



Association of
Independent
Gas Transporters

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Rupika Madhura
Ofgem
9 Millbank
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Dear Rupika,

Re: Consultation on our minded-to position on the review of gas transporter agency (Xoserve) costs in RIIO GD1 and T1.

The AIGT welcomes the opportunity to respond to the above consultation. The AIGT¹ has participated in the majority of the FGO programme groups and has contributed towards the ongoing development of UNC0565. The impacts of FGO on IGTs are far reaching and will introduce a major change to the way IGTs interact with Xoserve as well as the way such services are funded.

The AIGT is concerned about a number of areas in Ofgem's minded to position, including:

- That the total allowances that Ofgem are proposing for the CDSP and that which the Xoserve Board have signed off against for the remainder of RIIO GD-1 differ, and will result in a shortfall of funding within the GT price control, meaning IGT allowances will not be fully reflective of the services we are required to fund;
- That Ofgem are using the draft cost allocation methodology submitted by the GDNs which has not been fully discussed or reviewed under the FGO programme. This incorrectly allocates future investment and NEXUS over run costs to IGTs and the methodology itself is subject to further development and agreement by affected parties; and
- That including Xoserve related costs for GTs as an allowance in the base revenues does not appropriately balance control and risk to CDSP costs for IGTs. This is as IGTs will have limited input to the way the CDSP is run and governed and any CDSP overspend that is allocated to IGTs will be unrecoverable.

We provide our full thoughts and reasoning for this in Appendix 1 and would welcome the opportunity to discuss the issues raised in this letter further at a mutually convenient date and time.

Yours sincerely

John Barrett
Secretary, Association of Independent Gas Transporters

¹ * **AIGT members are:** Energetics Ltd, Energy Assets Pipelines Ltd, ESP Connections Ltd, E.S.Pipelines Ltd, ESP Networks Ltd, ESP Pipelines Ltd, Fulcrum Pipelines Ltd, GTC Pipelines Ltd, Independent Pipelines Ltd and Indigo Pipelines Ltd.

Appendix 1

Ofgem ask whether parties agree with the two minded to decision on items "one" and "two"; we provide our views on these in turn as follows:

Ofgem Item 1:

"Revise the total allowed expenditure for GTs for Xoserve costs for the RIIO GD1/T1 period from £600 million to £485 million (in 2014/15 price terms). The methodology we have used to arrive at these numbers is included in Annex 2, which also explains how we have allocated the expenditure between GTs".

The AIGT holds two main concerns regarding Item 1:

- i. That the total allowances differ significantly between what Ofgem are proposing for the remainder of RIIO GD-1 and that which the Xoserve Board have approved for the same time period; and
- ii. That Ofgem are using the cost allocation methodology that underpinned the GDN CAT submission for the purposes of amending the GDN allowance which was made as a draft submission, and was to be further refined by the FGO programme to ensure the robustness of the values as more information became available.

With regards to point one above, we are extremely concerned that the Xoserve Board have approved budgets for 2016 to 2021 that differ significantly to the allowances set out in the RRP submissions. There is a genuine risk that should the Xoserve budget, as approved by the Xoserve Board, exceed that which has been allowed for under the relevant price control, that parties will not have the relevant funding for such activities. Furthermore, such costs will not be recoverable should Ofgem implement it's minded to position of treating CDSP costs as an allowance within the base revenues rather than pass through costs. We would ask that Ofgem investigate this discrepancy with the Xoserve Board as a matter of urgency before any decision is made on the level of changes to the GDN allowances. We believe that Ofgem have the responsibility to ensure the accuracy of these submissions and values before it can pass them on to the Industry to fund within the price control.

Regarding point two above, we understand that the CAT submission made by the GDNs in January was a draft submission and was underpinned by a draft cost allocation methodology. We are concerned that Ofgem's proposed reductions in the GDN allowances are based on an inaccurate draft cost allocation methodology which has not been fully discussed with all affected parties. This concern was raised in the Cost and Allocation sub-group many months ago, and clarity should have been provided by Xoserve; however, to date we are still awaiting updated numbers.. The AIGT specifically raised this concern in our previous letter to Ofgem dated 27th May 2016 where it was stated:

"the CDSP Strategic and future investment costs as part of the GT submission had no formal discussion under the FGO programme with Xoserve deciding how costs should be smeared across the industry. This was of particular concern to IGTs (with IGTs being allocated a share of NEXUS overspend and business debt) with an AIGT member writing to Ofgem to voice concerns over the approach on January 28th 2016".

