energywatch
your gas and electricity watchdog

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Dear Joanna

Gas Distribution Price Control Review: Second Consultation Document

energywatch welcomes the opportunity to respond to the issues raised by this consultation. This response is non-confidential and we are happy for it to be published on the Ofgem website.

General comments

Consumers have general expectations regarding the delivery of their gas supplies by regulated network operators. There should be safe, secure and reliable supplies of gas delivered to consumers at an economic cost and in an efficient manner. energywatch would always expect Ofgem to take note of, and conform to, these expectations when considering future regulation of gas distribution network (GDN) operators in order to protect the interests of consumers for whom it must act in accordance with its principal statutory duty.

In the specific context of the price controls applicable to GDN operators, consumers have clear objectives which will need to be met in the short term (the interim one-year price control) and in the long term (the main five-year price control) and beyond. These can be stated as follows:

- information provision – including timely and accurate quotes for connection for all consumers and efficient connection services for I&C consumers, raising all consumers' awareness of guaranteed standards and the reporting and referencing of issues raised by them with GDN operators arising from the standards, as well as specific improved notification to vulnerable consumers;

- sharing benefits and reasonable pricing for services – requiring the pass through of efficiency savings to consumers of enhanced competition arising from the recent sale by National Grid Gas (NGG) of some of the GDNs to other operators, as well as much more effective competition in other areas such as connections where costs to consumers could be much lower;

- rapid and appropriate redress – allowing consumers to have problems resolved in a timely fashion by GDN operators through recognised and effective compensatory mechanisms which reflect the application of existing and, where necessary, strengthened guaranteed standards; and

- access to gas for off-gas communities – so that the large number of consumers who remain unable to access the benefits of gas in terms of heating and cooking, particularly the fuel poor and those in rural areas, are able to gain that access through economically viable connections, appropriately financed. This could be complemented by the use of other technologies, such as micro-generation.

We will expand further on these objectives below.

The interim one-year price control (2007-08)

We agree that the scope, form and structure of the interim price control should remain similar to that of the existing price control. It would be unnecessarily onerous to make significant changes for a single year only. The duration of the interim control of one year is appropriate, allowing all relevant parties to concentrate resource on the form, structure and scope of the main control which we consider to be of far greater substance in terms of consumers' objectives. The approach to the interim price control should be confirmed as soon as possible.

We believe that the period of the interim control ought to be used to make significant advances on some of the issues which need to be determined as part of the main control, including robust cost reporting mechanisms and identification of improvements to guaranteed and operating standards of practice which can benefit consumers going forward. This period would allow Ofgem and others to develop the most appropriate incentives and outputs which will ensure that cost efficiencies will be realised sooner rather than later, and certainly before the end of the main price control period in 2013. We do not see why consumers should wait for a prolonged period, perhaps beyond the 2008-13 price control, to obtain identified efficiency benefits.

We note that significant overspends above price control allowance limits have occurred recently. We would caution that any overspend should not be automatically accepted as reflective of the necessary level of efficient spending when setting the revenue allowances and the Regulatory Asset Values (RAV) for the interim price control period. There needs to be clear justification for the level of spending, whether this was incurred efficiently in the past, and whether some of these costs are avoidable in the coming years. GDN operators should be asked to provide detailed evidence to this effect, including information on the practices used in incurring the expenditure, as this will assist in any benchmarking of best practice, reflecting whether the spend was efficient or not.

If there are areas of spending which were unforeseen during the existing price control period but likely to have benefits for the consumer, these could be included, but efficiency of spend remains a key criterion. We would also view re-openers as of limited value, to be used sparingly, and only if new spending can be identified and justified on grounds of both materiality and being incurred efficiently.

We note Ofgem's options for dealing with shrinkage costs, which appear to have increased due to higher gas prices, during the interim price control period. We have no specific comment to make on a preferred option but it is important that there are effective incentives in place to reduce costs of purchasing shrinkage. Shrinkage must be tackled efficiently, by identifying its causes, identifying solutions which minimise it, and then incorporating lower target costs into the price control with appropriate incentives to keep these costs low. Consumers should not have to meet excess costs where they are unable to influence them. It is GDN operators who can manage the risks of shrinkage most effectively. A market price-related incentive may have merit and needs to be explored further.

