Review of Competition in Gas and Electricity Connections
(“the Review”)

National Grid Gas Response to the Open Consultation Letter

Introduction

This response is on behalf of National Grid’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 have a duty 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 Distribution believes that it has worked hard to improve connections performance and been proactive in facilitating competition in the gas connections market. New and revised standards of service for gas transporters were introduced 1 May 2005 and payments are made to end consumers if we fail to meet the specified service levels. We actively promote the importance of meeting customer commitments in respect of overall and guaranteed standards in connections activities and have ensured that standards of service processes are consistent and robust. In terms of competition in the gas connections market, over 70% of new domestic connections are provided by Independent Gas Transporters (IGTs) with Independent Connection Providers (ICPs) performing nearly half of all these gas connections.

We believe that competition in connections should be encouraged to ensure customers have a genuine choice in the market and National Grid Distribution provides a true supplier of last resort service, consistent with its obligations. However, in order to achieve this position, we believe that the current statutory framework would need to be changed. Until this can be done it is important to recognise the limitation this framework places on the market and the transporter and seek incremental improvements where competition can develop, but regulate to protect customers where it cannot.
We believe there is scope to continue to develop competition in the new housing and non domestic sectors and within this response we will set out our views of what we can do to facilitate this. In the domestic and small non-domestic sectors we believe a combination of statutory barriers and low margins will ensure this effectively remains a monopoly activity for the foreseeable future. As such, the regulatory regime should reflect these realities and be constructed in a manner that best ensures customers are protected.

Responses to Individual Questions Raised

This section details National Grid Distribution’s views on the questions raised by Ofgem in the open consultation letter.

1. Which of the issues raised in the attached appendices should be covered by the Review?

The Domestic Load Connection Allowance (DLCA)

As noted above, 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. Ofgem highlight that as ICPs are not subject to a price control, they are unable to offer the DLCA (recover the costs) and therefore are unable to compete with the connection charges offered by GTs. In its April 2003 consultation (Competition in one-off gas connections), Ofgem suggested amending the ten metre rule to facilitate competition by:

- Removal of the ten metre allowance; or
- Replacement of the 10 metre allowance with a fixed sum allowance or a job specific allowance for the relevant connection (both would be available to ICPs).

National Grid Distribution believes removing the Gas Act duty (sections 9 & 10) to provide a connection and removing the DLCA may encourage further competition in gas connections. However, removal of these barriers in isolation would have a limited affect, as the impact of the New Roads & Streetworks Act (NRSWA), geographic dispersal (i.e. high cost) of the work and low unit value would discourage competition other than at the margins. Of these, NRSWA is probably the most significant barrier, as ICPs incur additional costs and longer lead times by having to obtain permits to carry out works on the highway, that are not applicable to licenced utilities. Government and Local Government policy in respect of congestion due to road works, as demonstrated by the Traffic Management Act, is unlikely to support any proposals to relax existing planning restrictions.
Furthermore, from a public policy perspective, viewed through the prism of fuel poverty and environmental benefits of gas (over other carbon energy sources), it may be unacceptable to remove the DLCA. National Grid estimates that the removal of the DLCA could more than double (additional £700) the cost to potential new domestic connection consumers.

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.

Given the above issues, UK Distribution concludes that there is limited merit in amending the ten metre rule to facilitate further competition in one-off gas connections.

**Infills**

Ofgem invite views on how the provision of infill connections (existing domestic premises, in existence for not less than 6 months, and which have not previously received a supply of natural gas) could be encouraged and how competition could be developed. Currently GTs can charge an additional 10p/therm for no more than 20 years in transportation charges to properties that have been connected as part of an infill project. National Grid Distribution responds to all formal requests for infills, but in 2005 the uptake was very low with only 16 connections (2 infills) carried out at a cost of £21,000.

As part of its approach to fuel poverty National Grid Distribution is also actively involved in the Affordable Warmth Programme (AWP) that may involve a new one-off domestic connection or an infill. The AWP consists of seconded National Grid staff and aims to promote heat leasing, “warm zones”, community based mains gas extensions and renewable technologies to fuel poor communities not connected to the gas network.
National Grid Distribution would therefore welcome the opportunity to work with Ofgem, the DTI and industry to assess how we can best provide more infill connections. For example, by exploring funding for investment in feeder mains, that could provide infrastructure for GTS to connect local communities or obtain funding as participants in any government backed regeneration/fuel poverty scheme.

**Diversions**

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 GT will continue to have significant involvement to ensure customers are not adversely affected by the activity to re-connect. 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, we believe there is little demand for such work. Processes and contracts would need to be developed to enable GTs and third parties to work together effectively and determine the liabilities in the unlikely event that other customers should be affected by the work. The cost of developing these arrangements to facilitate an economic framework should be weighed against the demand for the service and the benefit of all customers on Distribution Networks.

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 plant in accordance with National Joint Utilities Group (NJUG) guidelines.

