RIIO|GD1

Response to Initial Proposals

Outputs, Incentives and Innovation

National Grid
Gas Distribution

September 2012

Contents

Outputs, Incentives and Innovation

The following responses address the questions raised within Ofgem's RIIO-GD1 Initial Proposals 'Supporting document - Outputs, Incentives and Innovation'.

Overview

We set out below our key themes of our response to workload disallowances and Outputs, Incentives and Innovation:

Workload Disallowances

1. There are a number of areas in which we do not support the workload disallowances (and hence disallowed outputs) that are contained in the Initial Proposals.

2. In particular, the reductions in condition replacement work and our Non Routine Maintenance Programme are not consistent with our statutory duties to ensure a safe and reliable network. This view has been reinforced in our discussions with the HSE.

3. For below threshold Tier 2 and Tier 3 replacement, which we had justified on a cost benefit basis, we would expect that workloads would be broadly consistent across networks if using a common approach that avoids variable standards of safety, reliability and efficiency for consumers across GDNs.

4. We also do not support the removal of the Tier 1 taper and set out our response to Ofgem's assessment of this.

Output Levels

5. For the reasons above, we disagree with the output levels proposed for the major primary outputs on safety and reliability and environmental emissions. Notwithstanding our disagreement with the logic in removal of the workload which underpins the proposed outputs, there are errors of logic in how the output levels have been amended in light of the proposed workload adjustments in the areas of leakage and repair risk management. The pro-rata approach in the former (given differences in leakage rates) and the target setting from 2011/12 (given peak conditions) in the latter are inappropriate ways to reflect the changes proposed and overstate which outputs are deliverable.

6. We set out two areas for Ofgem to further consider on fuel poor outputs, firstly the consistency of the cost allowances across networks and secondly the impact of introducing uncertainty over when the fuel poor review will take place.

7. Since our April 2012 Business Plan submission, we have revised our demand forecast for 2012/13 and the RIIO-GD1 period to reflect updated analysis on the peak to annual demand ratio, based on a greater understanding of peak conditions gained from experience of the previous two winters. The ratio between peak and annual has increased from our April plan forecast leading to a requirement for us to book higher NTS exit capacity for 2012/13. This has a knock on effect on our capacity cost forecasts for the rest of the RIIO-GD1 period. This has no impact on reinforcement costs or the capacity output charts which remain as per our April 2012 Business Plan submission.

8. We have set out a number of further questions surrounding the proposed end of period assessments for output measures. These include clarifying the scope, highlighting the challenges of basing this assessment on secondary deliverables, which by their nature are more leading indicators rather than firm measures of delivery of the primary measure and how Ofgem has determined the value applied to the end of period assessment. This is particularly pertinent given our discussions on output related incentives in these areas where the difficulty in valuing the customer and stakeholder benefits has been one of the prime reasons for not pursuing them further.

Incentives

9. For the rolling incentive mechanism on the environmental emissions incentive, we propose that option B should be progressed. We agree that the rolling incentive mechanism should also be applied to the shrinkage allowance.

10. We support the broad proposals on customer incentives. We have set out proposals for how the connections element of customer satisfaction should be targeted, the need for further consideration to be given to the differential expectations of London customers and how these are accounted for in the incentive framework. In addition, we propose that the Ombudsman referrals are removed from the complaints metric given the high level of performance already being attained and the disproportionate effect of including it.

Innovation

11. We do not understand the reasons for non-acceptance of our proposal for the full 1% of innovation funding allowances and seek further information from Ofgem over what was missing from our innovation strategy. We also set out our concerns on the development of the NIA governance document and the need to ensure a flexible approach to stimulate innovation.

12. On the basis that the Gas Act does not currently allow implementation of the NIC, we support the proposed option 2 to enable the scheme to commence.

Detailed Question Answers

The detailed responses to specific questions below describe our views on these areas in further detail.

Chapter 1 - Introduction

No specific questions were raised in this chapter.

Chapter 2 - Environmental Outputs

Question 1: *Biomethane information provision*: We would welcome respondents' views on whether our proposed information provision draft licence condition meets the needs of potential biomethane/entry connectees.

Response

2.1 We believe that the current draft of GDC83 (Distributed Gas: Connections Guide and Information Strategy) broadly meets the needs of entry customers. We have provided a number of more detailed drafting comments via the parallel Licence drafting consultation. One key area that seems to have been omitted is any requirement to consult with our customers on the form and/or content of the Connection Guide. In order to address this point, a requirement could be placed on Licencees to review the document with customers on an annual basis and demonstrate how their feedback has been reflected in any revision.

Question 2: EEI/ shrinkage incentive:
(a) Should we introduce option A or option B (or an alternative) in relation to the rolling incentive mechanisms for the EEI?
(b) Should we also adopt a rolling incentive mechanism in relation to the commodity cost element of gas transport losses, i.e. in addition to the EEI?

Response to (a)

2.2 We fully support the introduction of a rolling incentive mechanism in order to minimise the disincentive to invest to minimise environmental emissions towards the end of the control (Ofgem have previously referred to this as the periodicity problem). Although we note that both options for the rolling incentive mechanism address this issue to some extent, the optimal approach would be to introduce option B.

2.3 The basis for our support of option B is primarily driven by stability of network charges, both within the RIIO-GD1 price control period and beyond. Our concern is that option A has the potential to result in a significant 'true-up' in the RIIO-GD2 period. Although it is not yet clear (from the current drafting of licence condition GDC25) on the mechanism for true-up, if the option A true-up is recovered in a single year, this would result in

considerable charging instability. The alternative of recovering the true-up over the RIIO-GD2 period as a whole could lead to the recovery of incentive revenue up to 15 years after incentive performance which we consider to be wholly inappropriate. Additionally, significant delays in incentive revenue adjustments reduce the cost reflectivity of the resulting charges, since the population of consumers bearing the charges will align less with that of those who have benefitted from the initial emissions reductions.

2.4 The proposed option B doesn't attract any of the issues set out above as the reward / penalty is spread or smoothed over the RIIO-GD1 period. We recognise concerns that option B could result in increased charging volatility. However, we strongly believe that the introduction of a 2-year lag associated with the reward / penalty would provide predictability of revenue adjustments and would provide the appropriate balance between timely incentive adjustments and improved charging volatility. In addition, emissions improvements are likely to be driven by investment in the network which generates enduring reductions in emissions levels. We believe the scenarios with large fluctuations across years in incentive performance are unlikely to occur in practice. Option B also provides a better temporal incentive than option A in encouraging such investment to reduce emissions. As a result the emissions benefits of investment are likely to be realised earlier than would be the case under option A, to the benefit of consumers.

2.5 We note that the incentive mechanisms under both options need to deal with both enduring and non-enduring incentive performance. At present, the mechanism for distinguishing between these forms of incentive performance and their valuation is not explicit under either of the options outlined.

2.6 As referenced above, para 25.7 of GDC25 proposes that Ofgem will determine the rolling incentive amounts by reference to the Final Proposals document published in December. We consider that the rolling and annual incentive mechanisms should be unambiguous so as to provide certainty of treatment, in line with best regulatory practice. This should be done through either the Licence terms or the Financial Model and not be subject to Ofgem interpretation and determination in 8 years time.