Information provision

There are a number of ways in which adequate and effective information provision may impact significantly to the benefit of consumers and these should be reflected in the outcomes of the enduring price control.

In terms of identifying costs of network operation and the allowances flowing from the price control to GDN operators, there needs to be rigour, clarity, transparency and consistency of approach in the development and application of cost reporting mechanisms which help to determine the applicable costs and the derived revenue allowances. Good quality of data is also needed from the GDN operators to provide an informative picture of how costs are incurred and whether they are incurred efficiently, although we see no need for a specific quality of information incentive to rewards operators for good data which should be provided as of right. GDN operators may also need to justify their reasons for a particular treatment of asset life to justify particular levels of replacement expenditure.

This approach will assist in the development of appropriate types of incentives to ensure that there will be improvement in the reliability of networks and efficiency in terms of capital, operating and replacement expenditure. Best practice should be assessed to benchmark the minimum level of optimal efficiency that all GDN operators must meet in operating their networks, if necessary, by licence obligation, without the need to remove incentives to innovate. Ofgem notes that no separate incentives are required to ensure innovation occurs and we agree that the situation with innovation incentives for improved performance on electricity distribution networks does not necessarily follow in gas.

Another aspect of effective information provision which will improve benefits to consumers relates to the guaranteed and overall standards of performance. Generally consumers remain unaware of their rights under these standards. While we recognise that Ofgem has taken steps to lay down benchmarks in this respect, consumers can encounter problems in specific areas. In particular, there can be a lack of communication with consumers in identifying who is responsible for works if consumers are requesting, for instance, that a meter is moved, or if a consumer is off-supply but does not know who to contact to enquire about or complain about the matter. Further, in relation to new connections, consumers continue to experience difficulties obtaining accurate and clear quotes for works even though guaranteed standards already cover this.

We are concerned that there is inadequate adherence to the current standards and that they require more rigorous enforcement by Ofgem where problems come to light. Any review of the guaranteed and overall standards in the run-up to the enduring price control period must address these deficiencies, as well as identification of new standards which provide all consumers, but particularly vulnerable consumers, with adequate and effective protection. We are especially interested in finding ways in which the current standards can be made more relevant and robust and can be monitored in such a way as to ensure consumer protection is not compromised whilst reducing (where possible) the regulatory burden on companies.

We see real benefit in GDN operators being more communicative with consumers and not simply leaving issues to be resolved between suppliers and consumers, assuming a supplier is involved in the issue. There is scope for applying standards more effectively not just in off-supply situations but whenever the consumer has contact with the GDN operator. We believe that potential confusion may arise with different GDN operators in place after the recent sales by NGG, although this can be resolved if there are effective communication channels established within standards of practice.

There is also a tangible benefit in GDNs working with consumers outside of emergency or other problem situations to help them understand what they can expect of the GDN and what is expected of them. There is clear evidence in the electricity market that this approach works well and helps reduce the burden during emergency situations.

Sharing benefits and reasonable pricing

We have stated above our position on how to improve data flows about costs from GDN operators to Ofgem. We believe that Ofgem is taking a pessimistic view when it argues that the benefits to consumers of the recent GDN sales will not be realised until beyond the next main price control period. The purpose of introducing competition is to identify just how new approaches to operation can reduce costs. We believe that there is already scope for some benefits through efficiency savings to be derived from the short time that the new GDN operators have been in place. These savings can be identified by rigorous and effective cost reporting and scrutiny and benchmarking of best practice by Ofgem. Where GDN operators fall below minimum standards of operation, Ofgem should ensure that revenue allowances reflect this position.

We note that revenue drivers other than ones which is volume-related may be considered for improving efficiency of the GDNs. We agree that other approaches ought to be explored. It is important that the networks are responsive to change and that there are ways of measuring efficient operation which are not tied to one method of calculating costs. Some networks may be more able to take new connections than others and this could be used as a potential revenue driver.

