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Gas Distribution Policy Team
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By Email Only: Matthew.chambers@ofgem.gov.uk

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Dear Matt,

Independent Gas Transporters Relative Price Control review consultation

Thank you for the opportunity to respond to this consultation on the future arrangements for IGT Relative Price Control. I confirm that our response is not confidential to Ofgem.

I am writing on behalf of ES Pipelines Ltd, (IGT) which forms part of ESP Utilities Group Ltd (ESP). ES Pipelines Ltd is one of the longest established independent gas transporters serving over 700,000 customers across Great Britain. Our connections cover a range of gas users including existing homes on "infill" projects, new homes and industrial and commercial sites. We welcome this review by Ofgem of the charging arrangements and the positive engagement with the sector and other stakeholders that has preceded it

The Future Homes Standard will preclude the installation of new domestic gas connections over the next two years, but ESP will continue to manage and maintain the existing networks for the foreseeable future. It is therefore critical that the charging arrangements established in this review are fit for that future and allow appropriate recovery of the costs borne by IGTs.

Of the options proposed our strong preference is Option 1; in summary our view is:

- The case for change is well made given the current system creates asymmetry between IGT and GDNs in terms of recovery for the same asset.
- IGT service levels are as good, or better than, those of the incumbent and IGTs have delivered faster connections aiding housebuilding and the UK economy more broadly.
- The current system, if left unchanged, risks undermining financeability leading to poorer consumer outcomes.
- Removing the floor and ceiling removes regulatory complexity without negatively impacting consumers and aligns with the original intent of the framework.
- Adopting Option 1 would future proof the framework for the energy transition.

Q1. Do you agree with our assessment that the current RPC floor and ceiling have resulted in a material constraining effect on IGT charges over time?

Yes, there has been a significant constraint placed on IGT Charges since Relative Price Control (RPC) was introduced in 2004, due to the floor and ceiling mechanism. ESP, and other IGTs, provided evidence of this to Ofgem in a confidential response earlier this year.

The original intent of the RPC floor and ceiling mechanism was to implement a corridor around equivalent GDN charges for twenty years, providing protection for customers and an element of certainty over future revenues to encourage the growth of the IGT sector. The reality is that GDN charges have increased significantly since 2004 and IGT charges have largely been capped at the ceiling – this is particularly true of connections made earlier in the RPC cycle. The result is a sustained, and increasing, differential between IGT charges and GDN charges for providing the same service to consumers.

IGTs have demonstrated, with evidence provided to Ofgem, that service levels are as good, if not better, than those of the upstream networks and we are pleased to be working with Ofgem to develop these metrics into a regular suite of reporting for comparison purposes as part of this review of RPC.

The obligations on IGTs in relation to safe operation and disconnection of assets in line with the UK transition to Net Zero are the same as for GDNs and it is important that costs associated with these activities can be appropriately recovered. Were the constraining effect allowed to endure it would risk undermining the financial stability of the IGT sector with knock on impacts for connected consumers.

We are mindful of the acute pressures on household bills, and we have been unable to find any evidence that the IGT charge has a direct impact on consumer bills. The divergence in charges between GDNs and IGTs has not led to discounts being offered to IGT connected customers in the past, even though the GDN charge is the benchmark used in calculating the Energy Price Cap. We would therefore not expect any of the options proposed in the consultation to result in increased bills for consumers.

Given the equivalence of service, the transition away from gas heating, and the unintended long-term constraining impact of the RPC floor and ceiling, we are pleased that Ofgem has progressed this review of RPC and provided options for change as set out in the consultation.

Q2. Do you agree that a case for revising the RPC floor and/or ceiling has been sufficiently established?

Yes, as noted above, the floor and ceiling mechanism was designed to provide medium term protection for consumers and certainty for IGTs, but has in reality significantly constrained the IGT charges in comparison to GDN charges for the same service.

This is acknowledged in the consultation and was evidenced in our response to the Request for Input in February which gathered data relating to IGT costs and revenues and provided sufficient assurance that a robust case for reform has been made.

