Gas Distribution network
operators and other interested
parties

Promoting choice and value for all customers

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Dear Colleague

Final position on the non gas fuel poor network extension scheme

1. Introduction and background

1.1 Throughout the Gas Distribution Price Control (GDPCR) process we consulted with relevant parties on the options available to promote extensions of the gas network to fuel poor communities. Gas is usually 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 (May 2007), we concluded that the best option was to amend the Economic Test for network extensions that tackle fuel poverty. Specifically, we proposed that the Gas Distribution Networks (GDNs) could offer a discount on the connection charge (a fuel poor discount) equivalent to the net present value (NPV) of the net transportation revenue that it expects to receive from the new customer. The discount was limited to this value to ensure that existing GDN connected customers are not made worse off[1].

1.2 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 discount, but that households outside these areas would not be eligible.

1.3 On 18 July 2008 we published a consultation letter[2] seeking views[3] on our proposal to maximise the effectiveness of the non gas fuel poor network extension scheme by extending 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 discount.

[1] Under the current structure of the gas distribution price control, if the discount given to a beneficiary (which is funded via an addition to the Regulatory Asset Value -RAV- and hence charged to the generality of customers) is set equal to the NPV of that beneficiary's future payments, the existing customers will be neither better off nor worse off, because the discount is limited to the beneficiary's actual contribution to the RAV.
[2] 'Proposal to modify the non gas fuel poor network extensions incentive as outlined in gas distribution price control review final proposals document'.
[3] Summary of responses is set out in the attached appendix.

1.4 In light of respondents' views and after further thinking on our part, we have decided to widen the eligibility criteria further. This letter sets out the new criteria. In addition, following late feedback received from GDNs we would like to take this opportunity to set out our final position with respect to certain other policy aspects of the Network Extension Scheme.

2. Extending the eligibility criteria

2.1 The original eligibility criteria allowed the scheme to be focused on some of the most vulnerable in society - those in the most deprived areas. It also provided clarity as to which premises will qualify for the connection discount, based purely on location, reflecting a focus on non gas communities. However, following further thinking, we recognised that while the existing eligibility criteria allowed the scheme to target some of the most vulnerable in society, there remain a significant number of vulnerable households outside these areas who would not be able to benefit.

2.2 Accordingly, in order to better promote our policy intent that the network extension scheme should succeed in connecting the maximum number of vulnerable and fuel poor households at least cost, our 18th July 2008 consultation letter proposed that the eligibility criteria should be widened 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 discount.

2.3 In proposing to widen the criteria we recognised that it would represent a less prescriptive approach by including deserving households not captured by the IMD measure, resulting in an increased pool of eligible households. The consensus among respondents to the consultation letter was that while extending the eligibility criteria to the one outlined in our consultation letter would have a significant effect in the extending the gas network, it would still exclude some more vulnerable households that neither reside in the 20% most deprived areas nor qualify for government funds for 'in-house' works.

2.4 A significant proportion of households living in fuel poverty do not qualify for funding assistance for 'in-house' works as they do not receive qualifying benefits. For example, social housing tenants, who generally are not eligible for government grants because of their tenure, private households that don't receive benefits and those that live in hard to heat homes (e.g. solid stone walls cannot benefit from cavity insulation) that have restricted in-house options. Therefore extending the eligibility criteria to capture all fuel poor that are off gas irrespective of where they reside, and whether they would qualify for government funding for 'in-house' works would assist more vulnerable households.

2.5 On this basis, and keeping in mind our objective that the network extension scheme must target the most vulnerable in society, we have decided that the eligibility criteria should be extended so that existing households will qualify for the network extension scheme if they:

- reside within the 20% most deprived areas, as measured by the Government's Index of Multiple Deprivation (IMD), when measured at the Lower Level Super Output Area (LOSA). The index of multiple deprivation is defined separately for England, Scotland and Wales. Therefore, for instance, a Welsh household will qualify if it falls within one of the 20% most deprived areas in Wales as measured by the Welsh Index of Multiple Deprivation (WIMD); or

- are eligible for measures under Warm Front (England), the Home Energy Efficiency Scheme (Wales) or the Central Heating Programme and Warm Deal (Scotland); or

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- fall within the Priority Group (low income households and over 70 years of age)for measures under the Carbon Emissions Reduction Target (CERT); or

- are in fuel poverty based on the standard Government definition - that is spend more than 10% of their disposable income on all household fuel use to maintain a satisfactory heating regime.[4]

2.6 Note that eligibility will not be extended to non-domestic premises or domestic new build premises, regardless of whether they are in a deprived area or not. It is envisaged that developers will continue to pay for the full cost of connections for new build domestic properties.