However, this should not detract from focusing on the baseline of costs and how GDN operators can improve efficiency.

We identified above that consumers affected by new connections do not see tangible benefits in terms of sharing in cost reductions. This may be because the connection costs are not visible through adequate and transparent quotations outlining how the final billed amount is reached, while the cost recovery of connections from some consumers, for instance by suppliers to cover the costs of connection to IGT networks, is apparent in the consumer's bill but without adequate explanation. Consumers need to see clearly how bills and quotes have been calculated when they request new connections. Competition in connections has been inadequate to date and we are aware that Ofgem intends to review the effectiveness of competition to determine whether this is the best way to assist the realisation of cost reductions which should then be passed through to consumers. We will support the review process to establish how consumers are able to obtain clear benefits, including determination of the approach which improves effective regulation.

We will also consider further the scope of excluded services under the price control. We recognise that simply bringing certain costs within the price control may increase the risks to consumers of uncertainty associated with those costs and stifle competition where that may help to reduce costs to consumers. We note that legislation such as the Traffic Management Act can create uncertainty around levels of cost recovery and we will await further details on the impact of such legislation on the price control. However, GDN operators are best placed to manage these risks and not consumers and Ofgem must ensure that consumers are protected from carrying excessive cost burdens as a result.

Rapid and appropriate redress

We noted above that there is potential for improvements to standards of performance which we believe require further work as part of the main price control. Consumers, assuming they are aware of their rights under standards of practice, would find it difficult to hold GDN operators to account for failure to operate those standards appropriately and there is a need to introduce an efficient and effective independent dispute resolution and compensation mechanism. There remain too many instances where works are commenced but consumers are not provided with adequate information about the timescales, the costs or whether the works will leave the consumer in no worse a position as prior to their commencement. Equally we have heard of many instances where work has been paid for but not competed in the agreed timescales – again a detriment to consumers – this must be guarded against and consumers must be better protected in this area.

Access to gas for off-gas communities

Ofgem has identified that network extensions to off-gas communities has potential benefits. We agree that significant numbers of consumers, many falling within the vulnerable categories of living in rural areas or who are in fuel poverty, could enjoy the real benefits of lower cost gas compared to other fuels for cooking and heating. We appreciate that recent rises in gas prices, if sustained, may actually have an adverse impact on consumers but we continue to explore ways in which we can help bring about market solutions to improve security and reliability of gas supplies for all consumers. There are also real synergies to be obtained from providing access to gas to these communities and potential reductions in fuel poverty and improvements to sustainable development which may result, helping Ofgem to attain a number of its objectives. We believe that, with economically viable provision of access, there will be realisation of these benefits. We note that Ofgem itself identifies 4600 community clusters which are physically located close to gas supplies without access to them.

An element of subsidisation of these connections may be necessary but we do not believe that this should be at the expense of passing efficiency savings arising from the price control to existing gas consumers. There are a number of initiatives associated with reducing fuel poverty which could help to part-fund new connections. This would be a much more visible way in which to extend gas networks for a specific desirable objective.

There is a clear social benefit to provide finance for new connections to off-gas communities and all funding options ought to be considered. So long as the new supply is priced on an economic basis, there should be adequate incentive on those who are to be connected to agree with the network extension (otherwise the benefit will be lost – for the fuel poor in particular). Of the options presented by Ofgem, we consider that changing the application of the 10 metre rule could be developed in conjunction with other options to provide competitive connections which may keep costs low both to new connectees and to existing network consumers. Access to cost effective energy may also be provided through other, complementary, forms of technology such as microgeneration which should also be explored in this respect. Improvement of access is not a matter of a single solution and various options may be brought together to optimise the benefit to consumers.

Going forward, we will continue to keep these issues under review as the proposals for the interim and main price controls are developed and refined, always considering the possible impact on consumers.

We would appreciate being kept informed of the progress of the consultation and any related issues to enable us to comment as the need arises.

If you do wish to discuss our response further please do not hesitate to contact me on 0191 2212072.

Yours sincerely

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