National Grid House
Warwick Technology Park
Gallows Hill, Warwick
CV34 6DA

National Gas Emergency Service - 0800 111 999* (24hrs)
*calls will be recorded and may be monitored

Iqbal Hussain
Ofgem
9 Millbank
London
SW1P 3GE

Paul Rogers
Regulatory Frameworks
Manager

paul.s.rogers@nationalgrid.com
Direct tel +44 (0) 7775 821840
Direct fax +44 (0)1926 656520

www.nationalgrid.com

22 January 2013

Dear Iqbal,

Re: Statutory Consultation on modifications to the Gas Transporter Licence held by National Grid Gas plc (with respect to its retained distribution networks)

National Grid Gas Distribution (NGGD) is part of National Grid plc (National Grid) which owns and operates the high voltage electricity transmission system in England and Wales and operates the Scottish high voltage transmission system. National Grid also owns and operates the gas transmission system throughout Great Britain and through its gas distribution business transports gas in the heart of England to approximately 11 million customers. In addition National Grid owns and operates substantial electricity and gas assets in the United States.

In response to the Statutory Consultation on modifications to the Gas Transporter Licence held by National Grid Gas plc (with respect to its retained distribution networks), please find attached:-

Appendix 1 – Marked up version of National Grid Gas plc Gas Transporter Licence in respect of the RDNs (draft special conditions)
Appendix 2 – Word template showing other general comments against the Licence Conditions
Appendix 3, 4 and 5 – Word Templates of specific comments on the standard conditions, the standard special conditions in Part A and the standard special conditions in Part D.
Appendix 6 - Special Condition 4G Methodology for Network Output Measures

In addition, outlined below are a number of matters which NGGD consider are material and would like to highlight to Ofgem in order to ensure the Licence is fit for purpose for the 1st April 2013.

<u>Definition of Supply of Distribution Network Services</u>

We note that this definition has been omitted from the draft Licence. This definition is crucial to the operation of the price control conditions as it is the starting point for determining the activities which are the subject matter of the price control. As such, it is central to the working of the Transportation Revenue formula set out in Special Condition 1B Restriction of revenue in respect of the Distribution Network Transportation Activity and for establishing the difference between activities which fall within the price control and those which constitute excluded services.

It is unclear why this definition has been omitted and it should be re-inserted, because without it the price control will not work. As it stands, therefore, the drafting is wrong and will not achieve the aim of the Authority set out in Final Proposals. It should also be noted that a number of other definitions which are used in the present price control should be retained as the same concepts need to be defined in order to ensure the proper interpretation of the price control (or various elements within it) and these are highlighted in the accompanying documents.

<u>Calculation of Capitalisation Rate (Non Repex)</u>

The capitalisation rate for non repex categories of totex has been calculated using the allowances contained in the Price Control Financial Model (PCFM). The Capex and Opex allowances in the PCFM are different to the allowances stated in Appendix 8 of the Final Proposals Cost Efficiency Document (Pages 144-150). The allowances stated in Appendix 8 are consistent with all the supporting cost models we have been provided with. We understand through discussions with your finance team, that this is due to holder demolition costs being treated as capex within the PCFM and as opex in Appendix 8. The reason for the PCFM treatment is that this provides the correct tax treatment as demolition costs will be considered capex for tax purposes.

We agree with the tax treatment you have adopted, however conversations with your RIIO team indicate that they will continue to be opex costs for regulatory purposes and in addition the costs will feature as opex in our financial statements (and for all purposes other than tax). Demolition costs should therefore be treated as opex when calculating the capitalisation rates used in the PCFM. This treatment would then be consistent with Appendix 8 and the opex nature of demolition costs.

<u>Special Condition 1D NTS Exit Capacity Cost Adjustment and Allowances</u>

In relation to Special Condition 1D NTS Exit Capacity Cost Adjustment, we consider that the set level of the NTS Exit Allowances (AExt in Appendix 1) is too high. We have been made aware of similar concerns expressed by one of our stakeholders and in recognition of this we propose that these levels (and consequently the PUt terms in Appendix 1 of Special Condition 1B) be amended based on the exit cost levels consistent with the exit charges proposed by NG Transmission for application from April 2013.

