

FPAG Response to Gas Distribution Price Control Review Consultation

The main focus of this response is on Network Extensions to Non-Gas Communities. However we pick up 3 other points first.

General Points

-At the time of the sale of the LDZs, FPAG argued strongly that some of the money being made on the sales by National Grid should be returned to customers. This was not done and Ofgem argued that customers would benefit from comparative competition as a result of the sales. It is absolutely critical in our view that these benefits come to customers as soon as possible. If Ofgem waits until proven savings come through in the historic data there will be very few benefits to customers before 2013. It would be possible to make a start in the 2008 to 2013 period for example by looking at the statements made by some of the new owners about their cost reduction goals and achievements.

-FPAG supports the proposed approach on capital expenditure overspend.

-The possibility of changing the volume based revenue driver is raised in 2.8. Given that the relationship between costs and outputs will always to an extent be a matter of judgement, it does seem to us that, if changes are to be proposed, it needs to be demonstrated that the current system is clearly wrong – especially in present circumstances where many households are already experiencing hardship as a result of the gas and electricity price increases. There should thus be a robust justification with cost – benefit analysis before any decisions are made about changes to the driver.

Network Extensions

We welcome the fact that Ofgem is seriously considering the issue and raising it proactively in the Consultation.

FPAG views are:

-Ofgem has a number of relevant duties here:

- to have regard to the interests of a number of different categories of vulnerable individuals
- to have regard to the interests of individuals residing in rural areas
- to promote sustainable development

The Government's Social and Environmental Guidelines are also of course very relevant.

-Extension of the gas network is important for reducing fuel poverty.

-In 2004 32% of the fuel poor in England, compared with 13% of all households, did not have gas [English House Condition Survey].

-14% of those without gas in England were fuel poor in 2004 compared with about 4.5% of those with gas – a striking difference.

-As many as 24% of those without central heating were in fuel poverty, with the proportion higher still where gas is not available. Gas network extension would normally be accompanied by the installation of gas central heating, so there is the potential for a significant impact here.

-There are about 4600 clusters of communities of 50 homes or more within 2 kms of the gas network but not connected to it [as the Consultation paper notes].

-It is estimated that there were over 100,000 households in fuel poverty in these clusters – in 2003, and this is likely to have doubled as a result of the energy price increases. If these households were removed from fuel poverty by gas network extensions then this would constitute a material contribution to the reduction in fuel poverty.

-Given that these clusters are close to the network, the cost of extending the network is not prohibitive – on average according to the DTI/NG's Design and Demonstration Unit [DDU] about £850 per house if there is an initial 75% take-up of gas. Take-up at this level might be feasible if there is a co-ordinated drive in a community to secure the installation of central heating, as has been shown by the DDU's experience.

-Funds from a number of other sources would also be used especially for work within the house – especially Government and similar programmes for low income households or areas, and contributions from those able to pay. The costs of the work in the house are about £2000-£2500 per dwelling. Thus the major part of the costs of bringing gas to non-gas homes would be borne by Government in the case of low income customers, and other gas customers would only in effect be contributing a part of the costs.

-The Government has shown its commitment to the fuel poverty targets by increasing substantially the funds available for Warm Front, the main fuel poverty programme. There was a significant increase in the 2005 -2008 Spending Round, even though this was a tight spending round, and then a further increase in the 2005 Pre-Budget Review, so that the Warm Front Programme is on average £290 p.a over the 2005-8 period compared with £170m p.a over the previous 3 years – an increase of about 70%.

-If there were support for gas network extensions from existing customers, the costs to them would be extremely small. The cost per customer p.a would be about 25p in the unlikely event that 1000 communities were connected [20% of the 4600] in the 5 year period and if half the costs of the extensions were in effect supported by existing customers.

