 7.0% is more likely to represent the upper limit of required market returns.
 - c. Turning to Ofgem's assessment of the equity beta, we agree that a value of 0.9 is supportable by the available evidence. As implied by our response to question 2, it is also consistent with relative risk. Combining this with an assumption of 2.0% for the risk free rate and 5.0% for the MRP (implying 7.0% market returns), we suggest that a cost of equity of 6.5% would be more reflective of current evidence. Arguably, given current negative yields on benchmark UK government bonds and market evidence from transactions and City comment, this still represents a conservative view that would give GDNs a sufficient buffer to deal with changing market conditions.
 - d. As we have previously stated, we concur with Ofgem's proposed approach to cost of debt indexation. We believe it will provide benefits for consumers, by reducing the need for headroom in the cost of debt allowance, and will reduce the risk for shareholders of a mismatch between allowed and outturn costs of debt. It is clear

¹ <http://www.ofgem.gov.uk/Networks/GasDistr/RIIO-GD1/ConRes/Documents1/CEPA%20response%202nd%20business%20plans%20consultation%207112.pdf>

from market evidence on debt issuances that the index provides sufficient allowance for efficiently financed companies.

- e. We also agree that a notional gearing assumption of 65% is consistent both with delivering value for consumers and ensuring financeability for the networks. CEPA has also provided a supporting paper assessing financeability. While they found that (for some networks) financeability could be supported alongside a faster transition to 100% repex capitalisation, they did not propose any change to the notional gearing assumption.
4. Do you agree with our approach to transition of the Repex capitalisation rate from 50 per cent to 100 per cent in seven equal annual steps ('stepped approach')?
- a. We do not agree that a transition in seven equal annual steps to 100% Repex capitalisation is required for all networks. We attach a CEPA paper which concludes that financeability issues for the GDNs vary by network and are not as significant as implied by Initial Proposals. Ofgem's proposals front-load the price control costs to consumers beyond what is necessary to secure financeability.
 - b. We understand that efficient networks need to be financeable, and we agree that this implies financial proposals (including any transition arrangements) should allow for an investment grade credit rating. A significant part of this rating will continue to be driven by qualitative factors such as the stability of the regulatory regime. As UK networks with a stable, index-linked RAV, GDNs will continue to perform strongly in this area. We consider that any assessment of credit metrics (such as interest cover) should take this point into account.
 - c. CEPA's analysis suggests that for the majority of networks the need for transition has been overstated. A four year transition period (with Repex capitalisation beginning at 60% in 2013/14 and reaching 100% at the midpoint of the price control) would be consistent with key metrics largely remaining within target ranges. Arguably, Ofgem should consider a scenario with no transition period. Although this would likely result in some metrics breaching target ranges, given the overall security of the UK regulatory regime this would carry a relatively limited risk of credit rating downgrade and to networks' ability to access capital markets. Our overall view is that a four year transition period would represent a balanced approach for most networks.
 - d. The exception to this is the London GDN, which has a significantly higher proportion of Repex than other networks. As CEPA's analysis indicates, this means the case for Repex transition is stronger than for other networks. Although there is some evidence to suggest that financeability would be possible based on a four year transition, we agree that a longer transition period is warranted in this case to ensure that there is no undue financeability burden. We therefore agree with Ofgem's proposal to transition to 100% Repex capitalisation over the course of the price control for this network only.
 - e. We disagree, however, with Ofgem's proposal to delay this transition by one year. Applying Repex capitalisation of 50% in 2013/14 effectively maintains the status quo. It would actually result in Totex capitalisation being lower in 2013/14 than under GDPCR proposals. This does not correspond with our understanding of Ofgem's policy intent. We would argue that Repex transition should begin immediately.