<u>Special Condition 4G Methodology for Network Output Measures</u>

National Grid believes the proposed date of 31st March 2013 for a cross GDN consistent assessment of health, criticality and risk of each asset group is not achievable. We understand this is a commonly held view by all GDNs. We are absolutely committed to achieving Ofgem's goal of comparable health and risk assessment.

However, work to date has identified differences in approach that will require time to resolve. These differences arise across a number of key areas:

1. Factors used to determine health
2. Mechanism and weightings to convert these factors into a health score
3. Approach to deterioration, both rate and what the impact on health would be, as this is an entirely new framework
4. Factors used in assessing criticality
5. Likelihood of a failure resulting in the criticality being realised

6. ‘Scoring’ of criticality factors and mechanism to map from multiple criticality factors to a single rating
7. Data in terms of both quality and comparable completeness

For a number of asset groups the differences are relatively minor and we believe consistency will be achievable in the short term. However, there are assets where consideration needs to be given to data requirements, followed by the need for data gathering to achieve meaningful and comparable assessment. We have included further detail in Appendix 6 of our response and set out a revised timeline that could be used for the Licence Condition.

Special condition 1E Incentive adjustment in respect of the Broad Measure of Customer Satisfaction

Ofgem’s policy is that the Broad Customer measure is an incentive which allows companies to earn or be penalised up to +/-1% of allowed revenues. The licence drafting to enact this, contained in the tables within the Appendices of Licence Condition E1, shows a calculation of 1% of allowed revenues for each year. The tables however have been calculated solely from revenues expressed in an April 2009/10 price base and hence does not reflect the actual allowed revenues for each year in question. Hence given inflation and the potential for future revenue allowances through uncertainty mechanisms, in reality the licence drafting creates an incentive which is less than +/- 1% of revenues from year 2 onwards. The compound effect of this is a material difference as you progress through the RIIO period, the incentive being some £5m p.a. short of what a true 1% of revenues will be by 2017 (equating to a real incentive value of 0.8% of revenue).

We suggest that the most effective option in addressing this inconsistency with the policy is to modify the licence clause to define 1% of revenues with reference to the annual revenue figure derived from the financial model in each year. This would best reflect Ofgem’s intent, reflect the revenue allowances through the control and properly adjust for an increment or decrement in revenue through uncertainty mechanisms.

The following items, whilst not inaccurate also need to be addressed in order for the Licence to work effectively.

Licence Consents

NGGD currently holds a number of consents pursuant to National Grid Gas plc Gas Transporter Licence, some of which are due to expire on 31 March 2013.

We have evaluated all of our existing consents to determine whether they need to be retained or relinquished when RIIO and the revised Licence take effect from 1 April 2013. In addition we have examined the need for any new consents and at this stage do not believe any are required. We wrote to Ofgem on 8th October 2012 to understand its views and agree the process for reviewing and providing consents from 1 April 2013. Following James Grayburn’s response of 18 January, we look forward to addressing this issue with Ofgem as soon as reasonably practicable.

GD1 Price Control Financial Model and GD1 Finance Handbook

In Appendix Two, we have made a number of comments relating to the operation of the Model and the content of the Finance Handbook and would draw Ofgem’s attention to addressing these.

As you might expect, we are also still assessing the impact of the Final Proposals on our business plan before making a recommendation to the National Grid plc Board. Whilst the issues highlighted in this letter will form part of the assessment, the Board will also consider other issues with the package as a whole before making a decision on the Final Proposals.

Should you wish to discuss this response, please contact Ruth Thomas on 07768 173469 or ruth.thomas2@nationalgrid.com.

Yours sincerely,

[by email]

Paul Rogers
Regulatory Frameworks Manager
National Grid, UK Distribution

Cc
Thomas.Mackenzie@ofgem.gov.uk