Independent Networks Association

To: Matthew Chambers
Gas Distribution Policy Team
Ofgem

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Dear Matthew

Independent Gas Transporters Relative Price Control review consultation

Thank you for the opportunity to comment on this consultation document. This response is from the Independent Networks Association, who represents Independent Gas Transporters (IGTs) who own and operate networks for over 3 million gas customers. IGTs connect around 80% of new homes to their gas networks. Due to the transitional arrangements for the Future Homes Standard, there is still expected to be gas connections for new homes taking place until around 2030. IGTs will therefore be continuing to invest in new networks in the immediate future and will be providing services to those connected to their networks for decades to come.

Below are our responses to the consultation questions. The document also has a confidential annex that is provided separately.

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, we agree with Ofgem's assessment that the current IGT Relative Price Control (RPC) floor and ceiling has had a materially constraining effect on IGT charges over time.

When the RPC was introduced, the floor and ceiling mechanism was intended to provide a limited corridor around equivalent Gas Distribution Network (GDN) charges, balancing customer protection with a degree of revenue certainty for IGTs. In practice, however, the level and persistence of increases in GDN charges over the last two decades mean that the ceiling has increasingly prevented IGT charges from moving in line with the equivalent GDN benchmark. The result has been a sustained divergence between what an IGT is permitted to recover for providing the last-mile network and what the relevant GDN would have recovered for serving an equivalent customer base. Ofgem notes in its consultation that the current arrangements are constraining IGT charges, and that is consistent with our experience.

This matters because IGTs are delivering the same core last-mile network function as GDNs and should recover a commensurate level of revenue for doing so. Indeed, Ofgem's consultation recognises that IGT customers experience fewer unplanned interruptions than GDN customers and that, where interruptions do occur, they are resolved more quickly on average. The present framework creates an asymmetry whereby IGTs are expected to deliver equivalent, and in some respects, better services while being prevented from recovering the notional downstream cost at the efficiency frontier that an incumbent can recover. IGTs have the same obligations to ensure safe and reliable operations of their assets over their lifetime as do GDNs. They will also be under the same obligations around disconnections and the associated costs when, as anticipated, consumers move to lower carbon heating.

When the floor and ceiling were introduced, Ofgem intended them to be in place for twenty years[1]. The evidence now clearly demonstrates that the RPC floor and ceiling are operating as an enduring constraint that suppresses efficient revenue recovery and, if left unchanged, risk undermining the financial sustainability of continued high-quality service provision. In the accompanying confidential annex, we have estimated the impact of the value of this constraint over this period. However, for the avoidance of doubt, we are not seeking retrospective recovery of historic under-recovered amounts, only forward costs.

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

Yes, we agree that the case for revising the RPC floor and ceiling has been sufficiently established. Ofgem's consultation recognises that the current mechanism is constraining IGT charges and suppressing recovery relative to the GDN charges for the equivalent network. This conclusion was informed by a Request for Input in February which gathered evidence relating to IGT costs and revenues and provided sufficient assurance that a robust case for reform has been made.

This position is further strengthened by wider developments in gas network regulation. Under RIIO-3 Final Determinations, Ofgem considered the changing context for gas networks, including the implications of rapidly increasing disconnections, a reducing customer base 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 would be 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

[1] RPC Final Proposals Document – July 2003 Paragraph 3.75

realities of the transition, but IGT charging would remain artificially constrained beneath that level, meaning under-recovery faced by IGTs will intensify rather than diminish. This means that customers would be treated and charged differently over time.

For those reasons, continued under-recovery is a financeability issue. Where efficient revenues are persistently suppressed and pressure is placed, the ability to finance operations and confidence in the long-term viability of the regulated business model is eroded. At a time when the UK energy sector is seeking to attract significant investment to support the energy transition, failure to address the challenge would be an unwelcome signal to the market. Without change to the RPC mechanism there is a material risk that some IGTs will face increasing strain in maintaining high-quality last-mile gas services, with potential implications for service resilience and ultimately for consumers, should an IGT become financially unviable.

