GDPCR Consultation October 2006 – response from FPAG.

FPAG is alarmed by the proposals in the Consultation paper. The proposed increase in distribution charges for 2007/8 is a very substantial one. It is 9.7% in real terms but this amounts to almost 12.5% in money of the day, allowing for inflation. Moreover, the paper indicates that the charges in 2006/7 are also likely to be nearly 10% higher than was previously expected.

We appreciate that these costs only account for about 15% of domestic gas costs, but this is likely to rise again as wholesale gas prices fall and in the meantime we estimate that the total cost increase (for 2006/7 and 2007/8 combined) represents a substantial sum of around £20 on an average customer's annual bill. **This represents as much as 7% of the average domestic customer bill before the wholesale gas price increases and thus is very significant indeed. Obviously these increases will be borne by low income customers as well as others.**

We accept also that there are some challenging issues facing network regulation. Nevertheless, these proposals will lead to another addition to prices for customers, including low income customers, at a time when bills are already extremely high and it does not seem that the balance between customers and ability to finance is being reasonably struck.

For example, theses initial proposals are favourable to the network companies in several important respects – including pass-through of increased pensions and shrinkage costs – but Ofgem proposes to maintain a cost of capital which exceeds its own latest proposal (from the recent transmission price control review) and does not reflect the fact that more risk is being passed on to consumers. This is clearly very unbalanced.

FPAG does not have the expertise to comment on the specific issues – but on a range of issues – shrinkage, cost of capital etc it looks as if customers including low income customers are being asked to bear an undue proportion of the risks and the costs. We appreciate that the companies are being asked to absorb some of their very significant capex/repex overspend, but it is our view that they should be absorbing at least half of it. Instead, it is proposed to increase the capex/repex allowance for next year by nearly 60%

More generally we are very concerned about the lack of control and the ease of passing on costs. There seems to be overspending on investment, big increases in charges in 2006/7, and an ability to pass on costs – pensions, rates, shrinkage – which other companies in other sectors would have to absorb. Customers including low income customers are paying for this.

The upshot of all this is that allowable revenues will increase by an extraordinary amount with, as the Consultation Paper notes, a far smaller increase in costs.

The context here is also important. When National Grid sold the gas distribution companies Ofgem argued that there would be benefits to customers. We are seeing the reverse here. If the new companies paid high prices for the assets that is a problem for them and customers should be securing benefits as promised, not contributing still more. Since the new owners are clearly targeting greater cost savings than those envisaged by National Grid before the disposals, we would have expected Ofgem to set a tougher efficiency incentive for reductions in controllable opex.

It almost appears, on the face of it, as if the major impact of the sale has been that 4 companies are now making the arguments which would have been made by one company and Ofgem is more susceptible to this. We hope that this will be proved wrong by changes to the proposals and by a much more robust attitude in the 5 year control.