We are disappointed that Ofgem are proposing to amend the GDN allowances on a methodology that has not been fully developed by Xoserve and the FGO groups, agreed by all impacted parties, especially as this has the potential to negatively impact IGT allowances. This is extremely concerning as the very foundations on which FGO is to be based will not be made in the co-operative manner that Ofgem seek to achieve. The result of the current proposals will be that parties will contribute towards the costs of services that they are not fully funded for, in turn creating cross subsidies between industry parties and will not create a level playing field for all parties. This could create an environment where smaller companies are put at a distinct competitive disadvantage if they are not able to recover costs over which they have no control. We strongly urge Ofgem to await confirmation of the final cost allocation methodology from Xoserve and the FGO programme before deciding how the amounts of the GDN allowances should be amended.

Ofgem Item 2:

"Continue to include Xoserve related costs for GTs as an allowance in the base revenues for remainder of RIIO GD1 and T1".

The AIGT is concerned that the Shipper parties which requested the changes to the way Xoserve operate are not impacted by Ofgem's minded to position in so much that they are able to pass any unforeseen or additional costs onto end users. From an IGT perspective, we will gain very little under FGO yet take on a far greater risk to cost exposure. This issue is amplified by Ofgem's minded to position as any additional costs that are imposed on IGTs will not be recoverable.

The fundamental issue at stake is the balance of risk and control and the imbalance the current minded to position creates. IGTs in particular will not have much influence in how the CDSP is run. We are currently lobbying for a separate IGT voting constituency from the GDNs for CDSP contractual matters, but this is far from agreed.

Coupled to the above point, FGO through collective funding means that any liabilities that arise from the actions of the CDSP will need to be recovered from CDSP users themselves. We feel that this places an unacceptable level of financial risk on IGTs should we not be able to recover such costs through our price control. As such, we are of the view that a pass-through mechanism is the only way to offset such risks.

We note Ofgem's concerns – "Our minded to decision has been influenced by events that have developed since we concluded on our review of FGO in October 2013, principally, the delays in the industry led project to establish cooperative governance model for Xoserve as per our FGO review and delays in delivery of project Nexus. This has reduced our confidence in the industry being able to adapt swiftly to joint-working and shared responsibility to govern Xoserve costs. We are concerned that treating Xoserve's costs as "stand alone" and as such pass-through would not provide the proper checks and balances that need to be in place to protect consumers from inefficient, uncontrolled costs being incurred."

Although we appreciate Ofgem's view, to constrain the GDN price control and consequent IGT allowance would effectively only penalise two segments of a much wider industry. As the FGO programme will fundamentally change the way in which the industry operates, the time required to implement does not fall on one constituency or another and is something that has

to be developed collaboratively and comprehensively in order to meet the requirements of all constituencies. Whilst we do agree that there have been delays in other programmes, and the cause of those delays can be debated, we do not believe this minded to position creates the correct balance to establish a co-operative framework for the running of the CDSP. We are of the view that this approach will create an imbalance on how costs are apportioned to the users of the CDSP. In a broader sense, it could even inhibit the support from industry parties for future projects if they feel that they could be put at a disadvantage over things in which they have little overall control.

With regards to the Relative Price Control, we believe that the arrangements which are referenced in this document have benefits for customers, not only IGTs. Your point – *"We recognise that in this instance our decision to reduce the price control revenue for GTs would result in a reduction in the revenue iGTs can recover from their consumers but on balance, we believe the effect of this re-opener on iGTs costs is manageable given that in other instances iGTs have gained from the increase in the revenues GTs can recover (for example on recent decision on the enhanced physical site security uncertainty mechanism)."* – seems to characterise all IGTs as having gained financially from a previous Ofgem decision, which may not be the case where some IGTs have different business models and customer bases. We, and the wider industry, have always believed that Ofgem decisions are made on the individual merits of the issue at hand; this rationale seems to go against that understanding. We do not support treating these costs, or anything in the future, as an allowance which could negatively affect our financial positions on the basis of a potential gain from a previous decision; all decisions should have a clear set of facts and detail on which the decision is based.

IGT charges have generally been constrained by the RPC cap and IGT charges have consequently been lower than those of the GDNs. We would also like to comment that any possible "reset" of the price control arrangements will have a minimal impact on existing connections if constrained by the RPC cap as only new connections made post this arrangement would enter RPC at the equivalent GDN charging level. We therefore believe that a pass through mechanism should be allowed within the GDN price control to ensure, subject to the RPC cap, that IGTs can finance the activities they are required to fund.