Response to (b)

2.7 We fully support the need to extend the roller mechanism to cover the Shrinkage Allowance as the basis for making investment decisions to minimise Shrinkage are no different to that of the EEI and so the same rationale for a roller mechanism applies. We note however, the current drafting of Licence condition (GDC25) does not reflect this principle. National Grid would be happy to provide some proposed drafting to help ensure that the principle of the rolling incentive mechanism is applied consistently to both the EEI and the Shrinkage Allowance.

Question 3: Do you have any comments on our proposed shrinkage and losses output levels?

Response

2.8 We believe our output commitments for shrinkage and leakage within our Business Plan are in the best interest of consumers, as it is based on a defined mains replacement programme and other initiatives that allowed NGGD to further improve the impact our networks have on the environment.

2.9 Our arguments in support of our Business Plan workload and associated outputs that would benefit customers are detailed in our response to Initial Proposals - Supporting Document - Cost Efficiency, Chapter 8 Questions 1 and 2.

2.10 Notwithstanding this position, we have modelled and detailed the impact that the replacement workload adjustments, proposed by Ofgem in Initial Proposals, will have on our shrinkage and leakage output commitments.

2.11 The methodology used to adjust the shrinkage and leakage output levels is too simplistic and does not reflect the mix of pipes that have been removed from our workloads. Different diameter levels and material types have different leakage rates within the leakage model and so a simple pro-rata will not reflect the impact on shrinkage and leakage outputs. This is more significant as the replacement workload adjustments relate to larger diameter pipes and condition work covering different material types. The analysis we have provided (detailed in the tables below), better reflects the Initial Proposals workload adjustments and shows that this will:

- Reduce the annual leakage output commitment to customers by the end of the period from 19% (restated baseline[1]) to 14%; and
- Reduce the annual shrinkage commitment by the end of the period from 19% (restated baseline) to 13%.

2.12 Whilst mains replacement in future price controls can be increased to further reduce the level of leakage and shrinkage from our networks, the environmental impact our proposed RIIO-GD1 Business Plan workload level over the next 8 years cannot be recovered. Our plan output levels are designed to balance customer benefits that can be delivered now and for future customers, this was supported by our stakeholders throughout the RIIO process.

[1] Our April 2012 Business Plan output levels (previously 21% Leakage and 20% Shrinkage) have been restated without our proposed industry model amendments which will now be discussed and proposed in RIIO period. Equates to a 13GWh amendment over RIIO-GD1 period.

Figure 1 - Leakage and Shrinkage Volumes

11.1: Leakage Volumes

April BP (Restated): Leakage Volumes	RIIO-GD1								leakage reduction
	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	
East Of England	535	524	513	501	490	479	468	457	16%
London	298	291	283	275	267	259	251	243	21%
North West	384	372	360	349	337	326	314	303	23%
West Midlands	320	312	305	298	291	283	276	269	18%
	1537							**1271**	**19%**

NGGD IP adjusted: Leakage Volumes	RIIO-GD1									Change from Apr BP	
	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21			
East Of England	537	527	517	508	498	489	479	469	14%	3%	13 GWh
London	301	296	291	286	281	276	271	266	13%	9%	23 GWh
North West	388	380	372	365	357	349	342	334	16%	9%	31 GWh
West Midlands	322	317	312	307	302	297	292	287	12%	6%	18 GWh
	1547							**1356**	**14%**		**85 GWh**

11.2: Shrinkage Volumes

April BP (Restated): Shrinkage Volumes	RIIO-GD1								Shrinkage reduction
	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	
East Of England	569	557	545	534	522	511	500	488	16%
London	316	308	300	292	284	276	268	259	20%
North West	406	394	382	370	358	347	335	323	23%
West Midlands	334	326	319	311	304	297	290	282	17%
	1624							**1353**	**19%**

NGGD IP adjusted: Shrinkage Volumes	RIIO-GD1									Change from Apr BP	
	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21			
East Of England	570	560	550	540	530	521	511	501	14%	3%	13 GWh
London	318	313	308	302	297	292	287	282	13%	8%	23 GWh
North West	410	402	394	386	378	370	363	355	15%	9%	31 GWh
West Midlands	336	331	326	321	315	310	305	300	12%	6%	18 GWh
	1634							**1438**	**13%**		**85 GWh**

2.13 In light of the proposal to move above risk threshold Tier 2 mains to an uncertainty mechanism, we will need to discuss with Ofgem how to reflect the impact in the base shrinkage and leakage output levels. Currently, Tier 2 mains above the risk threshold are included in our baseline figures.

Chapter 3 - Customer service

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

a) *Customer survey: our proposed weightings for different customer interactions, and scores associated with maximum penalty, target and maximum reward (see table 3.3)*

b) *Complaints metric: our proposed weighting for each complaint element (incl. whether or not to include EO findings within the metric), and score associated with target and maximum penalty (see table 3.4)*

Overall revenue weightings: we welcome views on one GDNs proposed changes to the weightings of the different elements of the broad measure revenue (see table 3.5)

3.1 We welcome the constructive dialogue that has taken place in the Customer and Social Issues Working Group (CSIWG) and confirm our commitment as we work towards finalising the outputs in this area. Responses to the questions raised are detailed below:

Response to (a)

3.2 We agree that the setting of three different targets with separate penalties and rewards is sensible given the very different nature of the activities being undertaken and reflecting the relative starting position for each service.

3.3 As discussed at the CSIWG meetings we still remain concerned over the Connection element of the Broad Customer Measure. Although we recognise Ofgem's desire expressed at the CSIWG meeting that customers receive the same level of service for all services; we believe that the difference in existing scores is not necessarily around the level of service being provided, but that it actually reflects the nature of the activities being undertaken. For example:

- Unplanned interruptions - currently has the highest score. This is to be expected given that the customer is experiencing an unplanned and stressful event. A free of charge and immediate response is provided rectifying a potentially dangerous situation.
- Planned interruptions - currently ranks second. Again a free of charge service and as expected comes second. Although the customer is experiencing an unwelcome disruption there is no charge to the customer and the benefits of a continuing safe supply are readily visible.
- Connections - this is a high value service and the only one of the three services which is invoiced directly to the customer. The whole end-to-end experience of having a gas connection, a meter and central heating and/or other appliances installed is a relatively lengthy and costly experience.

3.4 In terms of connections, we have also raised our concerns around the introduction of permitry that will impact the timescales of work being undertaken. We provided evidence in our April 2012 submission that showed the reduction in CSAT scores which directly correlated to the introduction of permit schemes in our London network - London is the only area so far to have permitry introduced. As permitry is rolled out across the UK this will have the potential to impact CSAT scores for connections. This impact had not been taken into account during the 6 month trial when the Upper Quartile baseline score was being set.