The need for reform is made more urgent by changes in other areas of gas network regulation. Ofgem has reviewed the environment in which gas networks are operating now and over the next 5 to 10 years, including the implications of rapidly increasing disconnections, an expected reduction in customer numbers over time, and the need to accelerate cost recovery where asset lives are expected to shorten in the transition away from gas. In that context, it is increasingly difficult to justify retaining an RPC framework that leaves IGTs unable to track the equivalent GDN recovery path. GDN charging is being adapted to reflect the realities of the transition but, without reform, IGT charging would remain artificially constrained beneath that level, meaning under-recovery faced by IGTs would intensify rather than diminish.

We believe that continued under-recovery poses a financeability risk, which has implications for investor confidence in the sector. The regulated model has attracted long term patient capital in keeping with the operation of essential infrastructure. This appetite for investment is likely to be undermined if the regulatory model does not keep pace with the changing environment, which carries implications beyond the IGT sector.

The case for revising the floor and ceiling is therefore made, not only based on previous under-recovery, but based on the need to ensure that the model remains sustainable and fit for purpose as the UK transitions away from gas heating.

Q3. Do you agree with our proposed changes to the RPC floor and ceiling?
Ofgem's consultation sets out three broad approaches.

It is important to note that all options under consideration continue to provide protection for consumers as the IGT charge can never exceed that levied by the equivalent GDN for the same service.

Option 1 would remove the RPC floor and ceiling altogether. This was the original intent when RPC was introduced in 2004 and is also the most straightforward option to implement. It is our preferred option.

Complete removal of the constraints imposed by the floor and ceiling is the most effective way to ensure that IGTs can recover the same level of revenue for operating the downstream network as the equivalent GDN. This would address the challenges currently faced by IGTs as set out in the consultation and would future proof the methodology against energy transition and government policy changes.

Implementation of this option would be simple and transparent and offers an enduring solution in the face of further potential changes in GDN charging and wider gas network policy. As Ofgem's review makes clear, the sector is entering a period in which charging structures may continue to evolve in response to, changing asset lives, disconnections and the broader transition away from gas. In that context, retaining the floor and ceiling around the GDN benchmark risks recreating the same problem in future, even if an initial realignment is delivered now. In contrast, removing the floor and ceiling altogether would ensure that IGT charges continue to track the equivalent GDN position over time, rather than risk it repeatedly falling behind.

IGTs connect approximately 80% of new homes and, even with the introduction of the Future Homes Standard, it is expected that a significant number of new gas connections will be delivered in the two-year transition period to 2028. It is important the confidence in the sector is not undermined to ensure that those planned new homes can progress and help deliver the Governments house building targets.

Option 2a would retain the floor and ceiling but reset their starting point at the beginning of each GDN price control period.

This option provides a middle ground which, whilst retaining the floor and ceiling mechanism, does allow for re-setting of the corridor on a regular basis.

Ofgem's stated rationale for considering this option is that it would protect against "extreme within-period volatility". A review of historic RPC price changes shows that the volatility tends to occur in line with price control periods rather than "within-period". This option therefore appears to be introducing further complexity, in terms of implementation and transparency, to address a concern which we do not believe has been realised.

Under this option, we would ask that Ofgem consider the timeframe for the "re-set" and set an upper limit of 5 years. This would ensure that IGTs charges would not again be pegged within a corridor which may lose pace with GDN charges, should the GDN price control period be extended beyond the current 5-year span.

Option 2b takes the same fundamental approach as option 2a, but with a transition period applied to that initial reset.

For the reasons outlined above we believe that reform is urgent and we do not consider that a transition over two or three years is necessary or helpful in terms of simplicity, transparency and fairness.

The consultation acknowledges that the ceiling has materially constrained IGT charges over a multi-year period and that reform is needed. The case having been made there is limited justification for prolonging the constraint further.

We have not seen any evidence that the changes envisaged in the consultation would result in price increases for consumers. The energy price cap is calculated based on the GDN transportation charge and the constraint outlined in the consultation has not historically resulted in cheaper energy bills for IGT customers.

If Ofgem does opt to implement a transition period for this option, we would expect this to be a one-off implementation mechanism. At the end of the transition period the IGT charge should be aligned to the prevailing GDN charge, and the floor and ceiling recalculated from that starting point.