12. Should the financial model also capture, for presentational purposes only, the revenue from all incentive schemes?
- Yes. Transparency is key to suppliers, which includes the maximum and minimum expected incentive rewards and penalties.
13. We have set out three options to delay with the issues relating to SIU and legacy pensions arrangements. Which option do you prefer?
- Option 1. As the cost will only be logged up for a short period and the GDNs will receive efficient financing costs it seems logical not to change pricing regimes and potentially increase volatility in prices.
15. *IRM*: Do you agree with our proposal to restrict the reopeners for the roll out of innovation to the two standard reopener windows, i.e. 2015-16 and 2018-19?
- We have concerns over the transparency and process of the IRM, particularly the level of funding that could be approved and the length of time between Ofgem's decisions to changes in GDN prices.
 - We understand the roll-out costs will exceed 1% of allowed revenue multiplied by the network's efficiency rate but we have not seen a maximum or capped value.
 - We would expect that the funding will be lagged by 2 years following the review period. From the draft IRM document it appears that all parties will have six months notice or less between the Authority's decision and the price adjustment on 1st April 2016 / 2019.
16. *Lane rental*: Do you consider a revenue trigger to be appropriate for allowing additional costs related to the implementation of lane rental schemes? In particular do you have any views on how the unit cost of such schemes should be set?
- We would expect Ofgem to continue with the approach on efficient unit costs, including penalties, made in the last TMA reopener, document 189/11 on 20th December 2011.
 - A trigger of 1% of base allowed revenue continues to seem reasonable.
17. *Mid-period review*: Do you agree with our proposed approach to addressing any changes to the HSE iron mains policy at the mid-period review, and our proposed reopener in relation to asset integrity? Do you agree with our proposed materiality of 5 per cent in relation to assessing changes to costs?
- Given the uncertainty of the use of the networks, whether the irons mains policy will change and how the networks will update their asset integrity information we feel a midpoint review could be warranted. However we have concerns over the timings and the number of other reviews also suggested in Ofgem's Initial proposals, particularly the impact these will have on charging volatility and the risk premium suppliers may need to add to consumers' bills. We recognise Ofgem will shortly publish a decision on pricing volatility and we hope this eases our concerns.

18. *Smart meters*: Do you agree with our proposed approach to dealing with uncertain smart metering costs?
- a. We think it is unlikely a reopener will be required to deal with the impact of smart metering on GDNs as in our experience of rolling out smart meters only 0.16% of exchanges requiring GDN emergency (category A) support, whereas GDNs state their call out levels are between 4 -28% for all categories.
 - b. It is important to note: category A (emergency) fault only arises when the ECV is missing or damaged; changes to service pipes and other faults are designated as category B and non emergency. The category B faults are also designated as chargeable to the supplier; therefore have no impact on the GDNs' costs.
 - c. It is vitally important in assessing GDN efficient costs that the GDNs report on the correct categories, for items which have genuinely been incrementally impacted by smart meter installations and suppliers are able to cross reference to their experience, through a transparent process.
 - d. We hope that service level agreements can be agreed with the GDNs / DNOs for all fault categories and Ofgem helps the industry by incentivizing their performance.
22. *Scottish [Statutory] independent undertakings (SIUs)*: Do you agree with our proposals not to introduce an uncertainty mechanism in relation to supply to SIUs?
- a. The GDNs need to be encouraged to think innovatively about the SIUs and the legacy issues now coming to a head. We would welcome working with the networks to make the properties within the SIUs as efficient as possible and deciding the best investment plan to heat these homes.
23. *Do you have any comments in relation to our approach to uncertainty mechanisms?*
- a. Yes, we have concerns over the process, particularly timescales, transparency and how these uncertainty mechanisms will impact on volatility of charges.
 - b. As yet we have not seen Ofgem's decision on the volatility of charges arising from the price control process (consultation document 52/12) and we can foresee large movements in revenues being derived by the uncertainty mechanisms above.
 - c. Suppliers need significant notice of price changes, with material changes having increased notice, as price disturbances bring risks to suppliers and customers.
 - d. The uncertainty mechanisms need to be transparent to all gas distribution parties, with all triggers being open to scrutiny by shippers/suppliers and allow us to keep up to date with the potential impact and a view on the mechanism's outcome.

