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25 February 2016

Mr M Watson
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9 Millbank
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Dear Mick

Mid-period review
Response to points raised by British Gas and Citizens Advice

Further to the publication of the responses to the mid-period review, please see below our response to some of the points raised by British Gas and Citizens Advice.

1. RORE returns

British Gas and Citizens Advice have both commented on the RORE returns achieved by GDNs to date and the level of projected returns.

From an NGN perspective, our returns are not out of line with those expected for a frontier company. In addition, it is worth noting that the RORE measure does not capture the fact that in order to achieve our returns our shareholders have invested in a program of workforce change designed to:

- change our employee profile and increase the number of individuals on new efficient incentivised contracts;
- reduce our pension costs; and
- change the culture of our organisation.

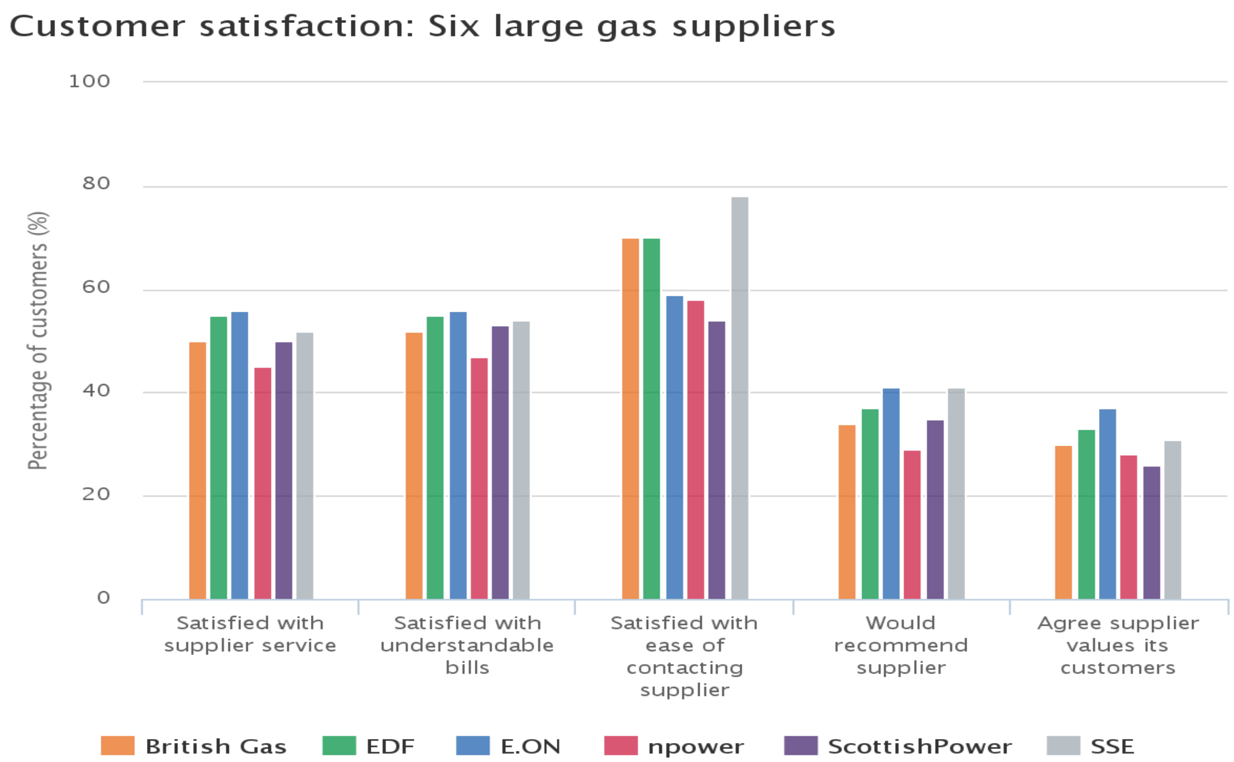
This investment by our shareholders has been instrumental in delivering our returns which, through the IQI mechanism, is benefiting customers.

2: Broad measure of customer satisfaction (“BMCS”)

British Gas have commented that the BMCS is failing customer needs by:
a. failing to provide value for money due to its asymmetric calibration; and
b. some elements are so inappropriately calibrated that they may provide signals to GDNs to worsen performance.

Response to 2a
Customer satisfaction
In order for a GDN not to be penalised for customer satisfaction they are required to achieve a score of around 8 or above. Generally, customer satisfaction scores of 8 or above are only achieved by companies who put a lot of effort into meeting their customer’s needs.

In addition, as evidence of how difficult it is to achieve good customer satisfaction scores in the utilities industry, the graphic below (which was recently published by Ofgem) shows the percentage of those customers who are satisfied with the big six gas suppliers.



Given the above, in our view, the fact that the majority of GDNs are achieving CSAT scores above Ofgem's target is proof, as a result of the outputs set by Ofgem, of the effort that is being placed on customer service within GDNs and not proof that the targets are too low.

