

August 2001

**Amending the Gas Connections
Charges Regulations
A Consultation Document**

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1. Introduction and Executive Summary

Purpose of this document

1.1 This document:

- describes Ofgem's proposal to amend Regulation 2(a) of the Gas (Connection Charges) Regulations 1986 (the regulations) in order to stimulate the extension of gas networks to premises in remote areas (infill projects): and
- discusses other issues in relation to extending gas networks to remote areas and seeks suggestions from interested parties.

1.2 Competition in the gas connections market was introduced by amendments to the Gas Act 1986 (the Act) by the Gas Act 1995. The Act introduced competition in the installation of gas networks and individual service pipes to connect customers' premises. The Act also required separation between the activities involved in gas transportation and the activities involved in the shipping and supply of gas by introducing separate licences for these activities. The Act precludes the holder of a shipping and/or supply licence from holding a gas transportation licence.

1.3 Competition is established in the provision of networks for new developments (primarily new housing estates) where it is estimated that gas transporters (GTs) other than Transco are providing about 50 per cent of connections. This type of connection needs to be differentiated from infill projects. There are two related issues with infill projects at present. The number of new schemes has declined and, as a consequence of this, there is little or no competition in the provision of infills.

1.4 Ofgem has received comments from various stakeholders on the issue of infill projects. Some GTs have suggested that the current regulatory framework does not encourage infill projects. Prospective customers have indicated that the quotes from GTs to undertake infill projects are often prohibitive.

- 1.5 Ofgem is aware of other possible causes for the decline in infill projects. For instance many of the most economic projects have already been completed. Therefore the remaining projects tend to be of higher cost and more difficult to finance. However, Ofgem's view is that the regulations, in accordance with which most infill projects are carried out, can be a significant factor.
- 1.6 The scope for amending the current regulations or, if new regulations are introduced, the ambit of those regulations is constrained by section 10(7) of the Act.

Section 10(7) provides that

"The Director may, with the consent of the Secretary of State, make provision by regulations for entitling a public gas transporter to require a person requiring a connection in pursuance of sub-section (2) above to pay to the transporter an amount in respect of the expenses of the laying of the main used for the purpose of making that connection if–

- (a) the connection is required within the prescribed period after the laying of the main;
- (b) a person for the purpose of connecting whose premises the main was laid has made a payment to the transporter in respect of those expenses;
- (c) the amount required does not exceed any amount paid in respect of those expenses by such a person or by any person previously required to make a payment under the regulations; and
- (d) the transporter has not recovered those expenses in full".

- 1.7 In this document, therefore, Ofgem is proposing an extension to the prescribed period in Regulation 2(a) of the regulations, from five years to twenty years. However, Ofgem welcomes the views of interested parties on other issues relating to the provision of infill connections.

- 1.8 In line with changes introduced by the Utilities Act 2000, Public Gas Transporters (PGTs)¹ are referred to as Gas Transporters (GTs) throughout this document.

Structure of the document

- 1.9 Chapter 2 details the proposal to amend the gas regulations and discusses some of the issues affecting infill projects and Chapter 3 discusses the process for amending the regulations. Appendix 1 describes the regulatory framework for infill projects and Appendix 2 contains a full text of the current regulations.
- 1.10 All responses to this document will be made public by placing them in the Ofgem library except those clearly marked confidential.
- 1.11 If you wish to express a view on the issues raised in this document, we would like to receive responses no later than **28 September 2001**. Responses should be sent to

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If you would like to discuss any of the issues raised in this document, please contact Idris Gobir on 020 7901 7094 (e-mail: [idrisc.gobir@ofgem.gov.uk](mailto:イドris.gobir@ofgem.gov.uk)) or Kiera Bower on 020 7901 7642 (e-mail: kiera.bower@ofgem.gov.uk) who would be pleased to help.

