Review of Competition in Gas and Electricity Connections

National Grid Gas Response to the Consultation (Ref: 159/06)

Introduction

This response is on behalf of National Grid Gas’s UK Distribution business. National Grid’s Transmission business may issue a separate response on issues raised of relevance to transmission connections.

As a gas transporter, National Grid Gas has a duty under section 9 of the Gas Act 1986 (as amended) to comply as far is reasonably economical to do so with any reasonable request to connect and under section 10 we are required to connect premises within 23 metres of a relevant main and to connect self lay pipes. Standard condition 4B: Connection Charges, of the Gas Transporter licence provides for the requirement to have a charging methodology for connections to the system and the duty to provide the first 10 metres of a connection in the public highway free of charge to domestic customers (the Domestic Load Connection Allowance, DLCA).

National Grid Gas Distribution (NGGD) has improved its connections service and continues to actively support competition in the gas connections market. The Connections Industry Review 2005/06 report shows that currently over 70% of new housing connections are provided by Independent Gas Transporters (IGTs) with nearly half of the physical works on these networks being performed by Independent Connection Providers (ICPs).

We believe that competition in connections should be encouraged to ensure customers have a genuine choice in the market, with NGGD providing a true supplier of last resort service, consistent with its obligations. In order to achieve this position, we consider that the current statutory framework would need to be changed but recognise the difficulties in addressing the constraints created by the street works regime. Whilst we believe that from an economic perspective removal of the DLCA would be desirable to remove a cross subsidy which distorts the market place and is an anomalous feature unique in utility service connections; taken in isolation its removal would not be sufficient to stimulate competition in one off domestic connections. Hence, the main impact of such a proposal would be to increase the charge to domestic customers for connecting to the gas network. We believe that when viewed from a public policy perspective, the possible consequential reduction in domestic consumer requests for gas connections would not support Great Britain in meeting its fuel poverty and environmental objectives.
We currently see little benefit for consumers from offering diversionary works on a competitive basis, as the costs that could be incurred in both developing and supporting competition in diversions could be significant in comparison to the benefits. We believe that it would be prudent for Ofgem to carefully examine the demand from industry for competition in diversions and weigh this against the potential benefits to the consumer before any further work is undertaken. Should competition in diversions be introduced it will be important to maintain a “level playing field” by ensuring that those choosing this route meet the additional costs efficiently incurred by the GDN.
Responses to Individual Questions Raised

This section details NGGD’s views on the questions raised by Ofgem in the consultation. Our response is confined to the questions raised within chapter 2 - Gas Connections Issues.

One-off Gas Connections

Question 1: If the 10 metre subsidy were removed, would ICPs offer one-off gas connections to customers as an effective alternative to a GDN?

The Gas Transporter’s licence requires that the first ten metres of pipe laid in the public highway as part of a standard domestic connection is provided free of charge and recovered through the transportation charges levied on all customers. As ICPs do not have wider regulatory responsibilities, they are unable to offer the Domestic Load Connection allowance (DLCA) and therefore are unable to compete with the connection charges offered by GDNs.

We believe that removing the DLCA and the related Gas Act duty (sections 9 & 10) to provide a connection may encourage more competition in gas connections. Furthermore it would remove a distortion in the market where domestic consumers requiring a connection receive a cross subsidy from existing gas consumers and therefore do not face the full cost of provision of the service. So far as we are aware such allowances do not feature in either water or electricity connections and are therefore unique to the gas market. However, removal of these barriers in isolation would have a limited affect on competition, as the impact of the New Roads & Street Works Act 1991 (NRSWA), the Town and Country Planning Order\(^1\), geographic dispersal (i.e. high travelling cost) of the work and low unit value would discourage competition other than at the margins.

Furthermore, from a public policy perspective, viewed in the light of fuel poverty and environmental benefits of gas (over other higher carbon energy sources), it may be unacceptable to remove the DLCA. We estimate that the removal of the DLCA would more than double (i.e. add an additional £800 to £1000) the cost of new domestic connection consumers.

Ofgem have previously suggested amending the ten metre rule to facilitate competition by replacing the 10 metre allowance with a fixed sum allowance or a job specific allowance for the relevant connection (both would be available to ICPs):

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\(^1\) The Town and Country Planning Order 1995 permits development, such as the installation of mains, pipes or other apparatus, to be undertaken by a gas transporter for its undertakings (Part 17 Class F). When a third party company undertakes the works for an owner or occupier of a premise then this subsection does not apply.
• Providing a fixed allowance to all connection service providers would be administratively easier to manage than a job specific allowance, but would not be without cost to the GT. Moreover, whilst it may encourage some competitive activity, without an actively monitored universal service obligation to all participants, it would encourage cherry picking of the most valuable customers, which ultimately would lead to higher costs to remaining customers. The benefits would therefore be largely captured by ICPs and a limited number of customers, but not by the majority.

• The same issues arise in relation to a job specific allowance as for a fixed allowance, but would lead to still higher prices, as the GT would incur costs from administering a significantly more complex connections process, as the GT would have to verify and calculate job specific allowances and audit compliance to ensure accurate claims were being submitted.

Our experience in the domestic one-off sector is that competition has not developed and is unlikely to do so in the foreseeable future, as the barriers already mentioned combine to discourage entry into the market by ICPs. Until these issues are addressed as a whole, we conclude that there is limited merit in removing or amending the ten metre subsidy to facilitate further competition in one-off gas connections.

**Question 2: What steps should be taken to address the constraints of the street works regime on extending competition into this area of connections works?**

NRSWA is probably the most significant barrier to introducing competition in domestic one-off gas connections, as ICPs incur additional costs and longer lead times by having to obtain licences to carry out works on streets that are not applicable to statutory undertakers.