3.5 Currently the simple approach proposed for setting the maximum reward aligns to the maximum score achieved during the 6 month trial for both Planned and Unplanned. If this was extended to Connections, and the same principle applied (giving a reduction of 1 for the maximum penalty) this would give a maximum reward score of 8.3 and a maximum penalty of 7.3, as follows:

Figure 2 - Maximum reward and penalty data

Element	Maximum Trial Score	Maximum Reward Set	Maximum Penalty Set
Unplanned interruption (no change)	8.92	9.0	8.0
Planned interruption (no change)	8.49	8.5	7.5
Connections	8.32	**8.3**	**7.3**

3.6 This is still considerably above Ofgem's aspiration of the target being set at above 8 out of 10, and will enable some flexibility for the uncertainty around the roll out of legislation that will have the largest effect on Connections.

Customer satisfaction in London

3.7 In both our November 2011 and April 2012 Business Plan submissions we provided evidence of a difference to customer satisfaction scores in London. Of greatest concern is the performance of our connections service where our customer satisfaction scores are further dampened by the working conditions in London.

3.8 We have more recently put forward evidence of key driver analysis which shows that customers in London place more importance on work completion times and scheduling than customers in other areas and that there is a direct correlation between lead times and customer satisfaction. As lead times decrease customer satisfaction increases, as lead times increase customer satisfaction decreases.

3.9 From the analysis put forward it can be seen that there is a 6% difference in CSAT scores across our London network for areas that have had permit schemes implemented to those areas where permit schemes have not yet been rolled out. We have the same delivery model throughout London, the only difference is in working conditions as a result of this legislation. As permits are rolled out across London, we envisage that our CSAT score will deteriorate in London driving penalties for legislation that is outside our control.

3.10 In our November 2011 Business Plan we put forward proposals to recognise the difference in London either through increased revenue or through a handicap in the form of a higher starting position. We continue to believe that the latter would better facilitate a level playing field, and given the evidence of a 6% differential where permitry has been implemented believe that this would provide an equitable solution.

Response to (b)

3.11 We recognise the work that Ofgem have done in reducing the weighting of the Energy Ombudsman element of the complaints mechanism but continue to remain concerned at the impact of even a 10% weighting. We do not believe that the level of penalty is proportionate to the offence, and this incentive which has the potential to provide a better quality of response to complainants will drive the wrong behaviours in this area.

3.12 The small and reducing numbers of Ombudsman enquiries being received by networks shows that companies take these referrals extremely seriously, without any additional penalties attached. Networks currently have a cost associated with Ombudsman referrals and can also be required to pay compensation up to £5,000. In addition, Guaranteed Standards of Performance payments are made to individual customers who are impacted by individual failures to our guaranteed standards.

3.13 We believe that this is enough deterrent to incentivise companies to improve service levels and it will, importantly, drive exactly the right behaviours – this is critical to the development of an appropriate incentive. We are fully committed to providing visibility to both our customers and stakeholders of our performance and intend to report publicly on an annual basis. This will provide a reputational incentive to continually enhance our performance in this area.

3.14 We provided further evidence at the September CSIWG of the impact of a 10% weighting on Ombudsman referrals and believe that the penalties being levied are wholly disproportionate to the offence. Whilst we do accept that companies have many opportunities to put a customer's complaint right, the baseline is already being set at the Upper Quartile - which for Ombudsman is zero. This is a fantastic achievement for the industry and further penalties are not commensurate with what could be considered as world-class performance.

3.15 Following discussion at the CSIWG, we have carried out further modelling on a number of weightings, including a minimum of 1%. Using the same scenarios as those used for the CSIWG discussion a 1% weighting could still invoke penalties of between £98,000 to £201,000 dependant upon network.

3.16 Even on a 1% weighting, the impact of losing a single Ombudsman finding is so significant to the overall points score of the complaints metric that the resulting financial impact will drive poor behaviours and move the focus away from other areas of importance. We do not believe that this is the intent of the complaints metric, nor is it a fair reflection of the benefit it will bring customers.

3.17 We therefore, do not support the inclusion of Ombudsman within the complaints metric. We are however, committed to improving our customers' experience in this area and reporting publicly on these instances. This will drive the right behaviours for customers, without providing perverse incentives.

3.18 We welcome the more objective measure of a balanced scorecard approach, put forward by Ofgem in response to stakeholder feedback.

3.19 We believe that this objective framework will provide companies with a link to reward, thus supporting appropriate investment in innovation and desired services to the benefit of both customers and wider stakeholders.

3.20 We are supportive of the 50/50 split between Customer Satisfaction and Stakeholder Engagement. This strikes a balance between incentivising the improvement of direct services that we currently offer to customers whilst incentivising the broader interactions and innovation desired by a wider group of stakeholders.

Chapter 4 - Social outputs

Question 1: We would welcome your views on the proposed number of fuel poor connections (see Table 4.1).

Response

4.1. We support Ofgem's proposal to continue to fund fuel poor customer connections as this reflects our stakeholder feedback, however, we have two areas that need to be addressed:

- Cost Allowance - We need a consistent approach to setting the Fuel Poor allowance to ensure consistent treatment of fuel poor customers across networks; and
- Policy change - We are not supportive of the Ofgem policy change to move from a single review of fuel poor policy from 2014 to anytime in the RIIO-GD1 period and have detailed our reasons below.

Cost Allowance

4.2. Fuel Poor connections are driven by either individual one-off fuel poor connections to our existing mains infrastructure or through network extensions (extending the gas mains network) to groups of fuel poor customers. We note that through Ofgem's assessment of costs, Ofgem have provided greater funding to SGN who will therefore be able to offer fuel poor connections to a wider group of customers through network extensions. We would recommend a consistent approach to setting costs across networks so that the delivery of fuel poor connections is not based on a 'postcode' lottery when the customer assessment criteria for the fuel poor voucher is the same across all gas distribution networks. The approach of using the fuel poor voucher is consistent with the treatment of fuel poor connections under GDPCR1.

4.3. As the SGN allowance is broadly equivalent to their fuel poor voucher level we propose that all networks should set cost allowances at the voucher value in order to ensure potential fuel poor customers can experience similar funding and treatment across all networks.

Policy change for fuel poor scheme review

4.4. We note the change in policy to move from a review in 2014 to a potential review of the fuel poor output at anytime during the price control period. To achieve the benefits of gas for fuel poor customers requires funding from many other parties such as housing trusts and local authorities to fund in house heating. Some of our schemes delivered to-date have taken up to two years from initial concept to connection. We believe an open ended review of the scheme could significantly discourage other funding as gas transporters will not be able to guarantee contribution to the connections through our fuel poor allowances with the possibility of funding being removed.

4.5. It should be recognised that this indecision over the scheme could have implications on delivering this output commitment. We have seen evidence of similar uncertainty such as the government decision to propose changes to allowances for solar power electricity connections which has had a knock on effect to the market. We would recommend that the review is either removed from the proposals or undertaken by a set point in time early in the RIIO-GD1 period to minimise the impact of any uncertainty.

Question 2: We would welcome your views on our proposed approach to CO issues including setting an output measure based on improving CO awareness.

Response

4.6. In Initial Proposals, Ofgem have not provided funding to deliver our output commitment of 2.1m Carbon Monoxide (CO) service contacts, if these allowances were to be maintained in Final Proposals we would have to fundamentally review what can be delivered for customers.

