Implementation of RPC

1. We have received a number of comments in respect of the final proposals for the regulation of IGT charging and my letter of 23rd July.

2. We have considered the points raised carefully and have taken the decision to revise some of the detail of our proposals, particularly in the area of implementation of the new arrangements. This letter sets out those areas in which we have reconsidered the policy previously advised.

Definition of legacy portfolios

3. My letter of 23rd July summarised which properties we proposed to include under the legacy arrangements set out in chapter 4 of the final proposals. In summary these were:

   - all properties approved by Ofgem under the original Standard Licence Condition (SLC) 4C or Interim Arrangements; and

   - properties charged for under SLC 4 only, whose meters were installed on or before 31st December 2003.

4. We received a number of representations about the latter definition. In particular, some licensees considered this to be unreasonable in view of the lead times involved in construction projects and the way in which this approach could result in projects being split between legacy and non-legacy properties. We have therefore taken the decision to revise the definition of legacy properties under SLC 4.

5. Under SLC 4, an entire site (or project) will be covered by the legacy arrangements where at least one property on that site is connected to the gas network before 1st January 2004 (i.e. gas is capable of flowing to at least one property on the site by that date). All future properties on that site will be treated as legacy properties regardless of when they are connected.
RPC entry-point for new properties

6 The final proposals set out the basis on which future properties would enter RPC. The point of entry to RPC for a particular property was defined as the point of meter installation. It is at this date that the initial RPC charge would be set.

7 We received a number of comments on this specific point. The main concern among licensees was that it would give them relatively little certainty about future charges at the time at which they enter into contractual commitments for new projects. In particular, there was concern that until the property entered RPC, the IGT would be exposed to any future rebalancing of Transco’s charges between the Connected System Exit Point (CSEP) and the Single Supply Point (SSP).

8 In view of this, we intend to allow each IGT the option of:

- **RPC entry being defined according to the date of connection**, with a minimum of ten years of the indexing, ceiling and floor arrangements running from that date. This means that the initial RPC charge will be defined as the Transco-equivalent charge at the date of connection, and subsequent charges over a period of at least ten years will be in accordance with the rules in chapter 3 of the final proposals; or

- **RPC entry being defined at the date of contractual commitment**, with a minimum of ten years of the indexing, ceiling and floor arrangements running from that date. A shadow charge will be defined at the point at which a contractual commitment is entered into, and indexed as per the rules set out in the final proposals. As properties are connected, charges will be in accordance with the shadow charge at that point¹. An IGT will need to decide whether to take this approach for a particular property or site within 60 days of entering into the contractual commitment, and must be able to demonstrate that such a commitment has been made.

RPC entry-point for migrated properties

9 When legacy properties join RPC at the agreed migration date, our proposal is that this occurs as though they are new properties entering RPC. That is, they join RPC at the Transco-equivalent charge in effect at the date of migration, with futures charges being indexed by movements in Transco’s charge to the SSP (subject to the floor and ceiling) for a minimum of ten years.

10 There were concerns expressed among licensees that this approach leaves them exposed to the risk of Transco’s charges moving between the date of RPC implementation and the date at which properties migrate into RPC. In particular, there was concern that a rebalancing of Transco’s charges between the CSEP and the SSP during this time could have a significant impact on future IGT revenues.

¹ The minimum period of certainty for the indexing, floor and ceiling mechanisms (i.e. ten years) will run from the time of contractual commitment. So, if the shadow charge is defined in year one but a property is not connected until year three, only seven years of certainty will remain in terms of the indexing, floor and ceiling mechanisms.
In view of these points, and given the approach taken in respect of the RPC entry-point for new properties, it is appropriate to extend the shadow charging principle to migrated properties. This gives IGTs additional certainty of charges at the point of migration. The process will work as follows:

- for all migrated properties, an initial RPC ‘shadow charge’ will be set at the RPC implementation date (that is, at 1st January 2004);

- the shadow charge will then be indexed (subject to the floor and ceiling) in accordance with the rules set out in chapter 3 of the final proposals for a minimum of ten years;

- when properties migrate into RPC, charges will be in accordance with the shadow charge at that point.

This mechanism gives licensees an enhanced degree of certainty over the charges that will be levied for legacy properties when they enter RPC. Specifically, it provides an added degree of protection against any rebalancing of Transco’s use of system charges between the date of RPC implementation and the date of migration.

Assumed connection charges under the reasonable profit test

Paragraph 4.9 of appendix 4 of the final proposals stated that under the reasonable profits test, a connection charge of between £200 and £300 will be assumed to have been recovered as a connection charge. This assumption would be made for any sites charging under SLC 4 after 1st August 2003 and was designed to equalise the approach taken to connection charging under SLC 4 and 4C.

We received many comments on this point. Licensees wanted more clarity on the exact circumstances under which it would apply and were concerned about its potentially retrospective effects.

In the light of these comments we have taken the decision to revise the circumstances under which the assumed connection charge will apply. In particular:

- the assumed connection charge will only apply in respect of new properties that are contractually committed to on or after 1st August 2003. Licensees will have to be able to demonstrate that such a commitment had been entered into before this date in order to prevent the assumed connection charge being applied;

- the assumed charge will not apply where licensees have adopted a policy of Transco-equivalent charging on a continuous basis for new quotes; and

- where it applies, the assumed connection charge will be set at £250.

Annual Quantities for billing purposes

The final proposals stated that standardised NExA AQs should be used for the purposes of calculating Transco-equivalent charges. This approach addressed the main concern
expressed by respondents to the consultation that there is currently a lack of uniformity in the approach taken to forecasting consumption levels.

17 Some licensees sought more information on this area. In particular, we were asked whether the NExA AQs would only be relevant for the first year’s estimated billing, whether quantities used for billing would be continually updated to reflect future changes in NExA AQs, and clarification was sought on the AQs to use in respect of I&C and domestic infill customers.

18 Our proposal is that NExA AQs will be used for the calculation of RPC charges each year. Where NExA AQs are revised in the future to better represent likely consumption levels, then such changes should be reflected in IGT charges. Clearly, this approach means that consumption levels will not be 100 per cent accurate for all properties at all times, but to the extent standard AQs are regularly reviewed, they should be representative on average and provide an efficient means of simplifying a potentially complex billing process. The main concern among shippers / suppliers is that the current approach to estimating consumption levels varies among IGTs - a standardised approach using NExA AQs would be beneficial in this respect.

19 NExA AQs are only applicable to new domestic properties. AQs for I&C and infill sites should be derived on the basis of a reasonable forecast of actual consumption, taking into account the type and size of the particular property involved, and previous consumption levels.

Next steps

20 The changes described in this letter, together with the policy set out in the final proposals, will be set out in draft modifications to GT licences. We plan to issue a draft of the proposed modifications for consultation later this month.

Yours sincerely

David Noble
Head of Gas Distribution Regulation