¹ Section 76(2) Utilities Act 2000

2. The Issues

- 2.1 There are approximately 25 million households in Britain, about 5 million (20 per cent) of which are currently not connected to the gas network. Connecting many of these premises to the gas network may require the installation of one or more kilometres of pipelines and other connections assets (e.g. a pressure reduction station).
- 2.2 In recent times there has been a reduction in the number of infill projects. Several factors have contributed to this. One of the factors commonly referred to by interested parties is the unsuitability of the prescribed period for the recovery of the cost of the main as provided in the regulations. Other factors raised include the current structure of the gas industry, and the charging methods adopted by GTs.

Industry structure

- 2.3 Prior to the changes introduced by the Gas Act 1995 British Gas was an integrated business and provided all gas services to its customers including gas connections, supply and transportation. Anecdotal evidence suggests that British Gas in many cases never fully recovered the cost of infill projects from infill project charges. However, with the ability to recover its costs from other sectors of the gas business, the company was able to invest in infill projects. This was because any costs not recovered from customers for the provision of connections assets could be recovered from supply or transportation charges - there was a cross subsidy.
- 2.4 After the separation of transportation and supply functions by the Gas Act 1995, Transco, the British Gas transportation company, was no longer able to cross-subsidise the cost incurred in the provision of infills with the revenue from the supply business. This may have contributed to the decline in the number of infill projects commissioned by the company.
- 2.5 Twelve new GTs have been licensed since the introduction of competition in the provision of gas connections. Of the new GTs, only a minority have carried out

infill projects using the gas regulations as the basis for recovering their costs. These GTs have indicated that the majority of the infill projects that have been commissioned have only gone ahead because of the existence of industrial and commercial premises which have requested a connection in the locality. In effect the infill project has 'piggybacked' on another project.

Condition 6 of the GT Licence

- 2.6 There is concern that the charging method provided under Condition 6 of the GT Licence (C6 methodology) for recovering the cost of connection assets has not been applied to recover the cost of infill projects. At the time of the introduction of Condition 6, it was intended to provide an effective method for recovering the cost of infill projects in a competitive environment.
- 2.7 C6 charges are recovered alongside transportation charges from shippers and not directly from customers as in the regulations. C6 charges are recovered over an extended period of time (20 – 25 years) while charges under the regulations are usually recovered as up-front payments from customers before the connection is provided, and can only be applied for five years. C6 charges are not necessarily separately identified on customers' gas bills thereby effectively rendering them invisible to the customer.
- 2.8 Most GTs that use C6 methodology have only applied it in relation to new housing developments. In these cases the customer requesting the connection is the developer. Usually with new developments there is an immediate uptake of connections to the main for all the premises on the development since they will have been equipped to burn gas. This provides a better prospect for the recovery of the GT's initial capital outlay.
- 2.9 GTs have proved reluctant to apply C6 methodology when undertaking infill projects. One reason is that, as these charges are recovered from shippers, it would not be possible to recover contributions from premises where pipes are installed but the customer does not consume gas. In an infill area, customers may take the opportunity to connect their premises at the time of the infill

project but delay consuming gas. This is often because the customers' existing heating/cooking appliances cannot burn natural gas.

- 2.10 Ofgem will shortly be reviewing the effectiveness of the C6 methodology.

GTs' Infill Viability Assessment Criteria

- 2.11 In responding to a request for connection, the GT will take into account the prospects for gas consumption in the area, either from existing residents or future developments. GTs will wish to recover the cost of providing a connection. Where estimates show favourable prospects for gas consumption and for recovery of its costs, the GT may carry out an infill project.
- 2.12 Different GTs have developed different criteria to assist them in deciding whether to proceed with an infill project. For example, one GT requires a minimum percentage (say 25 per cent) of the premises within the infill area to agree to connect to the main and begin to use gas once the main is installed. The GT then estimates the number of premises that are likely to subsequently connect to the main within the prescribed period. The number of assured and estimated connections for the five-year period is divided by the total cost of the main to arrive at a contribution per premises. This has meant that the lower the number of premises estimated to connect within the prescribed period the higher the level of contribution that will be requested by the GT.
- 2.13 It is possible that GTs are risk averse, taking a conservative view of the number of premises that will connect to the main within the prescribed period. As noted above, a GT can only require a contribution to the cost of the main from premises connecting within 5 years.