4.7. We believe that Ofgem have interpreted our plan as being able to deliver the CO Service output commitment at no extra cost. However, the delivery of our CO Service output commitment is only possible though the funding of our proposed minimum emergency resources outlined in our Business Plan proposals. Our engagement through the industry working groups, industry trials of the CO Service and the data provided to Ofgem in our November 2011 Business Plan (Chapter 9 – Work Deliver Expenditure) has provided the impact on job durations, which has not be included in the comparative analysis with the other GDNs. Instead we are being benchmarked against GDNs that are not providing this CO awareness visit output. However, we set out our views in our responses on cost efficiency, emergency and loss of meterwork, and believe the IPs are not consistent in their assessment of allowances for loss of meterwork and therefore allowances need to be increased. Should our proposed corrections be accepted, this may allow us to be in a position to continue to commit to our proposed level of CO awareness visits.

4.8. We will continue to look at ways to raise awareness of CO and are committed to the delivery of the CO awareness survey reporting requirement that builds on our trial document.

Chapter 5 - Connections

No specific questions were raised in this chapter.

Chapter 6 - Safety outputs

Question 1: Do you agree with our proposed approach to assessing non mandatory investment in relation to Tier 2 and 3 iron mains, e.g. based on a 24 year payback period, and consistent with our earlier investment appraisal guidance?

Response

6.1 We do not agree with Ofgem's proposed approach to assessing what they have termed as 'non mandatory investment' in relation to Tier 2 and 3 mains, there being two key issues.

6.2 Ofgem have applied an inappropriate cost benefit approach to network plans on condition related investment which is "mandatory" in terms of maintaining the integrity of the gas network. This is 'must do' work and as such NGGD do not see how at the very least they do not keep consistency with their approach of allowing costs in line with historical levels of expenditure given there is no evidence to suggest this will change.

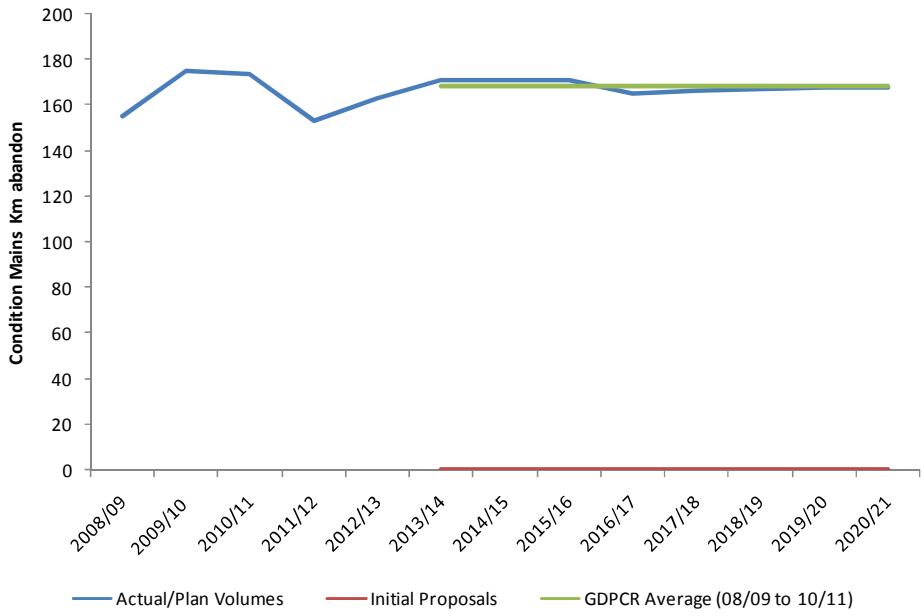
6.3 We have concerns with the 'common approach' used to assess cost benefit workloads, namely:

- Vastly different outcome of applying a common cost benefit approach across networks that results in variable standards of safety, reliability and efficiency for consumers across the GDNs.
- No apparent consideration given to the integrated nature of the London MP strategy and the impact of cherrypicking schemes that passed a 45-year NPV assessment.
- Overstated assumptions on the uncertainty over the future of the gas network used to formulate a 24 year payback hurdle.

Condition Workload Assessment

6.4 Ofgem have inappropriately applied a cost benefit approach to network plans on condition related investment which is 'mandatory' in terms of maintaining the integrity of the gas network. NGGD has had all of its condition workload forecasts disallowed on the basis of no CBA being provided. The figure below shows the historic spend, planned investment and Ofgem proposed allowances along with the 3-year GDPCR1 average. This shows our plan is in line with historic spend and the Initial Proposals are nowhere near this level at zero.

Figure 3 - NGGD condition mains workload actuals and plan



6.5 Condition workload has always been a critical part of our plans to meet the HSE mains replacement programme to target assets (such as steel and asbestos pipes) beyond 30m of a property. Ofgem need to reconsider their assessment of this workload to ensure their allowances are consistent with our statutory duties. We cover this in more detail in our answer to IP - Supporting Document - Cost Efficiency Chapter 8 questions 1 to 3.

Cost Benefit approach

6.6 We have 3 principal concerns with Ofgem's approach to assessing cost benefit workload:

a) Extreme disparity between networks workloads having applied a common methodology.

b) Selection of London MP schemes.

c) Overstated assumptions on the uncertainty over the future of the gas network used to formulate a 24 year payback that would have benefited from a more timely and transparent consultation process.

6.7 We will discuss these in turn below:

a. Disparity between networks

6.8 Using a common methodology should give broadly similar workloads across all of the networks. This is because fundamentally the assessment is being completed on networks which have broadly the same characteristics with respect to their low pressure pipeline assets. A high level assessment of the relative allowances shows that the outcome of Ofgem's methodology has produced incoherent results for customers.

Figure 4 - Allowed non policy mains workload

km lay	Allowed Tier 2<threshold and Tier 3 Mains	% of industry allowed work
EoE	4.5	2%
Lon	53.8	18%
NW	27.9	10%
WM	0.0	0%
NGN	190.8	65%
SC	15.0	5%
SO	0.0	0%
WWU	0.0	0%
	292.0	

6.9 Ofgem's assessment leads to a material disparity across the GDNs, the table above shows that the application of the methodology has led to NGN receiving 65% of the total workload allowance (a full allowance for cost benefit justified workload in its network).

6.10 Out of NGGD's submitted volume of 922km of abandonment, 230km per network, only 86km of MP mains were justified under the common framework that was outlined in the Initial Proposals. The volume we submitted of 230km per network is in the same region as NGN and that such a small volume (2.7km p.a.) was deemed as justified is not credible in the context of NGN's allowance.

6.11 NGN's workload of 25km abandonment per year was justified in 2 categories:

- Pipes not economical to repair that therefore have a net benefit to the customer.
- Pipes that enable unit cost efficiency in Tier 1 and Tier 2 above threshold.

6.12 This mirrors our approach and disallowances of NGGD work will therefore lead to two outcomes. Firstly we will have to replace pipes that are not economical to repair with no funding as our statutory obligations to maintain a safe and reliable network mean we have to replace these assets. Secondly there will be a detrimental impact on our Tier 1 unit costs as we will not be able to reach the same levels of efficiency as NGN who have been allowed this enabling work.

