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7th July 2016

Review of Gas Transporter Agency (Xoserve) Costs in RIIO GD1 and T1

Dear Rupika,

Wales & West Utilities (WWU) is a licensed Gas Distribution Network (GDN) providing gas transportation services for all major shippers in the UK. We cover 1/6th of the UK land mass and transport gas to over 2.5 million supply points.

Thank you for the opportunity to comment on your minded-to position on the review of gas transporter agency (Xoserve) costs in RIIO GD1 and T1. WWU has been engaged throughout the process at both FGO POB (Funding Governance and Overview Programme Overview Board) and supporting workgroups. We have also participated in the submission process culminating in the return made by Xoserve in January 2016. The "minded to" document detailed decisions on two specific points. Our responses to these are set out below.

In summary our views are:

- 1) The forecast costs in the January 2016 Xoserve cost allocation submission should be used for future industry allowances rather than the Xoserve 2015 RRP forecasts. The January 2016 submission costs provide a complete industry view with a more up to date view of efficient costs going forward.
- 2) The cost apportionment between industry groups (including Transmission and Distribution) must be based on the latest view being developed by the UNC modification 0565 workgroup as these are based on a post Nexus view of services rather than the pre-Nexus approach that had to be used for the January 2016 submission. At January 2016 there was not an agreed and robust post-Nexus view of cost attribution to industry parties. Use of an out of date apportionment methodology could result in a material shortfall of efficient cost allowance for WWU and other gas distribution companies.
- 3) If we, as a gas distribution network are to receive allowances for Xoserve funding (as opposed to a "pass through allowance") then an uncertainty mechanism needs to be put in place to recognise the potential material risk of changes to costs due to factors outside of our sole control.

The remainder of this response provides the detail to support our position.

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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 Ofgem minded to position has been arrived at using three specific inputs. We respond to each input as below:

1. Include the efficiently incurred costs in delivering the FGO programme.

- a. WWU supports the ability to recover the costs incurred in delivering the programme of FGO, as intended. This should include both the programme and legal costs incurred by the GTs as well as efficiently incurred Xoserve costs such as the costs of appointing non-GT directors which are reported as £1.8M in the January 2016 submission.

2. Use the forecast cost base as reported in the July 2015 RRP.

- a. The submission made in January 2016 reflected the latest and updated view of forecast future costs and resulted in variation to forecasts set out in previous Xoserve RRP returns. It is our opinion that the January 2016 submission reflects a more reliable forecast, using up to date information and consequently should be used as a basis for future industry cost allowances. In addition, the January 2016 submission includes £6.7M of expenditure relating to projects with a value under £0.5M for which there was no reporting line in the Xoserve RRP submissions templates. We therefore believe that it is more appropriate to use the costs in the January 2016 submission than those in the 2015 RRP. The Xoserve response to your "Minded to document" provides further information on the variances between previous RRP returns and the January 2016 submission.

3. Allocate charges to the constituency groups; and between the networks, based on the apportionment methodology set out in the January 2016 cost submission.

- a. The January submission apportioned costs based on the Pre Nexus service lines and the supporting costs in delivery of those services. Post Nexus go live, there is a potential for services to be delivered in a way that attracts a different cost apportionment. This may result in costs being born by the networks which would not be a fair reflection of an under/over spend, but merely reflect the Post Nexus distribution of costs rather than changes in Xoserve efficiency.
- b. It is our view therefore that allowances must reflect the cost apportionment in a Post Nexus delivery scenario. Work is currently being finalised within the Industry Cost Allocation sub workgroup to MOD565.
- c. Xoserve has reviewed the percentage shares of Transmission and Distribution Network funding of the CDSP and their application to forecast costs as set out in Tables 4 and 5 of the consultation letter, and have compared these to the percentage shares included in the January 2016 submission. Xoserve estimate that the approach adopted by Ofgem understates the proposed gas distribution networks' allowances for the four year period from April 2017 to March 2021 by

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£3.9M. This discrepancy would have a material and unacceptable impact on WWU and needs to be changed.

Continue to include Xoserve related costs for GTs as an allowance in the base revenues for remainder of RII0 GD1 and T1.

The FGO model seeks to provide all users of Xoserve services with the ability to manage the delivery of such services. As such the gas networks have given up an element of the control with the move to the FGO shared co-operative model. We are supportive of the co-operative model but this model increases the risk that cost increases will have to be borne by Xoserve and funded by the networks without having the ability to fully control or fund such costs. We note that the Ofgem minded to position is not consistent with the cost pass through treatment outlined in previous FGO models discussed through the FGO workgroups.

Cost Pass through is an appropriate mechanism to fund uncontrollable costs, however we recognise that moving to a full pass through arrangement may reduce the incentive on Xoserve to manage costs. On balance, where Xoserve has an appropriate cost allowance with sufficient control, WWU agrees with Ofgem that allowances should be set within totex for the rest of the GD1 period in order to maintain sufficient incentives to appropriately manage costs within its control.

As highlighted above, we have key concerns with the Ofgem minded to position on cost allowances and these must be addressed before we could accept funding via the existing totex mechanism.

Xoserve may, in future incur additional cost due to:

- the provision of new services, (for example owing to the implementation of modifications to the Uniform Network Code, Supply Point Administration Agreement, Smart Energy Code or other industry change)
- changes in levels of services required by other constituency members, but to which an element of the cost will be levied upon networks as a shared user of such services.

In these cases Ofgem must provide an uncertainty mechanism to allow Xoserve to recover efficiently incurred costs to deliver the services required. This process should be instituted at level of materiality appropriate to Xoserve's cost base and also noting that this would reflect networks' loss of control over the end to end budget process.

If you would like to discuss any aspect of this response, please do not hesitate to contact me.

Yours sincerely,



Steve Edwards
Director of Regulation and Commercial
Wales & West Utilities

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