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Dear Rebecca

Gas and Electricity Connections Industry Review 2007-08

Thank you for giving National Grid the opportunity to provide our views on this year's Connection Industry Review (CIR). This response is on behalf of National Grid's UK Gas Distribution business. Please find below our comments on the gas related questions raised within the Review.

1. Gas connections

Is this data reasonably representative of connection charges levied by GDNs and IGTs, and adoption payments made by IGTs and GDNs?

We believe that the total gas connection charges for Gas Distribution Network (GDN) operators look reasonable, but as the figures provided are for GDNs in total, we are unable to validate the exact amount shown.

Ofgem highlight marked differences in the connection charges reported by GDNs (average of around £800) and that of IGTs (average of around £200). We cannot confirm the GDN figure, but our average connection charge for a typical domestic customer is currently around £450 (after the Domestic Load Connection Allowance (DLCA) has been excluded). We believe that the difference in connection charges is mainly due to IGT work being predominantly on greenfield and brownfield development sites and that the cost of this work is lower than working in the public highway and connecting gas to existing premises.

We are unable to provide comments on the levels of connection charges and adoption payments levied by Independent Gas Transporters (IGTs). We can confirm that National Grid does not make adoption payments for the reasons provided by Ofgem in the Review - "GDNs are not permitted to include any adoption payments that they make in their Regulated Asset Value (RAV), and cannot recover these costs from regulated revenues".

Are adoption payments the main reason why ICPs have a much higher market share in connections to IGT networks than GDN networks? Are there other factors that account for the fact that only 5% of connections to GDN networks are installed by ICPs?

We believe that adoption payments are probably a major, but not the only factor as to why ICPs have a much higher market share in connections to IGT networks.

We believe there are a number of additional reasons why ICPs do not carry out and/or offer self lay connections to GDNs and this issue differs in the different market sectors. ICPs are more likely to concentrate efforts in new housing and higher value non-domestic connections, where IGTs are more active than GDNs and margins are better. Whereas, domestic one-offs and small new housing work is less attractive due to geographic dispersion, low margin and in the case of existing domestic one-offs within 23 metres of a relevant main, the presence of the Domestic Load Connection Allowance. This is

reflected in relative market shares with IGTs controlling around 50% of all new housing work and GDNs around 98% of domestic one-offs.

In addition to adoption payments and the reasons outlined above, we believe that the statutory framework also militates against ICP activity in the one-off domestic sector and will ensure that GDNs remain the default monopoly provider for the foreseeable future. National Grid has a Gas Act duty to provide a connection and there are other statutory barriers to competition such as New Roads & Streetworks Act (NRSWA) and the aforementioned Domestic Load Connection Allowance (DLCA)[1].

Of these, NRSWA is probably the most significant barrier, as ICPs incur additional costs and longer lead times in applying for planning permission to carry out works on the public highway, that are not incurred by gas transporters. To an extent the introduction of the Traffic Management Act may improve the situation, as GDNs will have to apply for permits and comply with local authority directions in relation to highway works, including connections.

Competition is more effective in the high value non-domestic market and we believe there is scope to continue to develop competition in this sector. From October this year National Grid has applied a 12% gross margin on connection charges in this market, and from April 2009 is proposing to charge for quotations requiring a design as this will allow competition to provide these services. We are also considering whether to expand standard charging to the small non-domestic sector, in order to provide more open price discovery and thereby possibly increasing pricing headroom for competitive bespoke quotations from ICPs.

National Grid is also actively promoting connections competition on its networks. Earlier this year we introduced a web based facility allowing customers who approach us for connection services to be offered a direct route to a competitive quotation from the ICP market. Customers complete a simple electronic request form which is then forwarded by National Grid, on their behalf, to a number of competitive providers. National Grid will still provide a quotation if requested. We believe that this initiative is one of the factors behind the ICPs increasing their share of the non domestic market.

***What factors enable IGTs to make adoption payments of these magnitudes? Do they have lower costs of operation, or are other factors at play, such as the degree of headroom in the relative price control*?**

We cannot comment on the size of the adoption payments made by IGTs. The key factor for IGTs making adoption payments is the fact that their Relative Price Control (RPC) allows them to charge per property (up to a maximum/capped amount) and recover the costs from these regulated revenues.