6.13 This results in an outcome where there are significant differences in the safety and reliability outputs being applied to these assets by network which is not consistent with the inherently similar nature of the assets across the network companies. Our customers will also have higher cost of delivering the Tier 1 workload throughout RIIO-GD1. This discrepancy comes from an inconsistent application of the approach. As discussed we have concerns over the calculation of the 24 year payback threshold. Moreover in applying a simple payback threshold, the results are very sensitive to the input assumptions.

6.14 The key variable in the calculation is the starting repairs per km for assessed mains. This is the key difference between the NGGD and NGN assessment with the sample assessed

for NGGD having maximum repairs per km of 2.68 whilst the NGN sample ranges from 5-5.5.

6.15 It is therefore apparent that the main difference between NGGD and NGN's approach is the selection of the pipes being evaluated. By selecting the poorest condition zones the repairs per km are higher and thus justify more work volume when extrapolated out. The table below shows different ways of considering NGGD's asset data and the impact this has on the repairs per km figure.

Figure 5 - Fractures per km for NGGD mains

	5 Year Average Repairs per km	EoE	Lon	NW	WM
	Max	115.3	90.6	39.6	49.1
Percentile	98th	9.5	14.0	11.8	11.9
	95th	6.5	8.6	8.0	8.7
	90th	4.5	5.7	6.2	6.4
	75th	2.7	3.1	3.6	3.6
	50th	1.5	1.6	2.3	2.3
	25th	0.8	0.9	1.3	1.3
	10th	0.4	0.5	0.7	0.8
	Min	0.0	0.0	0.0	0.0
	Average	2.2	2.8	3.0	3.1

6.16 There is a large range of repair per km figures and in the 90th percentile (top 10% poorest pipes) the repair rates compare to the NGN sample. This would suggest that there is a population of pipes where the benefits of replacement are sufficient enough to justify under a 24-year payback as was the case with NGN.

6.17 To demonstrate the importance of the fractures per km on the calculation we have run the cost benefit analysis for our West Midlands network using the low end of NGN's repairs per km (5 per km). The table below summarises the results which shows 431km of mains would justify for replacement under Ofgem's 24-year payback approach.

Figure 6 - West Midlands justified workload scenarios

WM LP CBA summary		Ofgem 24 year payback analysis		NGGD assesment over 45 years (with hurdle rates)	
km iron main	Length to assess	length pay back in 24 years using NGGD fracture rates	Length pays back using low end of NGN fracture rates (5 per km)	Length that passed NGGD assesment	NGGD proposed RIIO-GD1 workload
9"	31	0	31	26	11
10-12"	1,014	0	0	0	0
>12-17"	261	0	202	173	73
18"	125	0	93	75	32
>18-24"	73	0	65	53	22
>24"	40	0	40	32	13
Total WM	**1,545**	**0**	**431**	**359**	**151**

6.18 The table also shows the volume of work that passed NGGD's assessment in these categories (359km) and the volume proposed in the RIIO-GD1 period (151km or 18.8km). Both NGN's approach and the NGGD approach adhered to the common guidelines issued by Ofgem with respect to uncertainty, discounting and valuation of benefits. Both then came out with a similar answer albeit in slightly different ways (45 year pay back with hurdle rates applied for NGGD vs. 16 year pay back for NGN). These should act as a sense check for each other and give comfort to Ofgem that using the same guide lines two operators arrived at similar levels of annual workload.

6.19 Ofgem need to ensure that a consistent methodology is applied on cost benefit workload such that the outcome ensures a similar level of safety and efficiency for customers across the network areas. We note that our original plan proposed a workload in line with that which has been allowed for NGN hence it would seem a consistent approach would be to allow this workload.

b. Cherry picking on London Medium Pressure assessment

6.20 We do not agree with the approach to determining allowances for our London Medium Pressure strategy. Instead of considering our proposals as the integrated long term strategy we have provided, Ofgem have made allowances solely for those schemes within the strategy that individually passed a NPV test over a 45-year period.

6.21 This has resulted in a much reduced and piecemeal set of routes that allowances have been given for (although not correctly as discussed in our response to Initial Proposals - Supporting Document - Cost Efficiency, Chapter 8 question 3). A key part of the rationale for our proposals was an integrated strategy to allow pressures to be raised, such that significant parts of the replacement could be carried out through insertion thus minimising costs to customers and to significantly reduce the environmental and congestion impacts of the work. The piecemeal nature of the allowances means this is now not possible and indeed it may not be possible to physically complete the routes identified as 'open cutting' may not be feasible given traffic restrictions and the interactions with other utilities assets.

6.22 Ofgem have also failed to make any adjustments in the proposed unit costs to reflect the much reduced nature of the programme and the inability to 'insert' pipes. Our response to

this is contained in our answer to Initial Proposals - Supporting Document - Cost Efficiency, Chapter 8 question 3.

6.23 Ofgem need to reconsider their assessment of this workload and consider the integrated nature of this programme further and also ensure that any unit cost proposals are consistent and achievable against any revised programme.

c. Calculation of 24 year payback using real option analysis

6.24 Ofgem's investment appraisal approach is underpinned by a test against the future need for the investment, given long term uncertainty on the future use of the gas network. We fully support the need to account for this uncertainty. We are shortly publishing a new study with Redpoint, "Pathways for decarbonising heat" which confirms the earlier Redpoint / ENA work that gas has a role in supplying seasonal and peak heat demand in buildings, and without gas in buildings energy costs (heat and power) would be 12% more expensive in 2050.

6.25 The initial proposals factored in this uncertainty using a simplified 24-year payback as the test for whether investment should be allowed for the RIIO-GD1 period.

6.26 The justification for a 24 year payback hurdle on cost benefit analysis is obscure, and derived from unreliable assumptions that would have benefitted from a timelier and transparent consultation process. It is based on a consultation on real options and investment decision making - an application to gas network interruptible contracts issued one month before our April 2012 Business Plan submission date. This consultation derives an option value of 22% by considering uncertainty in the future utilisation of the gas network for load related investment.

6.27 It uses a study by the ENA members commissioned from Redpoint, which identifies four possible pathways to achieving the government's low carbon economy targets by 2050 and identifies the potential role of the gas distribution network. Ofgem's real option analysis draws conclusions around the level of utilisation of gas networks by taking a mid-point between the highest utilisation scenario and the lowest. It does not recognise that these are only possible scenarios and not intended to be boundary cases for the use of gas networks. Nor does it recognise that the scenarios with more gas demand in them allow the UK targets to be met at considerably lower cost than scenarios with a greater role for electricity in delivering heat. Nor does it consider any future policy change in government over the level and timing of the targets, or potential that government targets are not met.

6.28 To extrapolate this analysis to a CBA payback, Ofgem have taken the option value of 22% calculated for incremental capacity based on uncertainty in network flows and asserted it can be used to reflect other sources of uncertainty, such as deterioration rate of iron mains. This is incorporated in CBA by truncating the payback period to between 22 and 30 years. The initial proposals then apply a 24-year hurdle for all schemes to be allowed given this was one of the sensitivities required in our modelling.

