



Gas Transporters, shippers and
interested parties

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value for all customers*

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Date: 18 July 2008

Dear Colleague,

Proposal to modify the non gas fuel poor network extensions incentive as outlined in gas distribution price control review final proposals document.

Introduction

1. In order to maximise the effectiveness of the non gas fuel poor networks extensions scheme we propose to extend the eligibility criteria such that;
 - Where the GDNs work with a relevant funding agency resulting in any domestic premises securing government funding to increase the affordability of "in house" work costs associated with network extensions, the premises shall be deemed as eligible for the fuel poor connections discount.
2. This letter sets out the rationale behind the above proposal and invites views on whether or not it is appropriate. Responses to this letter should be sent in electronic format to indra.thillainathan@ofgem.gov.uk to be received no later than **5.00pm on 18 August 2008**.

Background

3. Throughout the GDPCR process we consulted with relevant parties on the options available to promote extensions of the gas network to fuel poor communities. Gas is a cheaper source of space heating energy than its conventional alternatives (e.g. electricity, oil, etc) so network extensions to non-gas communities could contribute to alleviating fuel poverty. After publication of a Final Impact Assessment in Initial Proposals, we concluded that the best option was to amend the Economic Test for network extensions that tackle fuel poverty. Specifically the GDNs offer a discount on the connection charge equivalent to the present value of the net transportation revenue that it expects to receive from the new customer. The discount will then be capitalised and added to the GDNs RAV at the subsequent price control. We concluded that in excess of 10,000 non-gas households would need to be connected over the next 5 years for the scheme to pay for itself.
4. We proposed that all households within the 20% most deprived areas, as measured by the Government's Index of Multiple Deprivation (IMD) would be eligible for the scheme.

5. A discretionary reward scheme (DRS) with awards of up to £4m per annum, complements the connection discount. Under this initiative GDNs are incentivised to coordinate with existing funding bodies, such as those aimed at tackling fuel poverty and regeneration, to increase the affordability of the “in house works” element of network extensions.

The proposal

6. The current eligibility criteria allows the scheme to be focused on the most vulnerable in society. It also provides clarity as to what premises will qualify for the connection discount. However there are challenges associated with such a specific criteria;
 - Further evidence provided by BERR has suggested that the 20% most deprived areas contain a significant number of premises that will not be suitable for gas connections. These premises are predominantly tower blocks, where connection to the gas network is deemed unsuitable on both safety and economic grounds. In some parts of the country this results in a significant decrease in the pool of potential premises to connect.
 - Many fuel poor households are located outside the most deprived areas and therefore will not be captured by this measure. It is likely that many of these premises would qualify for existing Government initiatives that seek to address fuel poverty. While some initiatives such as insulation or “in house” works associated with oil heating do not require a gas connection, many grants relate directly to gas heating.
 - A narrow criteria of eligibility may make it more difficult for GDNs to combine their network extension work with existing capex and repex programmes and may mean that the most cost effective connections, such as fuel poor customers sited close to existing gas mains, are not captured by the programme.
7. Ofgem is concerned to ensure that the gas network extension project is successful in connecting a substantial number of vulnerable and fuel poor households at least cost and we are committed to putting in place arrangements that facilitate connections in excess of the minimum needed to make the project viable. In the light of the observations above, we propose to widen the parameters of the eligibility criteria such that;
 - Where the GDNs work with a relevant funding agency resulting in any domestic premises securing government funding to increase the affordability of “in house” work costs associated with network extensions, the premises shall be deemed as eligible for the fuel poor connections discount regardless of the IMD of the area.
8. This would represent a less prescriptive approach by including deserving households not captured by the IMD measure, resulting in an increased pool of eligible households. To this end the proposal remains targeted at the fuel poor/vulnerable and is additional to the work that can be carried out through the IMD criteria. It would also increase the potential of the DRS to achieve significant results.

Challenges

9. There are many government programmes, often with a specific regional focus, that provide funding either to tackle fuel poverty or promote environmentally objectives. It

is important that GDNs have clarity as to which of these grants will confer eligibility status for the fuel poor connections discount. To address this, we propose that once GDNs have explored the opportunity for building partnerships with funding agencies, they each submit to us their proposed partner(s) for our approval of their eligibility status for the network extensions scheme. We will expect the GDN to demonstrate that its partner provides funding for "in house" work and that it has appropriate screening processes in place such that grants are targeted at fuel poor or vulnerable customers.

10. Proper co-ordination between the GDN and the funding body will be important. We understand, for example, that some grants associated with increasing the affordability of network extensions are only available after the relevant premises have been connected to the gas network. This might make it difficult for the GDNs to establish the eligibility of the relevant premises for the fuel poor connection discount before making a connection. The success of the scheme will therefore vitally hinge on the relationships that the GDNs can build with the funding agencies. It is important also that such agencies are accommodating and flexible in ensuring that practical obstacles can be overcome in extending the gas network to the most vulnerable in society.
11. In this regard, we note that the work BERR is doing on gas network extension provides a partnership model that GDNs can either participate in directly or draw lessons from. BERR's Design and Demonstration Unit (DDU) in association with the Regional Development Agencies (RDA) in North-East England and Yorkshire and Humberside has established two regional Community Interest Companies to tackle fuel poverty in deprived communities. These regulated social enterprise companies have successfully piloted gas network extensions by providing a 'whole-community whole-house' approach including: screening and liaising with communities; aggregating funding from conventional and non-conventional sources; organising the installation of heating systems and measures; providing benefits and energy efficiency advice and introducing efficiencies and scale economies to all links in the gas and energy efficiency supply chains. The DDU with the support of government agencies is replicating this model in partnership with the East of England RDA and the Welsh Assembly. GDNs are encouraged to liaise with the DDU to evaluate the scope to integrate their network extension activities with these arrangements or to emulate the model in other regions.

Way Forward

12. We are interested in views on the above policy development, on the challenges identified and any other challenges that respondents can identify. In particular, we would be grateful if you would answer the following questions:
 - Q1 – Does the existing eligibility criteria make it unlikely that GDNs will connect in excess of 10,000 households over the next 5 years?
 - Q2 - Do respondents feel that extending the eligibility criteria to include premises that can secure "in house" funding will have a significant effect in extending the gas network?
 - Q3 – What sources of public funding are available for "in house" works?
 - Q4 – Do respondents agree with our proposal in paragraph 9 above for establishing the qualifying funding agencies/grants?
 - Q5 – Can respondents identify any other challenges associated with extending the eligibility criteria?

13. The responses received will inform the proposed change to the non gas fuel poor network extensions scheme. 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,

A handwritten signature in black ink, appearing to read 'Rachel Fletcher', is positioned above a light grey rectangular box.

Rachel Fletcher
Director Distribution