2.7 The Carbon Emissions Reduction Target (CERT), which came into effect on 1 April 2008 and will run until 2011 places an obligation on energy suppliers to achieve targets for promoting reductions in carbon emissions in the household sector. Suppliers are obliged to direct at least 40% of carbon savings to a priority group of low-income and elderly consumers over 70 years of age. In extending the eligibility criteria for the network extension scheme to those that qualify as a priority group under CERT, we recognise that it will capture all over 70 year olds irrespective of their income status.

2.8 We note that in practice, eligible fuel poor households are unlikely to be able to afford the cost of in `house' works themselves. As not all fuel poor households will be eligible for 'in-house' government funding as identified above, they are unlikely to take up gas unless they can get some form of funding for `in house' works from other sources. Therefore we recognise that the choice of partner by the GDN may be crucial in deciding whether these households can benefit from 'in-house' works. For example, a not for profit making body such as a Community Interest Group could look to recycle profits from a programme (e.g. from CERT sponsorship by suppliers) back into community, rather than retaining it in the delivery body as profit. This could allow non-CERT/Warm Front qualifying households to receive free 'in-house' measures, and make them more likely to take up their eligibility for a fuel poor discount.

2.9 In the future we could look to widen the eligibility criteria further to take account of the Community Energy Saving Programme (CESP). With respect to gas, the CESP would run parallel to CERT, by placing a legal obligation on suppliers to invest in energy efficiency measures targeted at specific locations, particularly areas of high deprivation. Pending the outcome of the Government's consultation in December 2008, the obligation could be in place by July 2009. Once we know what the final position is on CESP we could evaluate whether those householders that would qualify for CESP should be eligible for network extensions.

3. Voucher scheme to implement policy intent

3.1 In order to facilitate the extension of eligibility criteria and the implementation of the scheme for only a given period of time, while still complying with the Gas Act, we have decided that it will be necessary to put into operation a voucher scheme.

3.2 It is our policy intent that only those domestic households as set out in paragraph 2.5 should be eligible for the network extension scheme. While non-domestic, new build domestic properties or richer households outside the most deprived areas may connect to network extensions, it is intended that they should not receive the fuel poor discount. They will continue to pay for the full cost of their network connection. In addition, we do not intend that GDNs would be able to continue to connect customers to each individual

[4] There are two definitions – one includes Housing Benefit and Income Support for mortgage interest and one excludes these.

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community based scheme[5] for an open ended period. Since the discount is funded via the RAV (see Appendix 2), we envisage that the discount available would conclude after five years. A fuel poor discount after this point would only be given to cover the cost of one-off connections.

3.3 However, the Gas Act[6] stipulates that each premise must be charged no more than previous similar sized connectees for a contribution towards the cost of a mains connection. This rule applies until the cost of the main has been recovered or twenty years, if the cost of the main has still not been recovered in that period of time[7]. While the Act allows contributions made by subsequent connectees to be less, the amount of the contribution cannot be increased.

3.4 Not being able to charge an existing domestic household a lesser amount than a similar sized non-domestic, or householders that connect at a later date would mean that we would need to widen the eligibility of the fuel poor discount to non-deserving premises (i.e non-domestics and all domestic households). Likewise, we would not be able to close a scheme after five years, unless the cost of the mains had been recovered.

3.5 We conceived the idea of a voucher scheme as a solution that would enable retention of our policy intent whilst complying with the Act. Under this solution, each connectee would be invoiced for the same contribution for the connection, but only existing domestic households that connect within the first five years of the scheme, or eligible oneoff connectees would receive a credit voucher from the GDN or GDN partner. The voucher would have a value equal to the NPV of the transportation revenue[8] for a typical 19,000kWh p.a. domestic customer in the relevant distribution network area (the maximum fuel poor discount). This voucher would allow the householder to pay for their share of the cost of the connection, up to the value of the maximum fuel poor discount. As per the original policy intent of the scheme, if the cost of the connection exceeds the maximum fuel poor discount, the householder would need to fund the difference. If the maximum fuel poor discount exceeds the cost of the connection, the householder would not be able to use the remaining value for other purposes, or to transfer that value to other householders.

3.6 As we are now widening the eligibility criteria to one-off connectees residing outside the most deprived areas, we see no other way of targeting the incentive appropriately to ensure only eligible households receive the fuel poor discount.

3.7 GDNs can choose to administer the vouchers themselves, or appoint a third party (i.e. a partner), subject to the GDN being satisfied that only eligible households will be awarded the voucher.

4. Approval of GDN partners

4.1 In the consultation we proposed that once GDNs have explored the opportunity to build partnerships with funding agencies, they would be required to submit their proposed partner(s) for our approval of their eligibility status for the network extension scheme. We also stated that we would expect the GDN to demonstrate that its partner:

- provides funding for 'in-house' works; and
- has appropriate screening process in place such that funds are targeted at fuel poor/vulnerable customers.