-The incentives and drive to extend the gas network are weaker, for the reasons set out in the bullet points below, as a result of the separation of distribution and supply, and it is generally recognised that special arrangements may have to be made for new networks and extensions [as happened for example with the new gas network in Northern Ireland]. [This is not intended to be a criticism of separation which has had a range of benefits but this is one of the by-products].

-In assessing the benefits of network extension an integrated company would take account of both distribution and supply margins. This does not happen if there is separation.

-With integrated companies there is a drive to secure new customers and increase market share, which is much less pressing for those owning the pipelines

-There are significant issues of organisation and integration for network extension between the sales and supply activities on the one hand and the network activities on the other which have a greater cost if there is separation

It is important that Ofgem takes steps to offset these difficulties, which are to a degree artificial, by actively promoting network extensions

-The installation of a network extension will usually only be viable if there is significant demand for gas very quickly in a local area. In other words there is an interdependence here – a series of individual simultaneous decisions are needed. This is unusual and the market on its own will have difficulty delivering – hence again the need for some Ofgem promotion

-There are 2 significant equity points:

-Gas network extensions will as noted reduce fuel poverty

-Many existing customers were connected before the separation of distribution and supply, and also when the criteria for extension were less stringent. It is therefore not unreasonable that existing customers – many of whom themselves benefited from support from already existing customers - should provide a measure of support for network extensions.

-The gas price increases have reduced the advantages of gas compared with some other fuels. Nevertheless the installation of an efficient gas central heating system, along with a full package of insulation, remains an extremely effective way of reducing fuel poverty.

-We appreciate that any increase in costs and prices as a result of the promotion of network extensions would be unhelpful for low income customers. Nevertheless it is in our view worth doing for communities close to the gas network as this is the most effective way of reducing fuel poverty for customers in such communities.

-The Design and Demonstration Unit has done a huge amount to put together programmes for integrating and coordinating the work needed for gas network extension and especially to secure and bring together sources of finance. Some promotion via the distribution price control review could act as a catalyst – and with extremely good gearing – since this would bring these other funds and enable a significant amount of

work to be done. This should be taken into account in any assessment of the costs and benefits.

-If there were some promotion of network extensions through the price control on a reasonable scale it would certainly be feasible to ensure that coordination arrangements for network extension projects continued to be in place – either via the DDU or via other organisations such as Eaga. Ofgem would obviously need to satisfy itself on this point but no difficulty is anticipated if the support via the price control is there.

Options for promoting extensions.

FPAG does not have the expertise to comment in detail on the various options but we would make the following observations:

Any scheme should have a sizeable impact and there should be significant funds/incentives.

It will obviously be in customers' interests if there are significant incentives to minimize the costs of network extensions but it will be important to have a scheme which is simple and which does not have high transaction costs.

We would not be in favour of any scheme involving a surcharge on the customers benefiting from the network extension as this would reduce or remove the beneficial impact on fuel poverty

Option 1 – no regulatory intervention because the key barrier is lack of coordination – does not seem to us to be defensible. The Design and Demonstration Unit has as noted done a huge amount to coordinate the work, has secured some funding but has highlighted the lack of adequate funding as a key obstacle.

Option 3 appears to us to be a token gesture. It would have very little impact especially because the companies would have to make new organisational arrangements to carry out gas network extensions on a sizeable scale. It would be misleading to draw too many conclusions from the response to other incentives introduced by Ofgem.

There are a couple of references to poor targeting of existing fuel poverty programmes - without any evidence. FPAG takes a very different view – notably that some changes may be possible but that there would be severe disadvantages and costs of different ways of targeting. If these considerations are important in Ofgem's assessment of the case for the promotion of network extensions, it will be important to discuss this further.

In summary, it is FPAG's view that promotion of gas network extensions via the price control could – in tandem with other, mainly Government programmes – have a significant impact on fuel poverty. Ofgem in its duties has to have regard to the interests of individuals residing in rural areas and most of the impact of the extensions would

clearly be in rural areas. We believe therefore that the price control should provide incentives on a reasonable scale for gas network extensions.