Revising the RPC arrangements is therefore justified not only by historic evidence of under-recovery, but by the need to ensure that the mechanism remains workable and sustainable going forward during a particularly turbulent period for gas distributors.

As we have set out in previous consultations, due to the formulation of the price cap, that takes the GDN charge costs, customers of IGTs will not pay more for their networks with the changes proposed in this consultation.

Q3. Do you agree with our proposed changes to the RPC floor and ceiling?

Ofgem's consultation sets out three broad approaches:

- Option 1 would remove the RPC floor and ceiling altogether.
- Option 2a would retain the floor and ceiling but reset their starting point at the beginning of each GDN price control period.
- Option 2b would take the same basic approach as option 2a, but with a transition period applied to that reset.

<u>Option 1</u> is the most straightforward and transparent. Complete removal of the constraints of the floor and ceiling is the most effective way to ensure that IGTs can recover the same level of revenue for operating the notional downstream network as the equivalent GDN. IGTs provide the same essential last-mile network function so it is difficult to see a continuing justification for a mechanism that systematically prevents full alignment with that benchmark and therefore fully compliant with competition law precedents. Removing the floor and ceiling would therefore best address the problem

identified in this consultation and would do so in a way that is transparent, durable and easy to administer.

This approach would also future proof the framework against further 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. By 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. It would also be more consistent with the historic intent of the arrangements which was introduced in a different context and was not intended to operate indefinitely.

A durable solution is important now because IGTs continue to play a major role in connecting new developments and in providing local gas infrastructure for around 80% of new homes. This is important in the context of the Government's housebuilding targets and the acknowledgement the role IGTs play in connecting new homes. The RPC is not just a historic charging issue affecting legacy portfolios; it continues to shape the economics of networks that are being adopted and operated today. A framework that allows IGTs to recover on the same basis as the equivalent GDN would provide greater regulatory clarity, support investability and avoid distorting decisions in the market for new connections. Total removal of the floor and ceiling is the option most likely to provide that certainty while preserving the underlying principle that IGT charges should remain capped by the equivalent GDN benchmark.

The consultation notes that retaining the floor and ceiling in either Option 2a or 2b would protect against "extreme within-period volatility". In practice, the most significant changes in the benchmark have tended to arise at price control resets, rather than through unexpected year-to-year volatility within a control period. Continuing to apply the floor and ceiling would therefore risk prolonging a known problem in order to address a concern that appears overstated in this context.

Option 2b We do not consider that a transition option is necessary. Customers have paid the GDN equivalent rate and there is no evidence that historically customers have benefitted from lower network charges. We do not believe that a further period of transition will result in benefits for customers.

Ofgem's consultation already recognises that the ceiling has materially constrained IGT charges and that reform is needed. Once that case has been accepted, there is limited justification for preserving a mechanism that is known to continue suppressing efficient recovery for a further period. The confidential annex to this submission contains detail of the continuing constraint on IGTs of a transition.

Despite the logic against this approach, if Ofgem nevertheless prefers to proceed with option 2b, any transition should be designed strictly as a short, one-off mechanism. Any transitional arrangement should apply only to the first adjustment. At the end of that initial transition period, the relevant IGT charge should be aligned to the equivalent GDN charge prevailing in the year the transition ends, and any subsequent floor and ceiling should then be recalibrated from that starting point. This would allow Ofgem to manage the first adjustment, if it considers that necessary, without turning transition into a repeated, complex structural feature of the regime.

Ideally any changes to the IGT licence would be future proofed, and so if Ofgem does decide to implement Options 2a or 2b, consideration should be given to how the interaction with the RIIO GDN price control is referenced. Given changes do occur in the duration of RIIO price controls, we believe that the reset of the ceiling and floor should take place at the start of a new price control period, or after five years, whichever is soonest.