The Prescribed Period

- 2.14 Some GTs have indicated that the five-year period under the regulations (the prescribed period) within which the GT is able to request contributions towards the cost of providing a main for an infill project is too short. At the end of the prescribed period customers wishing to connect to the main installed in an infill area only pay the cost of their service pipe which is usually much less than the mains contribution.
- 2.15 A research project commissioned by the Gas Consumers Council (now *energywatch*) in 1998 found that although the charges for infill projects were often considered to be very high, the charges applied tended to reflect costs. The research concluded that customers' choice of whether or when to connect to the main is primarily affected by the level of charges and length of payment period.
- 2.16 The research by the GCC also pointed to the fact that customers are reluctant to cross-subsidise subsequent connectees. The research suggested an extension to the period for which a GT is allowed to require contributions to the cost of a main.

Ofgem seeks the views of interested parties on the proposal to extend the prescribed period for the recovery of mains cost as provided under Regulation 2(a) from 5 years to 20 years.

- 2.17 The amended regulations would differ from the current regulations by the substitution of the word "five" in Regulation 2(a) with the word "twenty".
- 2.18 Ofgem considers that extending the recovery period in this way is likely to provide long-term benefits to customers in general and in particular to some amongst the fuel poor. Such an extension may also have a positive effect on the environment.
- 2.19 Although in a competitive environment, customers, as far as possible, are required to meet the actual cost to them of obtaining their connections, a GT would still potentially be in a position to recover its costs while keeping the level of individual contributions low. One option is for GTs to amend their

charging methodology by assuming a more generous view of the number of customers that will connect to the main and discounting the charges applied to customer with the future revenue stream that might accrue from future connections. In this way the change to the regulations could encourage the development of competition in the provision of infill projects while providing customers with a connection at a lower cost than at present.

- 2.20 It should be noted that the changes proposed in this document will not resolve all the difficulties attributable to the issue of gas to non gas areas. Many premises will still remain uneconomic to connect under the regulations. In its consultation document on fuel poverty, the Government recognises that the coverage and capacity of the gas transmission network affects the ability of consumers to use gas rather than more expensive fuels². DTI has established a working group with the aim of developing initiatives to encourage the extension of gas networks to rural areas. Ofgem is participating in the work of this group.

² Government's Fuel Poverty strategy, March 2001

3. Process for Amending the Regulations

- 3.1 The current regulations were made by the Secretary of State in accordance with Section 4 of the Gas Act 1986 (prior to amendments). The Gas Act 1986 was amended by the Gas Act 1995 and the power to make the gas connection charges regulations was transferred to Ofgem – see section 10(7) of the Gas Act 1986.
- 3.2 This document serves as a first step towards introducing new regulations for infill connections. All responses to this document will be taken into consideration in producing new draft regulations. The draft proposal will be published in due course.
- 3.3 The new regulations can only be made with the consent of the Secretary of State. The new regulations will contain appropriate transitional provisions for systems extensions already in progress at the commencement of the new regulations.
- 3.4 The Secretary of State will need to be made aware of the responses to this consultation document, especially where there are objections to amending the regulations. The current view is that it may not be necessary for the Secretary of State to carry out a further consultation exercise. If the Secretary of State decides that a further consultation exercise was necessary, the process could take three to four months. Once they have been drawn-up, the draft new regulations will need to be laid before Parliament for consideration before they come into effect, a process that often takes twenty-one days. It is only after these processes have been completed that new regulations can be brought into force.

Appendix 1

Regulatory Framework

Duties of the Gas and Electricity Markets Authority in relation to the provision of Gas Connections

- 1.1 Under the Act, the Gas and Electricity Markets Authority (Ofgem) has a duty to exercise the functions assigned to it in a manner which it considers is best calculated to secure that so far as it is economical to meet them all reasonable demands in Great Britain for gas conveyed through pipes are met³.

