

## **GAS DISTRIBUTION PRICE CONTROL REVIEW – RESPONSE FROM THE FUEL POVERTY ADVISORY GROUP**

This note briefly covers the overall level of charges and then discusses gas network extensions.

### **Overall Levels of Charges**

- **Cost of Capital**

The cost of capital remains our key concern. **Ofgem has not commented on the points made in our previous response and in the Dieter Helm article which we attached to our response. i.e. there is a clear risk here that there will be repetition of the situation where National Grid sold some of its LDZs and through this made gains for shareholders, which, at least in part, belonged to customers.**

The Consultation document maintains the assumption of a 62.5% gearing as this is needed to maintain an investment grade rating. But private purchasers of the companies would use much higher gearing. The issues are complex but it is important that Ofgem should set out its views on them.

These questions go of course beyond the energy sector and their importance has again been underlined recently by the sale of Southern Water at a 30% premium to its RAV. Although there is no information available yet to us on this it also seems likely that United Utilities will sell its electricity network at a premium to its RAV.

So we would strongly emphasize our concern that there is something wrong if regulated companies are as a matter of course sold at very substantial premia to their Regulatory Asset Values and the issue does need to be addressed.

The cost of debt being allowed seems to be generous and the cost of equity should be kept low as these are exceptionally low risk businesses.

- **Cost of capital and changes in charges**

The risks for GDNs will be reduced still further if GDNs are allowed to change their prices twice a year, if the capacity/commodity split is changed and if the volume driver is removed from the price control. We disagree with all these proposed changes but, if they are implemented, GDN revenue will be virtually fixed – apart from pass through items, incentives and an element of shrinkage. Such predictability of revenue is close to unique across companies and the low risk must be reflected in the cost of capital.

- **Opex**

On opex we are concerned about the relaxation of the targets – as a result of the use of the upper quartile rather than the best GDN and of the top down approach. The standard should be the best in class for each activity.

- **Investment**

This is difficult for us to evaluate and we can only express the hope that Ofgem will ensure that all the investment is necessary and represents the best possible value for money.

**In conclusion, the background to this price control is that, largely as a result of the one year price control, distribution charges in 2007/8 are as much as 20% higher in nominal terms [17% real] than they were in 2006/7. In addition gas and electricity prices are now again rising. These proposals will push allowed revenue still higher than the 2007/8 levels. We appreciate the challenges of setting this price control but it is particularly important this time that a balance is struck and that the interests of customers are tenaciously protected. Our concerns about the cost of capital need to be addressed.**

#### **Gas Network Extensions**

We again very much welcome Ofgem's positive approach on gas network extensions. We are grateful for the work by Ofgem on this and support the proposals.

October 2007.