In all options for change, time will be required for full testing of the changes to the IGT's billing system and Shippers will also need to validate their own systems. IGTs have different approaches on their billing systems, whether in-house or through external providers and so would look to have a period of up to six months to fully implement and test any changes to their billing. Ofgem will also need to ensure that sufficient capacity is provided within Ofgem to process the resulting IGT Charging Methodology revisions that will also result from these changes. Therefore, Ofgem needs to confirm its approach as soon as possible in order to effect changes by January 2027.

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

Yes, we agree in principle with Ofgem's proposed reporting requirements for the IGT sector. Greater transparency and more consistent reporting should help improve comparability across operators and support more effective regulatory oversight. However, for the regime to operate fairly and deliver data that is genuinely comparable, it will be important for Ofgem to establish standardised calculation methodologies, definitions and assumptions for each reporting item. Without that, there is a risk that different IGTs interpret the requirements in different ways, which would reduce the value of the information collected and make like-for-like comparison difficult.

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On customer complaints, we broadly agree with Ofgem's proposals, however this reporting should be proportionate and should not extend beyond reporting on complaints provided by other network operators or suppliers. In addition, customer satisfaction surveys would be a disproportionate requirement. Due to the low volume of complaints, we would recommend using complaints as proxy without additional reporting requirements.

We would also note a specific practical issue in relation to shrinkage reporting. In some cases, it may be difficult to obtain sufficiently robust real-world data to calculate shrinkage directly, particularly where the required data is not captured consistently or cannot readily be isolated at the relevant network level. In those circumstances, reporting may need to rely on theoretical or modelled calculations rather than direct measurement. If shrinkage is to be included, Ofgem should therefore propose a clear, standard approach for how it is to be estimated, including the assumptions, inputs and level of granularity expected, so that reporting is proportionate, workable and consistent across the sector. The INA would be happy to support Ofgem 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?

As set out in our response to Q4, we agree that improved reporting can deliver benefits in terms of transparency and comparability, but only if the requirements are designed in a way that is practical and proportionate for IGTs of different sizes. Proportionality has an important role to play in limiting unnecessary burden on IGTs, if it does not undermine the consistency and usefulness of the data collected. This reinforces the need for Ofgem to specify standard definitions, methodologies and assumptions across all reporting items, so that any proportionality measures operate within a common framework rather than leading to inconsistent reporting practices.

We support the collection of data on core customer and operational measures, including market data, vulnerability, interruptions, customer complaints, GSOP and Licence Condition D10, as these are central to regulatory oversight and cross-sector comparison. However, for reporting items that are more technically complex or data-intensive, Ofgem should consider phased implementation, reporting using representative samples, or the use of standardised estimation methodologies. This proportionate approach will be particularly relevant to shrinkage reporting, where, as noted in Q4, a theoretical or modelled approach may be necessary. A proportionate approach would help maintain data quality while avoiding requirements that are unduly burdensome or impractical to implement.

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

We agree with Ofgem's proposal to replace Retail Price Index (RPI) with Consumer Price Index (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 would be sensible if the existing annual adjustment mechanism is retained. However, this change is not necessary if Ofgem proceeds with the option of removing the RPC floor and ceiling altogether. We therefore support the proposed CPIH amendment only insofar as Ofgem retains a version of the current RPC calculation methodology which includes a floor and ceiling calculation.

We are concerned that the efficiency factor in the current RPC methodology results in "efficiency" being counted twice. The equivalent GDN charges that form the benchmark for RPC are already derived from a regulated charging framework in which efficiency assumptions are built into the underlying price control. Applying a further standalone efficiency factor within the IGT licence therefore imposes a second downward adjustment on IGT allowed charges relative to that benchmark. This creates an asymmetry that is difficult to justify. IGTs should be subject only to an efficiency adjustment that is equivalent to that already embedded in GDN charges, rather than an additional layer of efficiency applied on top. If Ofgem proceeds with the option of removing the RPC floor and ceiling, this issue would not arise, however, if any version of the current formula is retained, we consider that the separate IGT efficiency factor should be removed.

Please do not hesitate to contact me should you have any questions on this document.

Yours sincerely,

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