What factors lead IGTs to charge lower connection charges? Are ICPs/IGTs more efficient at installing the connection or are other factors at play?

We question the implication that ICPs/IGTs are more efficient at installing connections and that this is the reason why they make lower connection charges. As touched on previously, this apparent discrepancy is explained by a number of reasons:

- Most of the work performed by ICPs and IGTs is on greenfield and brownfield development sites and the cost of this type of work is far lower than working in the public highway and connecting gas to existing premises.
- As well as the relative engineering ease of working on new developments, there is a further advantage, in that, the costs and complexity of complying with streetworks legislation is largely avoided.
- As IGT work is typically concentrated on large scale new housing developments, they are not exposed to supporting the low concentration, high cost and geographically dispersed customer base that characterise a GDN network.

[1] DLCA – For domestic one off connections, the costs associated with providing the mains connection and up to the first ten metres of service pipe in land dedicated to public use are excluded from the connection charge pursuant to Paragraph 1 of Standard Condition 4B of our Gas Transporter Licence, and are recovered through transportation charges, subject to the terms of the relevant DN price control..

What impact does the contrasting nature of GDN and IGT price controls have on competition in gas connections?

The contrasting nature of GDN and IGT price controls is a major factor in determining the development of competition in connections. GDNs have little incentive to actively compete for connections as they earn very little for doing such work and investment is subject to significant real regulatory risk through disallowance in the price control. In National Grid's case this has driven a view that we will ensure we comply with our statutory obligations to provide a connection, but we will not compete with other market participants other than passively.

IGTs on the other hand, have a revenue driver that effectively rewards them for more connections and a commercial incentive to offer adoption payments, which is not open to GDNs and clearly distorts the market for new housing developments.

Although this distortion may have been a necessary requirement to encourage competition alongside lighter regulatory oversight, it is questionable whether it is tenable in the future. IGTs currently have a combined portfolio of around 1 million supply points and can no longer be viewed as small start up businesses. In such circumstances, customers may benefit from a levelling of the new housing playing field with better incentives for GDNs and more comprehensive regulatory oversight of IGTs to better protect customers.

The current regime has been good for competitors in new housing and higher value non-domestic connections, but it has meant a disproportionate burden of providing high cost, low value services falls on GDNs who effectively underwrite, the market. Although there may have been benefits with competition, Ofgem might wish to examine where these benefits have accumulated.

2. GT Performance against Guaranteed Connection Standards

We seek consultation responses on whether stakeholders agree that performance standards are as high as reported, and what lessons can be learnt from the gas connections industry and applied to the electricity connections industry.

National Grid believes that it has worked hard to improve connections performance. New and revised standards of service for gas transporters were introduced 1 May 2005 and payments are made to end consumers if we fail to meet the specified service levels. We actively promote the importance of meeting customer commitments in respect of guaranteed standards in connections activities and have ensured that standards of service processes are consistent and robust. We therefore see no reason to doubt that performance is as high as reported.

As part of the initial consultation for DPCR5, we have provided some thoughts on whether aspects of the gas performance standards should be introduced to electricity connections. Given the improvements in the quality of service and the levels of competition in our network geography, we understand why it may seem for "consistency" a worthwhile approach to adopt.

However, before changes are made to the current connections framework in electricity, it is important to understand how successful the connection review initiatives[2] have been in improving performance. If Ofgem do decide to introduce financial incentives with regards to quotation request timescales, Ofgem should be mindful of the impact on competition. For example:

- Timescales for the DNO to respond to customers should not be beyond those that the competition can deliver. If the DNO has to respond to the customer in 6 working days and the competition are only resourced to do so within 10 days, then the customer may choose to use the monopoly provider and in some cases this may be regardless of the cost.
- Where a connection request requires the competitive provider to request information from the DNO first, then the DNO should provide this information in a timely manner, so that the customer can receive a competitive quotation in-line with that provided by the DNO.

[2] Last year Ofgem introduced several measures, including a new licence condition and voluntary standards for DNOs as a result of the connections review.

If you require further clarification of the points raised or need to discuss matters further please do not hesitate to contact me.

Yours sincerely, (by email)

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National Grid