Utilities Act 2000

- 1.2 The Utilities Act introduces new duties for Ofgem. Ofgem's (and the Secretary of States') primary objective in carrying out their functions is to protect the interest of consumers in relation to gas conveyed through pipes, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with the shipping, transportation and supply of gas so conveyed⁴.
- 1.3 Ofgem, in carrying out its functions also has to have regard, *inter alia*, to the interest of individuals residing in rural areas.
- 1.4 In carrying out its various functions, Ofgem is also required to have regard to the effect that the exercising of such functions would have on the environment.

³ Section 4(a) Gas Act 1986

⁴ Section 9 Utilities Act 2000

Duties of a Gas Transporter

- 1.5 A GT has a duty under Section 9 of the Act as respects each authorised area of his to
- a) develop and maintain an efficient and economical pipeline system for the conveyance of gas; and
 - b) subject to paragraph (a) above to comply, so far as it is economical to do so, with any reasonable request for him to connect to that system, and convey gas by means of that system to ,any premises[or to connect to that system a pipeline system operated by an authorised transporter]⁵.
- 1.6 A GT also has a duty to avoid any undue preference or undue discrimination in the connection of premises to any pipeline system operated by him and in the terms on which he undertakes the conveyance of gas by means of such a system.
- 1.7 Section 10 of the Act makes it a duty of a GT to connect certain premises and provides for the powers of the GT to charge for a connection.
- 1.8 Sections 10(1) and 10(2) of the Act oblige the GT to connect to his network, premises that are within 23 metres of a relevant main and premises that can be connected to any such main by a pipe installed by the owner or occupier of the premises. This obligation only applies to those premises that are likely to consume up to 2,196,000KWh of gas per annum. All rights [and liabilities associated with⁶] any pipes or assets provided by third parties and connected to the GT's network automatically vest in the GT. Note that the GT is only obliged to connect to his system pipes or assets installed by others where such installations are fit for purpose.

⁵ Section 79(2)(b) Utilities Act 2000

⁶ Section 80(4) Utilities Act 2000

- 1.9 Section 10(5) provides that where a GT has supplied and laid a pipe for the purposes of connecting a premises he may recover the cost of the service to the extent that the relevant regulations allow⁷.
- 1.10 Under Section 10(7) of the Act, the Secretary of State is empowered to make regulations setting out the framework for charges applicable to customers for the installation of a main used for the purpose of providing a customer with a connection.

The Gas (Connection Charges) Regulations 1986 (the regulations) were established in line with the provisions of Section 10(7) of the Act. The regulations provide for the GT to be able to require a contribution towards the cost of mains installed for the purposes of connecting a customer. The regulations also provide for the GT to continue to require such contributions from any person wanting to connect to that main within a five year period (the prescribed period); provided that the contribution required does not exceed an amount paid by such (customer) or any other person previously required to make a contribution under the regulations. A full text of the legislation is provided as Appendix 2.

Standard Conditions of a Gas Transporters' Licence

- 1.11 **Condition 3** of the GT Licence deals with the charges applicable to gas shippers in general. A GT is required to furnish Ofgem with a statement showing the methods by which its charges for transportation arrangements are to be determined. Transportation arrangements is defined as arrangements whereby gas shippers may from time to time and in different cases and circumstances have gas introduced into, conveyed by means of and taken out of the licensee's (i.e.GT's) pipeline system. Condition 3 charges can be used to recover the cost of pipelines installed by the GT
- 1.12 **Condition 5** of the license provides for the obligations of a GT as regards charges for the provision of connections that are levied on the customer requesting a connection. Condition 5 limits the charge for the connection of

⁷ Section 10(5) Gas Act 1986

premises situated within 23 metres of the GT's existing main and expected to consume less than 73,200Kwh per annum (a typical domestic property consumes an average of 19'000kWh per annum). The Utilities Act abolishes this threshold and once it comes into force the free 10 metres of pipe will apply to any premises used mainly or wholly for domestic purposes. The GT is permitted to charge for pipes installed on the customer's premises and is required to provide the first 10 metres of pipe in the public highway free of charge.