6.29 We expressed concern over the application of strict cost benefit guidelines in response to the draft guidelines. We sought to reflect the guidelines, as we understood them, in our April 2012 Business Plan. The Initial Proposals make no acknowledgement of NGGD's

approach to CBA (saying merely that we did not propose investment which only paid back in 24 years). In Ofgem's February Initial Assessment, Ofgem highlighted the lack of sensitivity applied to the CBA we had undertaken and in response we reviewed our modelling and added a number of "hurdles" to scale back the benefits, we also undertook a sensitivity to inflate the cost to ensure only no regrets projects were included in our programme. This reduced the volume of work put forward in our April 2012 Business Plan under CBA, but in doing so ensured that customer benefits were considered over the life of the assets. This is not acknowledged at all in the Initial Proposal assessment.

Question 2: Do you agree with our proposed outputs levels in relation to risk removed (MPRS), and associated secondary deliverables (see also Appendix 7)?

Response

6.30 We do not agree that reducing the proposed output levels in relation to risk removed are to the benefit of customers. To put the proposed reduction in context, the level is equivalent to one of our networks not replacing any mains over the entire 8 years of the price control.

6.31 Our arguments in support of our Business Plan workload and associated outputs that would benefit customers are detailed in our response to the Initial Proposals - Supporting Document - Cost Efficiency, Chapter 8 question 1 to 3.

6.32 Notwithstanding our point that we do not agree with the output and workload reductions, the methodology to calculate the risk removed output in the Initial Proposals does not reflect the impact specific workload reductions will have across each of the 3 Tiers of the Iron Mains Replacement Programme.

6.33 The risk reductions proposed in Initial Proposals are significantly different across the 3 Tiers and therefore result in the requirement to adjust each Tier proportionately to the risk levels. We have detailed the revised output. In addition, we have provided the output levels based on moving the Tier 2 workload above the risk threshold to the revenue driver which supports Ofgem's and our view on managing this workload under a revenue driver.

6.34 From our calculation it can be seen that Ofgem's allowance will result in additional risk being carried forward into RIIO-GD2 and the associated benefits of replacement from iron mains, such as leakage and shrinkage opportunities will be lost. For National Grid the incidents removed level will reduce from 0.679 to 0.487 (26.9% reduction) for our networks.

6.35 If our replacement activity is reduced, the number of unplanned interruptions will be higher than we had forecast in our Business Plan. Therefore it is likely more customers will see disruption from these interruptions and again into the future when the main will need to be replaced prior to 2032. Through stakeholder engagement customers understood the need for completing the mains replacement programme and hence the requirement to be interrupted during these works. Customers also understood and shared the view that where possible they would value interruption once through replacement rather than twice;

(once through an unplanned repair interruption and then a subsequent time for a planned interruption to replace the mains). Our view is that our Business Plan balanced a number of customers, environmental and operational requirements over the short and long term, where Ofgem's proposals decrease the wider benefits identified in our plans.

Figure 7 - Mains Risk Removed Output commitments

5.1 - 5.3: Mains Risk Removed

April BP: Tier 1 - 3 Total Risk Removed (incidents per year)	RIIO-GD1								Tier 1-3 incidents removed
	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	
East Of England	*0.028*	*0.024*	*0.024*	*0.023*	*0.023*	*0.024*	*0.024*	*0.024*	0.194
London	*0.019*	*0.015*	*0.017*	*0.016*	*0.019*	*0.024*	*0.023*	*0.020*	0.153
North West	*0.026*	*0.025*	*0.024*	*0.023*	*0.023*	*0.022*	*0.022*	*0.022*	0.187
West Midlands	*0.019*	*0.019*	*0.018*	*0.018*	*0.018*	*0.018*	*0.018*	*0.018*	0.145
									0.679

Ofgem IPs: Tier 1 - 3 Total Risk Removed (incidents per year)	RIIO-GD1								Tier 1-3 incidents removed	*Change from Apr BP*	
	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21			
East Of England	*0.025*	*0.022*	*0.021*	*0.021*	*0.021*	*0.021*	*0.022*	*0.022*	0.176	-0.018	*-9%*
London	*0.015*	*0.013*	*0.014*	*0.013*	*0.015*	*0.019*	*0.019*	*0.017*	0.125	-0.028	*-18%*
North West	*0.021*	*0.020*	*0.019*	*0.018*	*0.018*	*0.018*	*0.017*	*0.017*	0.147	-0.040	*-21%*
West Midlands	*0.016*	*0.016*	*0.015*	*0.015*	*0.015*	*0.015*	*0.015*	*0.015*	0.122	-0.023	*-16%*
									0.570		

NGGD IP adjusted: Tier 1 - 3 Total Risk Removed (incidents per year)	RIIO-GD1								Tier 1-3 incidents removed	*Change from Apr BP*	
	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21			
East Of England	*0.025*	*0.022*	*0.021*	*0.021*	*0.021*	*0.021*	*0.022*	*0.022*	0.170	-0.024	*-13%*
London	*0.015*	*0.013*	*0.014*	*0.013*	*0.015*	*0.019*	*0.019*	*0.017*	0.083	-0.070	*-46%*
North West	*0.021*	*0.020*	*0.019*	*0.018*	*0.018*	*0.018*	*0.017*	*0.017*	0.122	-0.065	*-35%*
West Midlands	*0.016*	*0.016*	*0.015*	*0.015*	*0.015*	*0.015*	*0.015*	*0.015*	0.112	-0.033	*-23%*
									0.487		

NGGD IP adjusted: Tier 1 - 3 Total Risk Removed (incidents per year): Without Tier 2 above threshold	RIIO-GD1								Tier 1-3 incidents removed	*Change from Apr BP*	
	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21			
East Of England	*0.025*	*0.022*	*0.021*	*0.021*	*0.021*	*0.021*	*0.022*	*0.022*	0.169	-0.025	*-13%*
London	*0.015*	*0.013*	*0.014*	*0.013*	*0.015*	*0.019*	*0.019*	*0.017*	0.077	-0.076	*-50%*
North West	*0.021*	*0.020*	*0.019*	*0.018*	*0.018*	*0.018*	*0.017*	*0.017*	0.115	-0.072	*-38%*
West Midlands	*0.016*	*0.016*	*0.015*	*0.015*	*0.015*	*0.015*	*0.015*	*0.015*	0.108	-0.037	*-25%*
									0.469		

Question 3: Do you agree with our proposals in relation to the other primary safety outputs?

Response

6.36 We do not agree with the proposals for the Repair output measure baseline as the amendments do not reflect how this output is affected by the workload changes during a 1:20 peak winter condition.

6.37 Our emergency service is designed for a 1:20 peak winter condition and the repair risk output needs to be capable of being delivered should these conditions be experienced. Our closest approximation to a peak winter condition is the data from 2010/11 and our output measure contained this data set when determining an appropriate repair output commitment. Using 2011-12 as proposed by Ofgem which reflects a mild winter period would set an artificially low output commitment that networks are likely to fail should we experience a peak winter condition.

6.38 Our repair output proposal included a reduction in the level based on our Business Plan levels of mains replacement which is a valid assumption. However, these values are derived from the 2010/11 data which reflects our view of a peak winter condition.

6.39 Our proposal would be to either maintain our repair risk output level stated in our April 2012 plan for RIIO-GD1 or use a measure that reflects the reduction in iron mains

replacement volumes. We will have further debate with Ofgem should there be a need to have a measure that reflects the reductions driven from our iron mains replacement activity.