As currently we see little benefit for consumers in comparison to the potential higher costs that could be incurred in both developing and supporting competition in diversions, we believe that it would be prudent to examine both the demand from industry for competition and the costs of putting a commercial and safe regime in place prior to conducting any work to facilitate competition in diversions.
2. **Should the Review focus on the facilitation of competition in connections or improving service to connections customers via more regulation?**

National Grid Distribution believes that where effective competition exists or is developing successfully, regulatory obligations should be removed or minimised. Where effective competition is not practical and the prospect of the removal of barriers to competition is limited, then appropriate obligations and incentives should be used to protect customers and facilitate a good customer experience. Except on a defined transitional basis, mixing competition with regulatory obligations should be avoided as the inherent distortions lead to cherry picking and market failure.

We believe that in the gas connections market regulatory controls and mechanisms to protect customers and facilitate competition are sufficient.

Gas Act obligations place a duty on GTs to connect and not to unduly discriminate between customers. Domestic customers are further protected from the full cost of connection by the DLCA. In the provision of a connection all customers are protected by a comprehensive range of overall, licence and guaranteed standards of service. Where any of these obligations fail to be met, Ofgem has powers to take enforcement action under the Gas Act. We therefore do not believe that more regulation is warranted.

We conclude that the review would best be served by examining mechanisms to enhance competition, where there is a clear benefit to customers using the principle outlined in the first paragraph of this section.

**Standards of Service**

Where effective competition exists we feel it is appropriate to remove standards of service on relevant connections activities and this is an area where Ofgem can exercise regulatory control with some flexibility. Where the competition has not yet developed, such as domestic one-off connections, then standards of service should continue to apply.

The new connections standards of service introduced on 1 May 2005 comprise of Guaranteed, Standard Special Licence Condition D10 (D10 standards) and voluntary standards. The guaranteed standards ensure end consumers and their agents are protected through compensation payments in the event of failure to provide an adequate service, and voluntary standards, put in place by DNs, extend those benefits to commercial customers such as ICPs and IGTs. By contrast, the D10 standards monitor performance of DNs by reference to an agreed performance level of 90%. In all other
respects the D10 standards are the same as their guaranteed equivalents, having the same categories and timescales in which to meet or fail the standard. These standards were implemented as part of the assurance process to ensure all customer groups were protected by licence following network sales and it may be appropriate to consider whether this level of assurance is still required after 12 months of operation.

3. **Should the Review focus on specific connection market segments? For example, one-off domestic connections, the new housing market, industrial and commercial connections, unmetered services?**

We believe there is benefit in reviewing the following market sectors to assess how further competition could be encouraged:

- **Non-domestic connections** - these are competitive at the high value end, but DNs are still supporting small lower value non-domestic connections and we believe the review should identify and examine any incremental improvements that can be made to increase the scope for competition by ICPs.

- **New housing connections** – these are demonstrably contestable but DNs still retain a substantial share of small development business and there may be mechanisms to encourage more competition in this sector.

4. **In which segments is competition effective?**

5. **What improvements should be considered?**

*Please find below a combined response to Q4 & Q5.*

Competition is effective in the high value non-domestic market and in new housing, although most of the latter is related to IGT activity. However, this may reduce following the introduction of the IGT relative price control.

National Grid Gas Distribution believes removing the Gas Act duty to provide a connection and removing the statutory barriers to competition such as NRSWA, the DLCA and Gas Act obligation may help to facilitate competition. However, it is questionable whether to do so would be desirable from a government and public policy point of view.

Other more modest improvements may be more achievable such as our proposal to charge for quotations requiring a design, as this will allow competition to provide these services as part of the ICPs marketing strategy. We could also expand standard charging to the small non-domestic sector, in order to provide more pricing headroom for competitive bespoke quotations from ICPs. We recognise that this change in policy may
introduce an element of cross subsidy (by customers who currently incur lower connection charges) but we feel that as a transitional measure, it would create increased opportunities for non domestic customers to obtain competitive connections from service providers other than the incumbent GT.

Our experience in the domestic one-off sector is that competition has not developed and is unlikely to do so in the foreseeable future. Not only do the barriers already mentioned combine to discourage new entry, but also the value of the work and geographic dispersal make it unattractive to ICPs. Given these factors, we have chosen to move the service from Fulcrum back into UK Distribution, in order to provide customers with a more efficient service with an appropriate level of regulatory protection.

6. **Should we consider more radical changes to the way connections are provided?**

As stated by Ofgem, competition in gas connections has developed steadily since 1998 and Independent Gas Transporters (IGTs) now maintain a significant share of the gas connections market (5% of I&C connections and over 70% of new housing connections). As discussed earlier, radical solutions such as removal of Gas Act obligations and NRSWA restrictions are unlikely to be palatable to government or consumer groups.

In the absence of such remedies, we believe that incremental measures can be taken by DNs to increase competition in connections. As mentioned earlier we consider that by charging for quotations that require a design we can encourage customers to choose competitive offerings from ICPs. We can further facilitate competition by expanding the scope of standard charges to small non-domestic connections, thereby providing the opportunity for ICPs to provide bespoke quotations for individual jobs.