GTC
Gas Transportation Company

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Public Response

The Regulation Of Independent Gas Transporter Charging

Detailed below are the responses from the Gas Transportation Company to the thirteen issues raised within the consultation document published in May **2002.**

Issues **1** to **4** are concerned with Ofgem's view of real **or** potential excessive developer contributions. We believe that a clear definition of allowable regulatory costs, if any, should be prepared to enable clarity on these **four** issues.

Issue **1:** It is not clear that effective competition exists between IGTs in securing new contracts

Response: Disagree. There is intense competition between the larger IGTs in securing new contracts on new housing developments, and multi-utility operators can obtain work from developers in preference to IGTs only offering a single utility.

Issue **2:** Connection and gas transportation services are lacking clear and consistently applied definitions of: (i) the activities involved in each service, **(ii)** the costs (and relevant assets) of providing each service, and (iii) **the** structure of charges that separates the cost recovery of each service

Response: There needs to be clarification on the fundamental difference between connections from an existing finished network and connections from a new discrete network extension under build.

Most of the ***new*** *individual gas connections are to Transco's existing mains – as are electricity ones to existing networks. The definition of a service needs clearer definition, but is generally considered to be the tapping or jointing to the existing working main, the service connection to the house and the service termination equipment (now being defined within "end of network"). The activities, costs and structure of charges and any recovery are all clear, well understood and transparent.*

The connections made during a new build discrete network, whether gas or electric, are a very different matter. The gradual extension of the mains is at the developer's request and is invariably accompanied by the request for new services. In practise it is the other ***way*** *round with the developer asking, for example,* ***for plots*** *5,6 & 7 to* ***be*** *connected, and that by implication and necessity requiring associated mains extension.*

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There is no way that the developer will be prepared to ask one party to extend the mains, then a second party to fit the services bearing in mind that with meter unbundling, he may have to ask a third party for a meter fit. This is all a very costly and potentially lengthy process, and a long way from the intended drop out of costs through economies of working practices.

On a new build gas network, the services must remain with the mains extensions. We have very extensive evidence that the vast majority of connections and mains extensions are completely linked.

The entry of IGTs into the transportation market brought with it new capital to invest in network extensions necessary to achieve the aim of extending the availability **of** natural gas to as much of the population aspossible. Any attempt to apportion the cost of installing the new relevant main and the new services being connected to it would serve no practical purpose or benefit the market in any way.
Issue **3:** The cross-subsidisation of competitive connection activities with monopoly transportation revenues may be distorting competition in the connections market

*Response: See our reply to **2** above; Most connections are onto existing mains on existing networks, and there is no cross subsidisation, and competition for such connections is fully available.*

The separation of mains and services on new sites would result in higher costs, lower standards of service and longer lead times.

Issue **4:** The payment of allowances by IGTs to gain network development and connection contracts is distorting competition in the connections market

*Response: Completely disagree, as stated in **1** above, it is a completely different market where services and mains extensions are completely linked.*

Issue 5: The statutory connections (the 23m and 10m rules) distort competition in the connections market

*Response: Agree because such connections are to existing networks – otherwise they would have been planned into the original network build. **As** competition is available for connections, these statutory connections should now be removed.*

*They are also a barrier to rural network extension, because once a relevant main is laid, a potential customer **who** has opted not to pay for connection initially, can subsequently ask **for** a statutory connection, when those near him may have paid much more **for** their original connection.*

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Issue **6:** Effective competition does not exist within gas transportation and may not lead to an efficient outcome

*Response: Agree. **A** gas network is a natural monopoly, parallel piping is uneconomic – except for reinforcement – when the existing pipe will need to carry the new one economically until the added load develops.*

Issue 7: The lack of transparency and consistency in IGT charging methodologies and statements may be distorting shipper and supply competition

Response: Disagree. Shippers and Suppliers are already operating with a wide range of transportation charge discrepancies – e.g. customers situated in Norwich served with gas delivered from Bacton have significantly lower transportation charges than those in Penzance with gas delivered from St Fergus. Practically all Suppliers operate on a national retail pricing structure that averages these costs out. Therefore dealing with different charges from IGTs is a data process problem, not one that should cause distortion in the retail market place.