Removal of this statutory barrier is essential to opening up the connections market and we understand that Ofgem has previously raised these issues in the past with the Department for Transport but to no effect. Government and Local Government policy in respect of congestion due to road works, as exemplified by the Traffic Management Act (TMA), is unlikely to support any proposals to relax existing planning restrictions. We therefore recognise that these legislative constraints are unlikely to be addressed directly in the foreseeable future, although the additional powers conferred on Highway Authorities under the TMA in relation to permitry may act in some respects to remove some of the advantages currently enjoyed by GDNs.
Question 3: What are the impacts and costs on GDNs arising from opening domestic one-offs to competition?

Unless the NRSWA issues can be addressed, we believe there is little chance of creating effective competition in one-off connections and hence do not anticipate significant impacts or costs. To the extent that competition is created it is anticipated that any new entrants would select the easier and higher value connections; leaving the GDNs to carry out the difficult and more expensive connections. As a result GDN contractor costs are likely to rise causing an increase in the cost of one-off gas connections to the remaining customers.

Gas Diversions

Question 1: What is the level of demand for competitive gas diversionary works and do third parties currently exist with the necessary skills to offer these works on a competitive basis?

Diversions for specific major national projects such as the Channel Tunnel Rail Link have been carried out by third parties under statutory powers (The Channel Tunnel Rail Link Act 1996), in conjunction with GDNs. In general however, diversions fundamentally differ from connections and (specific) reinforcement in that the diversions are undertaken on the main pipeline system, needing careful management to ensure existing customers remain unaffected by the process of tying-in and commissioning the new mains and decommissioning the old. In addition, as diversions involve working on the existing pipeline system the GDN will continue to have significant involvement to ensure customers are not adversely affected by the activity to reconnect. This was demonstrated by our involvement during the recent Channel Tunnel Rail Link works. Clearly the costs of involving two parties in the process will reduce any savings that might result from competition. Conversely, a connection is driven by and impacts a single customer, rather than the local network.

Whilst opening diversions to competition may provide some benefits to some customers (specifically where a diversion and new connection are being conducted at the same time), we believe there is little demand for such work.

Question 2: What process, operational and commercial changes would be required to develop a framework that supports competitive gas diversionary works?

Processes and contracts would need to be developed to enable GDNs and third parties to work together effectively and determine the liabilities in the event that gas consumers are affected adversely by the work. In order to ensure these processes work effectively, the GDN would need to resource the activity adequately and this could only be justified economically if there
were sufficient demand for such services. Developing processes to facilitate little competitive
diversionary work would be uneconomic and inefficient. It is therefore imperative that verifiable
demand for the service is identified and those third parties requiring such services defray the full
costs of developing and supporting diversion work.

There are no additional benefits in terms of co-ordination of works between highway authorities
and utilities as these are already in place through existing statutory requirements and
processes. As diversions can involve a number of utilities in the same location, it is usual
practice to phase the works to avoid disruption on site and lay apparatus in accordance with
National Joint Utilities Group (NJUG) guidelines.

**Question 3: What are the potential risks and costs associated with developing
arrangements to support competitive diversionary works?**

The GDN will continue to have a significant involvement in any competitive diversionary works
to ensure customers are not adversely affected and we expect that this will result in additional
administration costs.

Consideration should also be given to the impact on the following related processes:

- **Betterment** - on occasion the gas transporter may increase the scope of works at his
  own cost to facilitate load growth into the future, i.e. increase mains diameter to provide
  further capacity. This is an economic way to develop the system and the gas
  transporter will be able to calculate the amount they can invest against their own
  contractor rates. A third party may not be able to undertake the extra works at the
  marginal cost increase that the gas transporter would be willing to fund economically
  and therefore the opportunity to develop the system would be lost or could increase the
  cost to the overall development of the network.

- **NRSWA Cost sharing and deferment of renewal allowances** - where an authority is
  acting in its capacity as a Highway, Bridge or Transport Authority as appropriate then a
  allowance\(^2\), may be applicable by the gas transporter. This allowance would not be
  applicable between a third party and the authority, thus affecting the ability to make this
  a fully competitive activity.

The cost of developing these arrangements to facilitate competitive diversionary works could
therefore be considerable and should be weighed against the demand for the service and the
benefit of all customers on Distribution Networks.

\(^2\) Allowance such as, up to 18% of the allowable costs dependant on work type and the authority meeting
required payment schedules (Cost Sharing principle) and deferment of renewal,
Question 4: Will specific accreditation arrangements be required to support competition in this respect?

In support of competitive connections the Gas Industry Registration Scheme (GIRS) was introduced in 2002. The scheme provides an industry recognised list of accredited ICP’s in the design, construction, commissioning and connection of mains and services and ensures ICP works for adoption by National Grid meet ‘fit for purpose’ criteria. We would expect that GIRS could be extended to cover diversions, if there is sufficient demand for this work.

Conclusion

We believe that removing the 10 metre subsidy in isolation will not be enough to encourage ICPs to offer one-off gas connections to customers as an effective alternative to a GDN and that its removal would not benefit domestic consumers as the advantages of competition would not outweigh the loss of the subsidy. We believe that although domestic consumers should retain the ability to choose a service provider, meaningful competition is unlikely to develop in this market in the foreseeable future, as barriers such as NRSWA will continue to discourage entry into the market by ICPs.

We also believe that there is little demand for competitive diversionary works. We currently see little benefit for consumers and the costs that could be incurred in both developing and supporting competition in diversions could be significant in comparison to the benefits.