Question 4: Do you agree with our proposed approach to measuring performance in relation to safety risk (see Appendix 10)?

Response

6.40 We welcome that Ofgem have now set out their policy views on how the end of period assessment might work, which allows us to understand how additional benefits that are delivered for customers may be awarded.

6.41 Whilst the assessment method is clear for both safety, asset health and risk metrics, and asset load/capacity utilisation, we need to discus with Ofgem three points for clarification:

1. We assume the financial assessment will not apply to the 3 Tier iron mains replacement where we have an absolute standard in place. This would be a move away from the position in the consultation on strategy for the next gas distribution price control - RIIO-GD1 Overview paper published 17 December 2010:

   "4.12. We have not proposed financial incentive mechanisms for all output measures. For example, we have not proposed any financial incentives for the set of safety related outputs where absolute standards are in place and HSE is able to take enforcement action in the event of non-compliance. We do not consider that it is reasonable or necessary for us to impose an additional penalty. Equally, we do not think it is appropriate to reward companies for outperforming safety requirements".

2. The rationale for financially measuring secondary deliverables to determine whether a primary output has been met. For example, the primary output of peak demand for NTS Exit Capacity is already a key incentive and Ofgem have proposed a measure of performance against a secondary deliverable for the associated asset load / capacity utilisation secondary deliverable, which either applies a double reward or penalty; and

3. Discussions on developing a clear framework on how Ofgem will value the benefits associated with delivery of our outputs, given that in response to networks incentives it has not been possible to agree the value incentives would bring.

6.42 We are fully committed to the delivery of our primary outputs and therefore, as many of these are set at specific volumes or units of delivery rather than with a tolerance, we are likely to exceed the target rather than run the risk of falling below the required output commitment level. It is welcomed that, whilst in the main these will be marginal over delivery, networks will be rewarded where there are clear customer benefits.

6.43 We will work with Ofgem to agree how the end of period assessment will be defined and develop a clear framework on how to value any over delivery.

Chapter 7 - Reliability outputs

Question 1: Do you agree with our proposed reliability outputs, and secondary deliverables?

Response

7.1 In summary, we have the following comments on reliability outputs and secondary deliverables, with further detail provided below:

- Interruptions - We do not agree with Ofgem's amendments to interruptions and have provided our rationale below.
- Peak Day Demand - Prior to the Initial Proposals, we notified Ofgem that our NTS Exit Capacity Bookings would increase in GDPCR1 based on the latest analysis of peak demand across our networks and have provided the necessary updates that would form the basis of our peak demand requirements over the RIIO-GD1 period at constant volumes.
- Asset Health / risk metric - We support the need to establish measures that are more comparable across GDN's, however, we do not support a reduction in our Non Routine Maintenance Programme Costs where we have articulated the benefits to customers in maintaining our assets.

Interruption output

7.2 We do not support the amendments made to our interruption output measure related to planned and unplanned interruptions as we do not believe:

- That the changes to the replacement workloads are in the best interests of customers; and
- That the deterioration rates scaled for National Grid have been adjusted on the same basis as other networks.

7.3 We have detailed our arguments to support our Business Plan workloads in response to the Initial Proposals - Supporting Document - Cost Efficiency, Chapter 8 questions 1 to 3 for planned interruptions and Cost Efficiency Chapter 6 question 1 for unplanned interruption volumes.

7.4 Notwithstanding these workload and deterioration amendments, whilst Ofgem have scaled planned interruptions in line with the IP workloads we would have concerns over the calculation and allowances made for unplanned interruptions.

7.5 Across gas distribution companies the level of reliability for customers is currently at 99.99% reliability. We are committed to ensure customers can enjoy this level of reliability over RIIO-GD1 and in response to the December 2011 consultation we proposed an incentive to drive further improvements in network reliability. The proposed incentive was

not accepted by Ofgem as it was not viewed as in the interests of customers to further improve on these reliability levels, which we can accept.

7.6 However, the level of workload reductions proposed in the Initial Proposals have a greater impact on unplanned interruptions than Ofgem have proposed. The result of these changes are that Ofgem are requiring networks to accept a lower cost allowance together with a lower level of allowed interruptions. These would potentially result in failure to deliver against this primary output commitment, result in further GSOS payments than we currently experience, as well as setting an aggressive efficiency challenge on reducing interruptions that we can only proactively control through our mains and service replacement activities. We therefore believe any output commitment in relation to unplanned interruptions should be set on network's view of deterioration regardless of any proposed amendments to network's workloads, recognising that this will still result in networks maintaining or improving on the number of unplanned interruptions over the RIIO-GD1 period.

Peak Demand

7.7 In July 2012, we made our bookings for NTS Exit Capacity for winter 2013 and have revised our forecast demand in line with the latest information available to networks. We notified Ofgem in July 2012 (prior to the publication of the Initial Proposals) that we expected to have to increase our NTS bookings in light of new forecast information provided by our demand forecasting analysis.

7.8 We have submitted our amended peak demand requirements which reflect our 2013 bookings to Ofgem (provided as part of our Initial Proposals response). The forecast we have provided is consistent with Ofgem's methodology for setting NTS Exit Capacity volumes over the RIIO-GD1 period at constant volumes.

Asset Health / risk metric

7.9 We support the need to establish measures that are more comparable across GDN's. However, we do not support a reduction in our Non Routine Maintenance Programme Costs where we have articulated the benefits to customers in maintaining our assets.

7.10 We have detailed our arguments to support our Business Plan workloads in response to the Initial Proposals - Supporting Document - Cost Efficiency, Chapter 6 question 1.

Question 2: Do you agree with our proposed approach to measuring performance in relation to asset health and risk metrics, and asset load/capacity utilisation (see Appendix 10)?

Response

7.11 We welcome that Ofgem have now set out their policy views on how the end of period assessment might work, which allows us to understand how additional benefits that are delivered for customers may be awarded.

7.12 Whilst the assessment method is clear for both safety, asset health and risk metrics, and asset load/capacity utilisation, we need to discus with Ofgem three points for clarification:

1. We assume the financial assessment will not apply to the 3 Tier iron mains replacement where we have an absolute standard in place. This would be a move away from the position in the consultation on strategy for the next gas distribution price control - RIIO-GD1 Overview paper published 17 December 2010:

"4.12. We have not proposed financial incentive mechanisms for all output measures. For example, we have not proposed any financial incentives for the set of safety related outputs where absolute standards are in place and HSE is able to take enforcement action in the event of non-compliance. We do not consider that it is reasonable or necessary for us to impose an additional penalty. Equally, we do not think it is appropriate to reward companies for outperforming safety requirements".

2. The rationale for financially measuring secondary deliverables to determine whether a primary output has been met. For example, the primary output of peak demand for NTS Exit Capacity is already a key incentive and Ofgem have proposed a measure of performance against a secondary deliverable for the associated asset load / capacity utilisation secondary deliverable, which either applies a double reward or penalty; and

3. Discussions on developing a clear framework on how Ofgem will value the benefits associated with delivery of our outputs, given that in response to networks incentives it has not been possible to agree the value incentives would bring.