There can be the possibility that some Licensees - Producers, Shippers, Suppliers and bTransporters are vertically integrated within a group, which could lead to distortion ofpricing through intra-group cross subsidisation.

We also question how transportation charges can distort Shipper and Supplier competition when the transportation charges for a given supply point are the same for all Shippers.

Issue 8: There are insufficient incentives on IGTs to invest and operate efficiently

Response:
Disagree for GTC. It is in the IGTs' own interests to ensure that their businesses are run in an economically sensible manner. . The IGTs have been operating in a freely competitive market since deregulation and therefore have of necessity had to operate efficiently. Therefore the RPI-X formula is inappropriate as it assumes that inefficiencies exist in the first place and any perceived lack of incentive would only be exacerbated by such a formula.

Issue **9:** There are insufficient incentives on IGTs to share efficiency gains **with** consumers, which may be reducing the value for money provided to consumers

Response: Agree. Our customers are Shippers not consumers. It is up to the Shippers to pass through to their customer the Supplier any savings gained through transportation efficiencies, and in turn the Supplier topass any onto the consumer.

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Issue **10:** There are insufficient controls on the ability of IGTs to exploit their monopoly position to earn excessive profits on 4B and 4C charges

Response: Disagree because reasonable profits have not been defined in an area where the initial capital is in fact high-risk start up capital and should be considered as venture capital.

Issue 11: There is no formal definition and verification of reasonable profit for Condition **4** charges to prevent IGTs from exploiting their monopoly position to earn excessive profits

Response: We refer you back to our response to your recent consultation document on cost of capital, and any attempt to standardise the definition of reasonable profit would restrict the type of entity that could enter the market. Competition would be reduced.

Issue 12: Cross-subsidisation **of new** gas connections with transportation revenues may not encourage efficient connection to the gas network and efficient use of gas;

Response: Disagree. Please see response to Issue 2. We cannot see how this "cross subsidisation" could in any way affect the efficient use of gas.

Issue **13:** Existing licence conditions may not be encouraging development of the rural gas network as intended.

Response: Agree. Condition 4C should be altered to cater only for those networks that are bringing gas to areas "remote" from the nearest relevant main. It should also be changed to clarify how supplemental charges can be calculated, applied and collected, and must allow for the integrated construction of connections and mains by the contractors to provide optimum efficiencies.

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Comments upon your proposals in "The Way Forward"

Option **A** – Increase the competitive pressure on IGTs

We believe that the franchising route has too many unknowns and hurdles, and you have not addressed what happens to existing IGTs network assets – both built and in build. An existing IGT who failed to win a franchise area could have limited networks within that area which would be expensive to service long term.

We do not believe that this option is viable, or would definitely provide any benefits to consumers. Successful operators would probably restrict investment to maximise return, and this would lead to lower levels of replacement and maintenance and potential safety problems.

Option B – Rate of Return Regulation

We have commented extensively upon this, and do not believe that it would be helpful in achieving your objectives.

Option *C* – Formal price regulation for IGT's gas transportation charges

We firmly believe that endeavouring to separate the costs of connections from the asset costs that generate transportation revenue is fundamentally flawed. On an integrated new build network where the developer asks for new services to be connected, and expects the mains to be automatically extended to provide the gas for those services, the division of the functions is totally impractical and uneconomic and involves significant regulatory costs without corresponding consumer benefits.

Price regulation would need to have agreed levels of reasonable profit against reasonable costs, and to take account of the venture nature of these start up businesses, and the risks involved in the timing and volume of revenue against capital committed,

Established utilities such as Transco have such a large and established base that the risks associated with new developments are minimal when taken within the whole.

Option D – Relative price regulation for IGTs gas transportation charges

We believe that this option as described will not encourage further investment by IGTs and it is difficult to choose a truly transparent reference point.

Option E – **A** revised approach to enforcing existing licence conditions

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This proposal is for a fundamental change to the way IGTs were originally set up, which was to encourage innovation and competition in transportation.

There does not seem to be an equitable method of harmonising IGTs charging Methodologies.

An agreed definition of reasonable profit would undoubtedly lead to a cost plus scenario. This would not encourage efficiencies – in fact quite the opposite.