Appendix 2: Cost efficiency

1. Do you consider our overall approach to cost assessment appropriate, and if not what changes would you propose?
 - a. In assessing cost efficiency in RIIO-GD1, the use of forecast data for the eight-year price control is difficult with different methodologies and assumptions used by individual networks. Ofgem's favoured approach of using the simple average of historical and 2-year forecast models for both a bottom-up activity level model and a top-down Totex model, giving four efficiency estimates, provides consistent rankings of GDNs. We believe this approach and the rationale for using a 2-year forecast is appropriate.
 - b. The regression analysis conducted excludes non-controllable costs, such as business rates and pension deficit repairs, street work costs, smart metering costs and TMA costs. Using a technical or engineering assessment to assess the efficient level of costs in these categories is appropriate and we agree that costs that are non-controllable should not be subject to the IQI mechanism.
 - c. A positive aspect from the Initial Proposals is the specified efficiency catch-up. Ofgem has worked on the basis that companies will have to close the efficiency gap to the upper quartile by 75%. We support a 75% catch up and consider that this should be made in a way equivalent to a P0 adjustment. It is not wholly clear to us that this is the case (as the break-even point in the IQI is over 100). Ofgem should set out clearly in its Final Proposals how the adjustment is made. As part of an incentive package, attempts to improve the efficiency of companies and reduce costs to consumers are a positive step. The strengthening of incentives in the IQI matrix appears to be a positive step in efficiency terms, but the lack of published data here makes it difficult to comment on how the mechanism works in practice.

Regional adjustments, RPEs and ongoing efficiency

2. Do you agree with our assumptions for real price effects and ongoing efficiency?
 - a. No, our concerns over allowances for real price effects remain. With a high degree of uncertainty over the economy it is clearly not sensible to set allowances for as far out as 2021 when there is no need to do so. The real price allowances given in GDPCR1 have proven to be over-generous, particularly for wage growth. We also note that considerable positive allowances were granted at DPCR5 which also appear very generous, with negative allowances appearing more appropriate. The lessons of recent price control settlements need to be learnt and extreme caution taken when considering RPE allowances.
 - b. RPEs should only be set for the first 4 years of the price control and then be included for review at the midpoint when it is hoped there will be more certainty over future values. Due to current negative RPEs it is likely the allowance will be close to zero. With the recent ONS announcement of potential changes to the RPI calculation, a midpoint review may well be needed in any case to capture any impact of this.
 - c. We do not believe that the ongoing efficiency assumptions are sufficiently challenging. This is effectively the first price control with GDNs under multiple ownership. We believe that comparative analysis will drive down the costs of all GDNs, in addition to allowing benchmarking between networks. It is highly unlikely

that all of this benefit has been realized in a single price control period. The implied productivity gains in the early price controls for Electricity Distributors were higher than suggested here and still stood at 1.5% pa at the *fourth* Price Control Review.

- d. For companies in a competitive environment, particularly in the current economic climate, there is pressure to reduce costs in *nominal* terms (hence even greater reductions in real terms), therefore the GDNs should be challenged to reduce controllable costs and outperform inflation.

Total expenditure and total opex, capex and repex analysis

1. Do you consider our approach to Totex is appropriate, and if not what changes would you propose?
 - a. We urge Ofgem to commit to an ex post review of the Totex approach during the GD2 review and share their findings with all stakeholders.

Assessment of costs excluded from regression analysis

2. Do you agree with our proposals for smart metering?
 - a. No, our experience has shown that the GDNs only get called out in 0.16% of smart meter exchanges (i.e. category A, emergency faults). We believe that these emergency costs are not significant to the GDNs and so no allowance is required. All other faults, such as moving the service pipe / ECV is chargeable to the supplier / customer and therefore has no cost impact on the GDN.
3. Do you agree with our proposals for loss of meter work?
 - a. No, we believe that the loss of meter work is a risk wholly manageable by the GDN and consumers should not be funding this. The GDNs have a number of options to mitigate this risk, utilizing their engineers differently, reviewing their direct / contract labour mix, using engineers for carbon monoxide awareness and contracting with suppliers in their smart meter rollout programmes.
 - b. We would like to see how Ofgem have calculated the loss of meter work / increase in emergency work financial adjustment.

Capital expenditure

2. Do you agree with our approach for allowing costs in line with historical levels for investment where supporting evidence is lacking or not sufficiently supported by CBA?
 - a. We have not been party to the CBA analysis so cannot comment on whether any evidence was lacking or insufficient.

Combining the elements of our cost assessment and applying the IQI

1. Do you agree with how we have applied IQI, and if not what would you propose to change? Do you agree with our approach to combining elements of the cost analysis?
 - a. We consider there is a risk that the IQI as applied by Ofgem has not delivered the intended consequences – although we acknowledge that the evidence is very difficult to interpret. As part of its analysis of the cost of equity, CEPA in its supporting paper has provided its views on the IQI. This analysis suggests that

companies may have found it beneficial to submit 'padded' cost estimates as part of their business plans i.e. the 'truth telling' incentive has not been wholly effective.

