

## **DTI Position Paper on Policy regarding the treatment of Independent Gas Networks**

### **Issue**

1. Transco plc's ("Transco") intention to dispose of its Distribution Networks raised the question of Special Condition 18 (SC18) in Transco's gas transporter licence and the protection this condition gives to consumers in areas where gas is conveyed to premises via independent gas networks (i.e. networks not connected directly or indirectly to the main gas network).
2. SC18 requires the licensees to provide arrangements for the conveyance of gas to premises connected to independent systems. The Condition also requires that the average charge for the conveyance of gas, consisting principally of methane, to premises connected to independent systems should be no more than the average charge for all conveyance to premises in Great Britain connected otherwise than to independent systems supplied with gas at a similar rate which the licence charged on 1<sup>st</sup> March 1996, adjusted in-line with RPI. Under this condition, gas deliveries to consumers in areas not connected to the main gas network are subsidised. In the case of liquefied petroleum gas (LPG) networks, Transco is required to subsidise the cost of the gas itself as well as the costs of conveyance.
3. Commercial parties involved have calculated that the removal of SC18, without alternative arrangements, would mean that approximately 11,000 consumers would see an estimated increase in their gas bills of between £130 and £600 p.a.<sup>1</sup>, if the true cost of delivering gas to consumers on independent systems was borne by those consumers. In Stranraer, which currently benefits from the cross subsidies of SC18 although it is no longer an independent gas network, it is estimated that consumers would see an increase in their gas bills of approximately £41 p.a., if the true cost of delivering gas to consumers on Stranraer was borne by those consumers. The cost of subsidising all consumers connected to independent systems to all GB consumers is estimated to be approximately 7p-35p p.a. per consumer. These figures should be compared to an average annual gas bill of £335 p.a.

### **Background to Special Condition 18**

4. During the implementation of the Gas Act 1995, the DTI took the view that consumers connected to independent systems that were supplied with liquefied natural gas (LNG) and LPG should not be denied the advantages of competition. As a result, SC18 is a condition that was included in Transco's gas transporter licence, which took effect on 1 March 1996. Standard Condition 29 of Transco's licence was also amended to ensure that if Transco disposed of, or relinquished operational control over, the independent systems, it should put in place a suitable alternative arrangement to the like effect of SC18, or procure that such suitable alternative arrangement is put in place prior to the disposal of the independent systems.
5. There are five independent LNG networks in Scotland and four independent LPG networks (in Scotland, Wales and the North of England). All of these networks

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<sup>1</sup> Note that the actual value depends upon the type of independent system (LNG or LPG) and the location of that system)

were independent networks when SC18 was introduced (i.e. separate from the main UK gas transportation system), and all of these systems except one (Stranraer) remain independent.

6. Under the provisions of SC18, consumers connected to independent networks should be charged an average price for conveyance which is 'no more than the average charge for conveyance to premises in Great Britain' on 1<sup>st</sup> March 1996, adjusted in line with RPI. In the case of the LPG networks, Transco is required to charge no more than the amount it would have charged had the gas transported consisted principally of methane, less an amount assessed by it each year to be equal to the difference between its reasonable estimates of the average price for LPG supplied to large industrial consumers in Great Britain and the average price of gas, consisting principally of methane, supplied to large industrial consumers in Great Britain.

7. In the process of considering the licence changes that may be required to facilitate the commercial and regulatory arrangements that would be in place, should the proposed sale of distribution networks by Transco proceed, Ofgem asked the Department of Trade and Industry (DTI) to review SC18 in Transco's current GT licence.

### **DTI Policy**

8. That the existing arrangements continue. Under these arrangements:

- a. consumers connected to independent networks are charged an average price for conveyance which is no more than the average charge for conveyance to premises in GB;
- b. this average price is calculated annually;
- c. a sunset clause should exclude independent gas networks that are subsequently connected to the main gas network (e.g. Stranraer).

9. That, should Transco's proposed sale of Distribution Networks proceed, the Secretary of State would issue Transco with a Determination to confirm what 'alternative arrangements' are suitable and should apply as and from the proposed disposal by Transco. Appropriate changes to Transco's licence would be implemented by Ofgem as part of the formal consultation under section 8AA of the Gas Act 1986.

### **Reasons for Continuing the Existing Arrangements**

10. By maintaining the existing arrangements, the Secretary of State would be acting in accordance with her primary duty under section 4AA of the 1986 Gas Act. The SoS's obligation under section 4AA is to 'protect the interests of consumers in relation to gas conveyed through pipes, wherever appropriate by promoting effective competition...'.

11. DTI included SC18 in Transco's licence to ensure that consumers connected to independent networks are aligned with other GB consumers in benefiting from the economic and social aims of the Gas Act 1995, which amended the Gas Act 1986.

This remains the policy objective.

12. It would be open to interested parties to seek a review of these arrangements in due course, in the light of experience of their operation and effect.

13. This Position Paper is without prejudice to the Secretary of State's eventual decision on whether to consent to the sale of Distribution Networks, and does not fetter her discretion on that decision.