Adopting a transitional implementation would prevent IGTs from recovering a charge equivalent to the GDN charge, which is the overall intent of the reform, during the transition period. We would ask that Ofgem review options to ensure that the impact of such a transition is neutral for IGTs. This could be affected by widening the floor and ceiling corridor in subsequent years to ensure fair recovery of the equivalent overall charges across the price control period. There is precedent for this approach, indeed a mechanism to ensure neutrality was used when RPC was first introduced in 2003 with each Licencee agreeing dates for "migrating" networks to RPC at a date which achieved NPV neutrality.

Q4. Do you agree with our proposed reporting requirements for the IGT sector?

We welcome the proposed reporting requirements as an opportunity to evidence the quality of service we deliver.

Greater transparency and consistency in reporting will allow comparisons across networks and improve regulatory oversight. To ensure the data is concise and transparent, clear guidance and agreed calculation methodologies will be required for some metrics. We are pleased to have already started working with Ofgem to ensure that the reporting suite provides data which is reliable and useful.

Much of the reporting metrics outlined by Ofgem are standard data sets which IGTs should easily be able to collate and share, and we have undertaken to provide detailed feedback on the templates. That said, we would draw Ofgem's attention to shrinkage reporting; this is one area where we anticipate data collection will be challenging. IGT networks are not metered at the connection point (CSEP) and we do not believe real world data exists to measure this. Given this, we consider reporting may need to rely on theoretical or modelled calculations rather than direct measurement. ESP would be happy to support Ofgem and other colleagues in developing these proposals.

Q5. To what extent should proportionality (such as thresholds, phased adoption, sampling) be applied to this reporting that would maintain data quality while limiting burden on smaller IGTs?

We welcome the collaborative approach Ofgem has taken in sharing proposed reporting templates with IGTs and we are committed to working towards achieving reliable data sets to demonstrate the benefits of the IGT sector. To allow true comparison with the GDNs and give Ofgem data which captures insights into the whole market, we think it is important that all IGTs should be captured by the reporting requirements.

There will be some data items which are not currently captured in the precise format or manner which Ofgem would prefer, and we welcome the proposal that a period of voluntary reporting could be used to establish the requirements and iron out any discrepancies. This will also reduce the reporting burden on smaller IGTs in the first phase.

For more complex reporting areas, such as the challenges described above regarding shrinkage measurement, we support phased implementation, reporting using representative samples, or the use of standardised estimation methodologies. A proportionate approach would help maintain data quality while avoiding requirements that are unduly burdensome or impractical to implement.

Q6. Do you have any views on our proposed 'other' changes to the IGT RPC?

We agree with the proposal to replace RPI with CPIH within the RPC methodology. CPIH is now the more appropriate and credible measure of inflation and aligning the licence drafting with wider regulatory practice makes sense if the floor and ceiling mechanism is retained. However, we note that this change is not necessary if Ofgem proceeds with the first option of removing the RPC floor and ceiling altogether.

We consider that the efficiency factor in the current RPC methodology results in this measure being double counted. There is already an "efficiency" factor built into the GDN charges which RPC charges are linked to. IGTs should not have to be *more* efficient than GDNs under the regulatory framework. Were IGT charges artificially raised by the floor, then an argument could be made that the IGT charge was avoiding that efficiency element, but the reality is that the vast majority of IGT charges are at the ceiling of the framework.

We have not to date calculated exactly how much of a negative impact the efficiency factor has had on IGT revenues since the commencement of RPC, but we would be happy to undertake the analysis to further inform any decision Ofgem takes on this matter.

As with the RPI /CPIH question, this anomaly will naturally fall away should Ofgem implement Option 1. If a different option is chosen, then we would strongly recommend the removal of the efficiency factor completely. The least preferred route would be for the efficiency factor to remain, but to be standardised across all regions, replacing the current system which applies 8 different efficiency factors to charges according to geography.

Finally, we would remind Ofgem of the need to maintain momentum in this review and the importance of adhering to the timetable set out in the consultation. The need for Licence, system, and charging methodology changes, to enact any of the options set out in the consultation means any delay put implementation timetables at risk. We estimate that a minimum of 3 to 6 months (depending on the option taken forward) is required to implement and adequately test the necessary system changes.

If you would like to discuss any aspect of our response, please don't hesitate to contact me.

Yours sincerely,

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Regulations Director

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