[5] A community scheme is defined here as a scheme which involves laying a gas main, i.e. a pipe that serves more than one premise.
[6] Section 10(7)(c)
[7] Section 10(7) of the Gas Act 1986 and regulation 3 of The Gas (Connection Charges) Regulations 2001
[8] Approximately £1500 although this will vary per network

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4.2 With respect to pre-approving partners, our main concern is whether fuel poor discounts are appropriately awarded to eligible households. For this reason, the GDN will need to demonstrate to us that they have appropriate arrangements in place with the partner assigned to award the voucher, such as stipulating in the contract that the partner must conduct a means testing for eligibility. We will review the information that GDNs provide to us and will indicate to GDNs whether or not the GDN has satisfied us that they have appropriate arrangements in place with the partner in question. However it is for GDNs to satisfy themselves that the partner in question can do the appropriate testing. Moreover, the GDN must use reasonable endeavours to ensure that its partner continues to act in a legitimate manner, otherwise fraudulent activity may result in us disallowing costs going into the RAV. We anticipate that we will review any such instances on a case by case basis.

4.3 The GT must work with an approved partner in order to undertake Network Extensions. We see the presence of an approved partner co-ordinated to fund 'in-house' works for the eligible household as a clear indication that gas will be taken up once the GT connection has been made. For this reason, GTs should not undertake to make any connections to a Network Extension scheme until it has allied itself to an approved partner that has demonstrated that it will provide funding for 'in-house works'. Failure to demonstrate that a connection has been undertaken in alliance with an approved partner may lead us to disallow any connection payments made by the GDN from going into the RAV when we come to assessing RAV additions at the next Price Control.

5. Third party connections

5.1 In line with our policy of promoting a competitive connections market, GDNs will be able to connect and adopt network extensions built by Independent Connection Providers (ICPs). GDNs must have a proper audit trail to show that this was a mechanism to fund an eligible network extension scheme and that the full benefit of the discount was passed on to the eligible customer. GDNs will not be allowed to put more than the NPV of the transportation charges in the RAV.

6. Next steps

6.1 GDNs should now endeavour to revise their connection charging methodologies accordingly to take account of the final position of the network extension scheme as set out in this letter. GDNs should submit the revised versions by **Friday 30 January 2009**, which we will look to approve as soon as possible. Having settled these matters we look forward to seeing GDNs deliver the network extension schemes.

6.2 Looking further ahead, Ofgem will consider whether to review how the arrangements are working under the Network Extension Scheme 18 months from the publication date of this letter.

6.3 If you have any questions in relation to this letter then please contact Indra Thillainathan at indra.thillainathan@ofgem.gov.uk or by telephone on 0207 901 7294.

Yours sincerely

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Appendix 1: Summary of responses to 18th July consultation

We received ten responses from all the GDNs, Energywatch, two community interest and 'not for profit' organisations set up to deliver fuel poverty and associated programmes, one commercial provider of 'in-house' measures, one charity working in the area of affordable warmth for low income households and a provider of social housing in Scotland.

A summary of their responses to the specific questions listed in the consultation letter is given below.

1. Does the existing eligibility criteria make it unlikely that GDNs will connect in excess of 10,000 households over the next five years?

Of the eight respondents that provided comments, three agreed that restricting eligibility to households within the 20% most deprived IMD areas would mean that we were likely to connect less than 10,000 households. One respondent considered that using this criteria would mask many pockets of deprivation at the local level. They suggested that a community should be eligible for the scheme if half the number of households is classified as fuel poor.

One GDN considered that it could meet its share of the national target in their area, although they could not be sure if this was the case with the other GDNs. Another GDN considered that it was important to keep the proposed policy under review against government targets and expectations. They also added that further incentive arrangements could also be explored if achieving the target was proving unlikely. For example, allowing GDNs an enhanced rate of return for progressing certain schemes.

Another respondent stated that the scheme should not look to exclude those most in need just because the type of housing stock involved is deemed to be unsuitable, i.e. people in tower blocks. Finding more imaginative solutions such as installing CHP plant for communal heating should instead be adopted. Therefore ease of access should not be prime factor in determining fuel poverty policy.

2. 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?

There was unanimous agreement from respondents that extending the criteria would have a significant effect in extending the gas network. It was considered that it would target an increased pool of households, by including those that require the most assistance but crucially fall outside the IMD score. The rural poor were cited by a couple of respondents as prime examples of households that can be fuel poor but are not within the specified IMD score.