There is an exemption from the obligation to provide the free 10 metres of pipe. It does not apply to premises

- i. in areas where the charges for connection of premises are based on regulations made under Section 10(7) of the Act; or
- ii. that are in an area designated for the purposes of Condition 6 (of the GT licence) and the charges to be made of a gas shipper by the transporter in respect of the conveyance of gas to those premises would include a supplemental charge.

1.13 Condition 6 of the licence provides for a GT to be able to recover, from gas shippers, charges for the laying of pipes for the purposes of conveying gas to premises in a designated area. The charges are recovered alongside transportation charges on a supplemental basis, usually over a period of 20 to 25 years. The conditions to be fulfilled for an area to qualify for a designation by Ofgem are contained in Condition 6(1) and 6(2).

Appendix 2

STATUTORY INSTRUMENTS

1986 No. 1448

GAS

The Gas (Connection Charges) Regulations 1986

<i>Made</i>	-	-	<i>23rd August 1986</i>
<i>Laid before Parliament</i>			<i>26th August 1986</i>
<i>Coming into Operation</i>			<i>13th September 1986</i>

The Secretary of State, in exercise of the powers conferred on him by sections 10(7) and 47(3)(b) of the Gas Act 1986^(a) and of all other powers enabling him in that behalf and after consultation with the Director General of Gas Supply, hereby makes the following Regulations:—

1. These Regulations may be cited as the Gas (Connection Charges) Regulations 1986 and shall come into operation on 13th September 1986.

2. A public gas transporter^(b) may require a person requiring a connection to a relevant main under section 10(2) of the Gas Act 1986 to pay to the transporter an amount in respect of the expenses of the laying of the main used for the purpose of giving that connection if—

- (a) the connection is required within five years after the laying of the main;
- (b) a person for the purpose of supplying whom the main was laid has made a payment to the transporter in respect of those expenses;
- (c) the amount required does not exceed any amount paid in respect of those expenses by such a person or by any person previously required to make a payment under these Regulations;
- (d) the transporter has not recovered those expenses in full; and
- (e) the transporter has made available to the person requiring the connection such information as may have been reasonably requested by that person for the purpose of ascertaining—
 - (i) the expenses of the laying of the main;
 - (ii) the date of the laying of the main; and
 - (iii) the amounts paid in respect of those expenses by the persons for the purpose of supplying whom the main was laid, or by persons previously required to make a payment under these Regulations.

3. Regulation 2 above shall apply in respect of any main laid before the commencement of these Regulations as if for sub-paragraph (e) (iii) of that Regulation there were substituted the following sub-paragraph:—

“(iii) the amounts paid by all persons to the supplier in respect of those expenses.”

^(a) 1986 c.44.

^(b) See Gas Act 1995, Schedule 5 paragraph 20 for saving and application to public gas transporters.

23rd August 1986.

David Hunt
Parliamentary Under-Secretary
of State for Energy^(a).

EXPLANATORY NOTE

(This Note is not part of the Regulations.)

These Regulations make provision for entitling a public gas transporter within the meaning of Part I of the Gas Act 1986 to require a person requiring a connection to a relevant main in pursuance of section 10(2) (duty to connect) of that Act to pay to the transporter an amount in respect of the expenses of the laying of the main used for the purpose of giving that connection. The Regulations make such provision in respect of mains laid either before or after the commencement of the Regulations.

^(a) Treated as made by the Director General of Gas Supply – see paragraph 20 of Schedule 5 to the Gas Act 1995

Appendix 3

List of Groups of Consultees

Gas Transporters

Gas Shippers

Gas Suppliers

Consumer Representatives

Local Authorities

Utility Infrastructure Providers and Independent Contractors

Members of Parliament

Regulators