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James Grayburn
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Dear James

Ofgem Initial Proposals – RIIO GD1

Thank you for allowing opportunity to respond to Ofgem's Initial Proposals for gas distribution price controls from April 2013.

Vector Business Services is an independent management consultancy specialising in the energy and utilities sector. To February this year we provided interim management services to a representative trade body in the sector (SBGI, now EUA) and participated on their behalf in the Price Control Forum and Innovation Working Group, as well as providing input to many network stakeholder events over the life of RIIO-GD1. We continue to provide programme management services to technology providers in the IFI programme and operate more generally as advisors in the gas networks, utility metering and asset management sectors.

Our comments here are restricted to issues concerning the iron mains replacement programme and aspects of the Innovation Stimulus, and are made in relation to the Overview, Cost Efficiency and Outputs, Incentives and Innovation documents.

<u>Iron Mains Replacement Programme</u>

We welcome Ofgem's view that Tier 1 mains replacement work should continue, funded at an efficient level, through to completion in 2032. We do support the networks view on the need to taper the approach to 2032 in terms of work load (see for example the approach to smart metering deployment) but would propose that this could be addressed at the next price control review point.

With regard to Tier 2 work volumes, we support the common approach now in place to set risk thresholds as a way of ensuring, in part, common safety approaches across the networks. We do however have real concern over the varying approaches used in determining replacement volumes in the 'cost-benefit' section. It is just not credible that one network's case can be accepted in full, whilst another is totally disregarded. These networks stem from a common engineering heritage and, not withstanding local variations in labour rates, sparsity and congestion, one would expect cost/benefit outcomes to be broadly similar in all 8 networks. We would suggest that it is the application of modelling assumptions that is the prime variable rather that the true condition of the networks (and actual customer benefit realisable) that gives this variability. We would suggest that Ofgem and the networks re-consider their approach in this sector.

In justifying T2 work below the risk threshold the networks have fundamental differences or approach. For example, one network takes the ‘worst pipes’ and applies a down-scaling method to reflect that ‘the sample is not representative of the population’. In this way some projects will always meet the NPV threshold. Although it is difficult to judge from the public information presented, an approach based on the ‘average’ project will always struggle to meet the same NPV threshold.

The differences in approach used to determine cost-benefit analysis for T2/T3 gives the industry and regulatory process a real credibility issue. This needs to be corrected in the final proposals. At the current levels of business in large diameter works, it is difficult to see supply chain companies investing significant sums to bring to market alternative pipe-relining technologies.

We note also the wide variation in revenue drivers for large diameter mains in above-threshold T2 (Table 8.4).

<u>Innovation Stimulus</u>

Ofgem’s announcement that the NIA (successor to IFI) could be between 0.5 and 1.0% of allowed revenues was tremendous news for supply chain companies as prospective solution and technology partners. It is disappointing therefore to see proposed allowance of 0.5% (2 networks) and 0.6% (two networks). Ofgem has identified rightly the superior quality of two technology strategies, but coupled with the proposal to allow the network companies themselves to spend a greater fraction of monies internally, opportunities for supply chain to participate in the scheme are reduced somewhat. Coupled with the likely deferment of NIC for gas, there is a strong case for enhancing and stretching the award band beyond 0.6% for the ‘best networks’.

With regard to NIC we see collecting funds from the customers of ‘winning networks’ (an enhanced NIA allowance?) as contrary to the philosophy of the scheme and would urge speedy resolution for the regulatory barriers preventing transfer between licence holders.

We trust you will find these comments useful in moving forward to final proposals.

Yours sincerely

Martin Atkinson

Managing Director