Complaints metric

Ofgem's customer complaints metric is calculated based on the percentage of complaints which remain unresolved after 1 and 31 working days, the percentage of repeat complaints and the number of EO decisions that go against the GDN as a percentage of total complaints.

In order for a GDN not to be penalised for customer complaints, they are required to achieve a score of 11.57 or lower. Again, given the weightings set by Ofgem, this is a challenging target and a significant amount of effort is required to ensure it is achieved. In order to achieve this target within Northern Gas, we have implemented a number of measures, including the following:

- changing the culture of the organisation to be customer focused;
- the introduction of continual training and forums to share best practice;
- a target of resolving 90% of complaints in 60 minutes; and
- a call every morning with senior management to ensure any outstanding complaints have been dealt with 7 days a week, 365 days a year.

In addition, as GDN's CSAT scores improve the number of complaints they will receive will generally reduce. As a result, it will become more difficult to achieve the customer complaint target set by Ofgem, as a higher percentage of the complaints which remain will be difficult to resolve first time and within the required timescales.

Stakeholder Incentive

We note that British Gas have commented that customers would pay £77m towards the Stakeholder Incentive over the course of the RIIO GD1 price control even if performance levels did not improve on the level achieved in the very first year. However, as Ofgem clearly pointed out as part of the 2014/15 results, in order to achieve the same or a higher score than the previous year GDN's needed to demonstrate year on year improvement.

This can be evidence by the 2014/15 incentive payments made to NGN, EOE, Lon, NW and WM which were lower than those awarded in 13/14, not due to deteriorating performance, but due to the fact that they were deemed not to have improved on their 2013/14 performance.

Response to 2b
British Gas have commented that elements of the BMCS have been calibrated in a manner which has weakened the incentives on GDNs to deliver improvements over the duration of the price control and suggest that they may provide signals to GDNs to worsen performance.

In practice, it would be extremely difficult for a GDN to worsen their performance without risking penalty, as it is extremely difficult to ascertain the exact impact of the many measures GDN's have implemented to improve their overall customer service. In addition, the assertion made by British Gas is disproved by the evidence provided by the first two years of RIIO-GD1 and the year to date information available for 2015/16 which generally shows continual year on year improvement by the GDN's.

3: Exit capacity incentive

British Gas have commented that the exit capacity incentive:

a. **Gives incentives to book capacity at more expensive offtake points.**
b. **GDNs appear to have significantly changed their approach to delivering their 1 in 20 peak day obligation.**
c. **The use of forecast prices can create inappropriate incentive rates.**
d. **The incentive is delivering poor value for money for customers.**

Response to 3a
The point raised here by British Gas is reliant on GDNs being able to rebalance their exit capacity bookings across a region.

However, this is typically not possible as distribution networks within a region are not all connected and therefore GDNs can't simply decide which offtake site to use. For example, on our network, there are a number of large areas which are supplied by one off-take.

In addition, even in areas where it is possible to switch between off-take sites, British Gas have not considered the formal rules in the Uniform Network Code which place a number of restrictions on the timescales when you can ask for increases \ reductions in capacity and the length of time capacity must be held. Furthermore, based on the actual actions taken by GDNs to date, there is no evidence to support their argument.

Response to 3b
We note that British Gas have commented that NGN have "benefitted through the incentive by significantly changing their approach to delivering their 1 in 20 peak day obligation to rely more on flexibility capacity". However, this is not the case as all NGN have done is carry out a detailed review of offtake capacity levels and reduced bookings, which is in line with what the incentive is trying to encourage as it benefits customers.

Response to 3c
British Gas have stated that the forecast prices used can create inappropriate incentive rates. However, the use of a three year forecast is used to enable GDNs the time to take appropriate actions. In addition, from a customer's perspective, the risk highlighted is symmetrical as it could lead to lower or higher costs.

Response to 3d
British Gas have commented that NGGT revenue will be unaffected by reductions in exit capacity. However, any reductions in bookings will ultimately lead to lower costs for NGGT and hence customers as a result of reductions in future capacity investment.

4. Iron mains risk reduction programme

British Gas have commented that a there is a need for a review in order to examine whether the expenditure reductions brought about by the change in HSE policy are fully reflected in expenditure allowances.

The RIIO-GD1 revenues for iron mains risk reduction set by Ofgem were based on the HSE's revised approach to iron mains risk reduction and therefore fully reflect this change. As a result, given the HSE's decision not to change their approach in light of the robust evidence already provided by the GDNs, we see no reason to review the risk reduction output.

In addition, it should also be noted that the costs associated with the current iron mains reduction programme cannot be dealt with in isolation as they are delivering other benefits for customers, including lower costs due to improved network reliability as well as improved safety and environmental credentials.

If you wish to discuss any aspect of the above further, please let us know.

Yours sincerely

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