

## FOR PUBLICATION

4<sup>th</sup> January 2007

Ms. Joanna Whittington  
Office of Gas and Electricity Markets (Ofgem)  
9 Millbank  
London  
SW1P 3GE

Dear Ms. Whittington,

### **Re: Summary of Response to the Consultation of the DN's Gas Distribution Price Control Review – Matters Relating to Infill Extensions**

On behalf of the **ESP Gas Group Ltd** ("ESP"), which includes E S Pipelines Ltd, ESP Networks Ltd, ESP Pipelines Ltd and ESP Connections Ltd, I am writing in response to the above consultation specifically to matters relating to Infill extensions. This is a summary version, for publication if required, of the more detailed letter provided in confidence.

#### **Comments on Options**

Option 1: It is ESP's view that there are too few infill projects being carried out within the UK and to do nothing is not in the best interests of consumers not connected to the gas mains. This is because many of these customers could be connected if the full benefit of the additional transportation revenue they will generate is taken into account. To do this there needs to be changes to the regulatory environment.

Option 3: Any incentive schemes on DNs should be on ways of making them actively go out and get more connections to their existing asset base rather than the current passive policy of waiting for connecting requests from these customers. Therefore if the incentive schemes were restricted to premises adjacent to the DNs' existing gas network it would force them to focus their resources on these customers first rather than their efforts being directed to infill customers instead. This will also ensure these assets generate more income so benefiting the other connected customers by reducing overall transportation charges. For example the DNs could be given a budgeted amount within their price control to actively market to these customers by communicating not only the connection costs but also the different funding schemes available to them, and in addition facilitate easier access to these funds for the customers. In conjunction there would be a target connections number of fuel poverty customers they are required to connect each year with a penalty if this target is not reached. Conversely if a DN achieves its target without spending the full budgeted amount it is permitted to retain the underspend as additional profit so encouraging efficient use of the budget.

Option 5: This option has many practical problems associated with it and without strict, and very likely quite onerous, regulatory control has the potential for anti-competitive behavior and the inefficient use of capital expenditure. It is also difficult to see how competitive neutrality can be achieved with iGTs as this option is based on an integrated DN operation and many of the suggestions could not in practice be adopted by an iGT in the same way. Therefore as this option appears to be trying to ring fence an infill operation with an existing DN, would it not be far more practical for the DN to operate a separate iGT business at arms length for its infill projects as this would have much the same effect but in a far more transparent and equitable basis.

Option 6: Of the all the options ESP generally favors this one as being the most practical to administer and also because it ensures all infill projects a clearly subjected to an economic test by both the DN and the iGT to ensure they are only funded by the income they generate without any potential of cross subsidies nor the requirement for additional funding. This will ensure capital expenditure on infill is applied in an efficient manner. The only important point to be raised with this option is how the calculated funding is provided to the project in a way that is the same for both the DN and an iGT. For example if the economic test specifies a contribution towards the CSEP connection that is higher than the actual cost of the connection the DN should give the iGT the excess to invest in the network. If not the iGT will be at a disadvantage to the DN who would be able to take into account the full amount when it assessed the project as an integrated network. It should be noted that this option would require careful monitoring by Ofgem to ensure the CSEP funding is ONLY based on income from existing domestic premises and no I&C nor new housing is included even if they are part of the new network. In addition the house AQs used need to be monitored to ensure they are not inflated to increase the CSEP funding. Therefore should this option be adopted ESP would suggest that strict guidelines are set up for Ofgem to asses a CSEP funding application before it is submitted by an iGT or by the DN itself to ensure consistency and equality.

### **Concluding Remarks**

In conclusion ESP believes that the only way DNs should be allowed to develop infill projects is as an iGT completely separate from the rest of the DN to ensure they are subjected to exactly the same conditions as other iGTs. This will ensure Ofgem can ring fence them in such a way that they cannot benefit from the DN in anti-competitive ways, and that the DNs will act the most economic and efficient way. Therefore it is ESP's belief that the incentives for infill should be specifically for an iGT (whether it be an existing iGT or a DN with a ring fenced iGT) and thus the review should focus on making it economically viable for an iGT to develop more infill projects. This can be done by additional funding being provided by the DN who is required to contribute towards the CSEP connection by taking into account the additional income they will receive to the CSEP. By this method the funding for infill will be transparent and available to all. Regarding the DNs themselves the review should focus more on incentives to make the DNs actively market to premises already within reach of their existing networks rather than the passive approach they take now, and so allow within their price control an operating budget to fund this activity in conjunction with connection targets.

Yours sincerely,

Robert Wallace  
Managing Director