- b. Ultimately efficient costs are unknown. The relatively high company IQI ratios may, reflect that Ofgem has held down its baseline assessment of costs, despite any padding. Our understanding of Ofgem's approach to cost assessment, however, suggests that business plan forecasts could exert an influence on both bottom up and top down models. CEPA's analysis of the IQI matrix suggests that the incentive for companies to submit accurate cost estimates is relatively weak. It is difficult to be confident that baseline costs for the IQI have not been inflated. The risk is that, by submitting padded business plans and influencing Ofgem's cost assessment, companies have been able to improve their IQI reward payments and that these are effectively windfall gains, although the extent of these gains is unknown at this stage. Such additional rewards may not have been acknowledged in other elements of the price control package (such as the cost of equity).

Appendix 3: Outputs, Incentives and innovation

Environmental outputs

2. EEI/shrinkage incentive:

Should we introduce option A or option B (or an alternative) in relation to the rolling incentive mechanisms for the EEI?

Should we adopt a rolling mechanism in relation to the commodity cost element of gas transport losses, i.e. in addition to the EEI?

- a. Option A is preferred as it results in less volatility of charges and does not assume that initial performance is enduring for the eight year period.
 - b. No, we are not convinced the rolling mechanism will have the desired impact on the GDNs and adds more complexity to the incentive regime.
3. Do you have any comments on our proposed shrinkage and losses output levels?
- a. The GDPCR1 shrinkage targets appear to have not been stretching enough, as the GDNs have outperform by approximately 13% in the gas years 2010/11 and 2011/12, see evidence in appendix 4. For example, in 2011/12, the GDNs had already beaten the 2012/13 targets (as published in the IP document, except in London). It is difficult to assess whether the impact from utilizing smart meter data has been fully accounted for in setting the new targets however, we would expect higher savings to be achieved in GD1 from using this data, along with investment in above ground installations and the removal of gas holders.

Customer service

1. We would welcome views on our proposed approach to the broad measure, namely:

Customer survey: our proposed weightings for different customer interactions, and scores associated with the maximum penalty, target and maximum reward

Complaints metric: Our proposed weightings for each complaint element (incl. whether or not to include Energy Ombudsman findings within the metric), and score associated with target and maximum penalty

Overall revenue weightings; we welcome views on one GDN's proposed changes to the weightings of the different elements of the broad measure revenue

- a. We believe that symmetrical rewards and penalties are best for consumers and we do not understand why Ofgem have decided on a larger gap for penalties. We also note that the example used in the Initial Proposals is based on low allowed revenue of £250m per annum and does not highlight the true reward most GDNs could receive.
- b. We also have concerns that the stakeholder engagement reward is subjective and is asymmetrical, i.e. only positive. We believe the GDNs need to prove that their engagement has been productive and informed their views, not just a tick box exercise. Not all stakeholders will agree with each other and undoubtedly they will

not agree with everything the GDNs have said, however this does not appear to be reflected in the business plans.

Social outputs

1. We would welcome your views on the proposed number of fuel poor connections
 - a. It is difficult for us to assess the right number of fuel poor customers requiring connection by network. However, we welcome the review mentioned in the initial proposals and we would expect a holistic approach to ensuring the right fuel source is enabled by the energy industry, particularly with the Green Deal and other initiatives from Central and Local government.

Reliability outputs

1. Do you agree with our proposed reliability outputs, and secondary deliverables?
 - a. Yes, although we would have liked to see an output for offtake metering accuracy rather than a secondary deliverable, given the impact this has had on the industry in the recent past.
2. Do you agree with our proposed approach to measuring performance in relation to asset health and risk metrics, and asset loads/capacity utilization?
 - a. Unfortunately we cannot comment as the asset health and risk metrics were in the main redacted by the GDNs from stakeholders. We believe the metrics need to be shared with interested stakeholders to allow future comment.