7.13 We are fully committed to the delivery of our primary outputs and therefore, as many of these are set at specific volumes or units of delivery rather than with a tolerance, we are likely to exceed the target rather than run the risk of falling below the required output commitment level. It is welcomed that, whilst in the main these will be marginal over delivery, networks will be rewarded where there are clear customer benefits.

7.14 We have noted that the proposal is for an end of period assessment for capacity / utilisation charts which currently is a leading indicator. Following Ofgem's policy guidance on primary and secondary (leading) outputs we will need to discuss whether Ofgem intend to define capacity / utilisation charts as primary output commitment. At present there is already a significant incentive of networks being able manage the peak demand primary output commitment in the most efficient way and it is not clear whether a further assessment is appropriate.

7.15 We will work with Ofgem to agree how the end of period assessment will be defined and develop a clear framework on how to value any over delivery.

Chapter 8 - Encouraging innovation

Question 3: We welcome your views on the proposed level of funding for the licensees' NIA, based on the quality and content of their innovation strategies.

Response

8.1 We do not believe that the level of NIA funding that Ofgem have proposed to award NGGD during RIIO-GD1 is sufficient. Given the scale of challenges that we face in the RIIO-GD1 period, and how we will need to evolve in response to them, there is an even greater need for an enhanced level of funding to be made available to all network companies. Innovation will have a significant role to play in delivering the efficiencies required during RIIO-GD1 and we are concerned that the level of funding proposed will limit the potential to develop our innovation portfolio to ultimately deliver benefits and value for money for our customers.

8.2 We set out a comprehensive innovation strategy in our April submission which reflected Ofgem feedback to be more clear on what we could achieve with an enhanced level of funding and specifically our business processes for prioritising Innovation during RIIO-GD1.

8.3 One of the two reasons stated for not awarding a higher level of funding, was that NGGD should have been specific about which stakeholders had been consulted and how. We clearly articulated when we have discussed innovation with our stakeholders through our Talking Networks process and we reflected this in both our November and April Business Plan submissions[2] - summarised below. More specifically, our Stakeholders state that Innovation is seen as a key enabler in ensuring we are operating efficiently and support the need for an innovation strategy making a case for the full 1% fund.

[2] www.talkingnetworksngd.com
- November Plan: Chapter 4 Our Stakeholder Requirements
- April Update: B1 Our Continued Stakeholder Engagement

Figure 8 - Detail of where Innovation was discussed with Stakeholders:

Engagement	Type	Focus	Facilitator	Attendees	Method
Stage 1 Nov 10 – Jan 11	Industry Forum (SBGI)	Safety & Reliability, **Innovation**, Uncertainty	NGGD utilising existing relationships	Supply Chain Partners	Workshop
Stage 3 Jun – Oct 11	Industry Forum (SBGI)	HSE review, **Innovation**	NGGD utilising existing relationships	Supply Chain Partners	Workshop
	Employee Engagement	**Innovation** & RIIO Outputs	NGGD	Employees	Brainstorming & open discussion
Post Submission Dec 11 – Apr 12	Regional Stakeholder Workshop (London)	Regional plans, including asset mgt, streetworks, **Innovation**, customer bills and developing regional relationships	NGGD	Various	Workshop
	Regional Stakeholder Workshop (EoE, NW and WM)	Regional plans, including asset mgt, streetworks, **Innovation**, customer bills and developing regional relationships	NGGD	Various	Workshop
	Mini Consultation	Regional plans, including streetworks, services to vulnerable customers, carbon monoxide, smart metering, asset management **Innovation** and financing our plan	n/a	n/a	On-line, face to face and email

8.4 The other reason cited for not awarding a higher level of funding was that we should have been more specific about potential customer benefits of chosen priority areas. Where specific projects have been identified, a detailed benefit analysis is carried out, which is then provided to Ofgem in the form of an annual report. For RIIO-GD1, although we know the areas of innovation we need to target, we have not determined specific projects for an 8 year period. Articulating potential benefits of project areas would be purely arbitrary, subject to significant uncertainty and, in a number of cases, customer benefits may not be realised until RIIO-GD2 once the innovation has been proven. We recognise that Ofgem need to be assured that NGGD will only progress with projects that deliver customer benefits and value for money however the NIA governance process should provide this assurance.

8.5 We do have concerns over the development of the NIA Governance document, in its current form there is not enough flexibility to encourage the scale of innovation needed over RIIO-GD1 and beyond. We have raised these concerns at the Innovation Working Group (IWG), responded formally to the NIA Governance consultation and the first licence drafting consultation. The following highlights our main areas of concern which we believe Ofgem have not yet addressed:

- Knowledge Transfer / Intellectual Property Rights (IPR) - Projects will be varied (e.g. range of participating parties / involvement of overseas partners) and a concern is that the requirements provide limited flexibility with regard to what can be agreed with others, particularly with regard to IPR. Furthermore, projects may be subject to other

funding/membership conditions which are unlikely to be consistent with the default requirements proposed. A deviation from these IPR requirements requires Ofgem agreement which could delay projects. Our view is that the IPR requirements should be less prescriptive with project participants simply being required to ensure that arrangements meet stated overarching objectives e.g. with regard to knowledge transfer.

- Transition from IFI to NIA - Our working assumption is that all current in flight IFI projects will continue during RIIO-GD1. However, issues such as registration process, IPR arrangements (set out above) and clear monetary benefit need to be addressed to ensure a smooth implementation in its current form, an exemption from NIA Governance would be required for some IFI projects.

- Registration - There are specific circumstances where Ofgem propose that licencees have to seek approval prior to the commencement of work via a registration process, which are analogous with a large number of IFI projects we have today. Bearing in mind the volume of projects that NGGD (and NGET) progress, this would result in a significantly onerous process. Additionally, the 'self governing' approach set out proposes that Ofgem will respond to written submissions within 20 days of receipt, which could be extended in the event that additional information is required. Such a process would incur costs associated with scoping out the work, with no guarantee that Ofgem would accept. Also there is a concern with the associated delay in project commencement and detrimental impact this will have on customers.

- Net Financial Benefit - One of the criteria set out in the NIA governance document is that projects should have the potential to deliver net financial benefits to gas/electricity customers. This is intrinsically difficult to assess for projects at a lower TRL level and we have concerns about the prescriptive approach to assessing value that Ofgem are proposing.

- Knowledge Sharing Process - Although we support the principle of sharing knowledge, the requirement to share information at registration, produce an annual report, provide real time update via a number of industry portals, submission of regulatory reporting pack returns and holding an annual conference seems overly bureaucratic. We think that a less administrative intensive and less costly approach should be adopted which would still facilitate an adequate level of knowledge sharing.

Question 2: In relation to funding the NIC for 2013-14, do you support either option 1 (run the NIC and raise the required funds from the winning licensees' customers) or option 2 (no NIC, but roll-over funds to 2014-15). If NIC is delayed beyond 2013-14, what option would you support?

Response

8.6 On the basis that the Gas Act does not currently allow implementation of NIC in the Gas Sector and therefore cannot be implemented until a change in Primary legislation is

progressed, we would support option 2, which would ensure the appropriate socialisation of costs across all consumers whilst maintaining the level of RIIO-GD1 funding.