



*Promoting choice and
value for all customers*

Gas transporters, shippers and
interested parties

Our Ref: RFA/IGT/10
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26 February 2007

Dear Colleague,

Regulation of Independent Gas Transporter (IGT) licence holders as affiliates of existing licensees

1. Ofgem has been approached by Fulcrum Pipelines regarding an application for an Independent Gas Transporter (IGT) licence. As Fulcrum Pipelines is an affiliate of National Grid Distribution, a Gas Distribution Network (GDN) we have considered whether any further action is required following the issues we raised last year with respect to affiliated IDNOs¹. This letter sets out our proposed approach and seeks views on whether it is appropriate.
2. Responses to this letter should be received by **26 March 2007** and sent to Indra Thillainathan by email to indra.thillainathan@ofgem.gov.uk.

Background

3. On 24 August 2006, Ofgem published a decision letter on the treatment of Independent Distribution Network Operators (IDNOs) that are affiliated to Distribution Network Operators (DNOs). The letter concluded that in the interests of promoting competition and protecting consumers an affiliated IDNO should be treated as part of the host DNO for the purposes of the DNO's price control. The letter also recognised that the issues raised may have a read across for our regulation of a GDN which also own an IGT. The issue of affiliate IGTs had been considered briefly as part of DN sales in 2004 when the purchase of two of the gas distribution networks by a consortium including SSE who already had an IGT took place.

¹ 156/06 - Decision letter on regulation of independent electricity distributors: affiliates of existing licensees and price control issues, August 2007; 71/06 – Regulation of independent electricity distributors; consultation on implications of licence applications from affiliates of existing licensees, April 2006.

4. Having considered this further, we have decided not to extend the approach agreed upon for affiliated IDNOs to affiliated IGTs, nor adopt any other extra provisions. The rest of the letter sets out our reasoning behind this decision.

Rationale for the different approach

5. While IGTs and IDNOs are comparable in a number of regulatory respects, the markets in which they operate are at very different stages of their development. In particular the IGT market is now well established. There are more than 850,000 customers connected to an IGT network and according to the latest data IGTs accounted for 68.2% of new connections in the new housing market in 2005. This compares with the smaller but growing IDNO market which has approximately 4,000 customers (as of September 2006) and which was responsible for approximately 0.5% of new low voltage (LV) connections (Connections Industry Review 2005/06).
6. Against this background when considering affiliated IDNOs our concern was that they may be able to avoid the restrictions imposed by the price control by carrying out an activity that they were able to do so under their DNO licence in a market which was as not yet fully established. In the context of the IGT market we do not have the same concerns because we think that the extent and established nature of the competition in the IGT market would prevent the affiliate IGT from being able to exploit potential customers. In terms of new connections in the new housing market in 2005, the GDNs have a smaller market share of 31.8% compared to the IGTs.
7. The issue of IGT affiliates and their impact on competition had already been considered by Ofgem as part of the GDN sales process in relation to Scotia Gas networks (SGN) and SSE Pipelines. At the time, Ofgem concluded that existing provisions in the licence condition and competition law powers were sufficient to address potential discrimination and competition concerns that may arise as a result of the common ownership of SGN and SSE Pipelines. No additional protections were sought. We are not aware of any new information or thinking which should lead us to change our position.
8. Another potential concern identified recently by Ofgem with regard to affiliated IGTs is the cherry picking of low cost sites. Due to the way that the Relative Price Control (RPC) operates affiliated IGTs can maximise margins by selecting low cost sites, which over time could lead to an increase in the average costs of the affiliate GDN, to the detriment of their customers. However, while this may be reason for a GDN to apply for an IGT licence, the issue of cherry picking is not exclusive to affiliated IGTs as it exists for all IGTs. Treating affiliated IGTs in the same way as affiliated IDNOs would not resolve this particular problem, although it would reduce the number of companies able to do this.

Conclusion

9. We are content that under the current arrangements and given the level and established nature of competition in the IGT market, NG would not be able to use the Fulcrum licence to avoid the effect of the price control. We will not seek to undertake any action with regard to affiliated IGTs. However, Ofgem reserves the right to reconsider this decision if we have reason to believe that the actions of GDNs with respect to affiliated IGTs are not serving the best interests of their customers. In particular we may wish to revisit the decision in the event that this was a market in which the GDNs started to compete in the same market as the IGT affiliate, and if we

thought that an IGT affiliate was doing one-offs in order to avoid its GDN licence obligations.

10. We will consider any responses received in due course. In the meantime, please feel free to contact Indra Thillainathan on 020 7901 7294 if you would like to discuss this letter further.

Yours sincerely,

Joanna Whittington
Director – Gas Distribution