Encouraging innovation

1. We welcome your views on the proposed level funding for the licensees' NIA based on the quality and content of their innovation strategies.
 - a. We have concerns over the licensees' limited experience of innovation and whether self governance of these projects is in the best interests of consumers. We are not convinced that the recent and planned projects within the business plans have sufficient value for consumers to allow self governance.
 - b. We believe it will be a benefit to customers, if suppliers have the ability to flag innovation projects to Ofgem and Ofgem directs GDN(s) to partake, including working together with suppliers to enable trials etc to happen.
2. In relation to funding the NIC for 2013-14, do you support either option:

Run the NIC and raise required funds from the winning licensees customers or
No NIC but roll-over funds to 2014-15?
If NIC is delayed beyond 2013-14, what option would you support?
 - a. We support option 2, as we believe the rollover of the funds should produce improved innovation projects, through longer development time and improved

choice by the networks. We would not expect Ofgem would need to allocate all the funds, as there will be limited resource to complete double the projects in a shortened period of time.

Appendix 4: Data for Shrinkage incentive

Data from the assessment and analysis reports produced by the GDNs and published on the Joint Office website.²

Shrinkage Analysis

GWh	From licence		Estimated		10/11		Estimated		Incentive	Assess v T
	10/11 incentive	10/11 prepared	10/11 final	10/11 assessed	Incentive	Final v Ass	10/11 Throughput	% throughput	% throughput	
EA	286	244	230	228	58	2	45,783	0.6%	0.5%	
EM	409	333	312	320	89	-8	67,423	0.6%	0.5%	
LC		0	0	0	-0	0	35	0.0%	0.7%	
LO		0	0	0	-0	0	34	0.0%	1.1%	
LS		0	0	0	-0	0	142	0.0%	0.2%	
LT		0	0	0	-0	0	49	0.0%	0.5%	
LW		0	0	0	-0	-	45	0.0%	0.5%	
NE	292	276	276	279	13	-3	43,500	0.7%	0.6%	
NO	230	222	222	218	12	4	36,500	0.6%	0.6%	
NT	393	356	338	346	47	-8	58,448	0.7%	0.6%	
NW	488	441	418	424	64	-6	74,814	0.7%	0.6%	
SO	278	265	247	242	36	5	60,000	0.5%	0.4%	
SE	433	399	378	382	51	-4	70,000	0.6%	0.5%	
SO	298	283	269	253	45	16	45,000	0.7%	0.6%	
SW	292	268	268	267	25	1	32,000	0.9%	0.8%	
WM	393	361	345	344	49	1	50,803	0.8%	0.7%	
WN	61	60	59	58	3	1	7,500	0.8%	0.8%	
WS	163	143	143	147	16	-4	29,500	0.6%	0.5%	
Total	4,016	3,651	3,507	3,510	506	-2	621,576	0.65%	0.56%	

13%

GWh	From licence		Estimated		11/12		Estimated		Incentive	Assess v T
	11/12 incentive	11/12 prepared	11/12 final	11/12 assessed	Incentive	Final v Ass	11/12 Throughput	% throughput	% throughput	
EA	286	235	235	227	59	8	45,599	0.6%	0.5%	
EM	408	325	325	312	96	13	65,226	0.6%	0.5%	
LC		0	0	0	-0	0	35	0.0%	0.7%	
LO		0	0	0	-0	0	35	0.0%	1.1%	
LS		0	0	0	-0	0	144	0.0%	0.2%	
LT		0	0	0	-0	0	50	0.0%	0.5%	
LW		0	0	0	-0	0	46	0.0%	0.5%	
NE	288	264	264	204	84	60	40,250	0.7%	0.5%	
NO	227	209	209	254	-27	-45	35,850	0.6%	0.7%	
NT	390	356	356	335	55	21	57,480	0.7%	0.6%	
NW	484	428	428	419	65	9	71,497	0.7%	0.6%	
SO	272	258	258	247	25	11	55,000	0.5%	0.4%	
SE	421	386	386	380	41	6	65,000	0.6%	0.6%	
SO	292	263	263	250	42	13	40,000	0.7%	0.6%	
SW	285	258	258	252	33	6	32,500	0.9%	0.8%	
WM	391	349	349	332	59	17	47,800	0.8%	0.7%	
WN	60	56	56	56	4	0	7,500	0.8%	0.7%	
WS	157	139	145	136	21	9	28,000	0.6%	0.5%	
Total	3,961	3,527	3,534	3,406	555	128	592,011	0.67%	0.6%	

14%

² <http://www.gasgovernance.co.uk/node/3208>, includes the revised leakage figures from National Grid, published on the 5th September 2012.