However, it was considered essential that Ofgem widen the criteria even further in recognition that many fuel poor would not be eligible under the proposed criteria as they do not qualify for funding for 'in-house' works. Respondents identified social housing tenants that don't qualify for funds for heating schemes, hard to heat homes (with solid stone walls that would not benefit from cavity wall insulation), fuel poor that don't qualify for social benefits or persons that are under 70 years of age as examples of particular groups that while fuel poor would not be captured by the proposed criteria.

A GDN pointed out that extending the scheme to include fuel poor would increase the uptake rate for a community scheme and make the economics more viable for a GDN.

It was considered that charitable and energy advice agencies could fulfil the role of identifying the fuel poor in partnership with local authorities. They added that they were best placed to identify vulnerable households off the gas mains as they had access to socio demographic mapping data. This they considered would free up the GDNs from having to identify and engage with fuel poor customers.

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3. What sources of public funding are available for 'in-house' works?

The following sources of funding were identified by respondents: Registered Social Housing, utility companies, local authorities, Government's Warm Front (England), HEES (Wales), Warm Deal (Scotland), Warm Zone (which also accesses private funding) and CERT. Respondents added that most of these funds were not available to households if they were not receiving social benefits.

Two of the GDNs were unable to comment although a third GDN was able to cite Warm Front as a source of funding. Two GDNs stated the difficulty in accessing the schemes, with one of them citing the difficulty in obtaining public funding as a reason to why it sets up its own affordable warmth programme in partnership with others.

4. Do respondents agree with our proposal in paragraph 9 for establishing the qualifying funding agencies/grants?

There was general support for Ofgem to approve the eligibility status of a funding agency identified to act in partnership with a GDN. Views were also expressed to extend Ofgem's approval beyond funding agencies to include charitable organisations working in the area of alleviating fuel poverty such as National Energy Action and Energy Savings Trust.
While one GDN supported the requirement for Ofgem to approve a GDN/agency partnership, they considered that approval should also extend to schemes developed solely by the GDNs if they were able to reduce costs or provide free of charge, central heating as part of the gas connection. One GDN raised this approach in its response amid concerns that the different objectives and priorities of each funding agency could potentially mean a bespoke scheme for each agency, which they considered would make the schemes too complex and resource intensive for the GDN to manage effectively. The GDN added that the establishment of community interest groups could also be used as a vehicle to deliver the benefits, where no agency partner can be found.

5. Can respondents identify with any other challenges associated with extending the criteria?

The challenges identified by respondents were also set out in their answers to the previous questions, where a more detailed account is given. To recap they are:

- Wide support to widen criteria to all CERT priority recipients to allow over 70s to qualify (although respondents recognised that this would capture non-fuel poor);
- One respondent called for Ofgem to broker the partnerships in recognition of cultural and procedural differences between the GDNs and the agencies;
- Should allow GDNs to develop their own schemes where they are unable to find a suitable partner;
- GDNs should be able to partner suppliers in utilising CERT and related schemes to maximise the benefits of the scheme; and
- Review how the arrangements are working after 12 months experience.

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Appendix 2

a. The amount that goes into the RAV where GDN undertakes Network Extension

Where GDNs provide fuel poor discounts, they will be able to capitalise the discount, and recover it via additions to its Regulatory Asset Value (RAV) at the subsequent price control. We have decided to adopt two different approaches to the amount that can be put into the RAV, dependent on whether the GDN needs to recover mains costs (i.e. community based projects) or just service pipe costs (one-off connections).

Community based projects

In schemes where the GDN is recovering the cost of the mains, we would allow the GDN to put the NPV[9] of future transportation income into the RAV for a five year period, regardless of the actual cost incurred in installing the mains and service pipes. The NPV of the transportation revenue to be added to the RAV will be based on the charge rates applicable at the time the scheme was quoted for a domestic customer with a typical AQ of 19,000kWh, and will not vary throughout the five year period of the scheme as customers actually connect.

Consider the following example, where the NPV of future transportation revenues is £1,500, and the GDN estimates that the cost of mains and service for each premise is £1,000. We will allow the GDN to put £1,500 in the RAV[10] for each customer connecting within the first five years of the scheme. Any eligible one-off connection made after five years would be subject to the RAV treatment set out in the approach for one-off connections below.

By allowing the full NPV of each connection to be put into the RAV for a period of five years, the GDNs would be subject to an upside if actual connections exceed the expected number of connections, and a downside if actual connections are less than the expected number of connections. However, the upside/downside outcome will be subject to the sliding scale mechanism at the next price control, which will mitigate the risks to the GDNs if their costs exceed revenues. Under the sliding scale mechanism GDNs will bear 33-36% of any unrecovered amount, and the generality of customers will bear the rest. In the case of an over recovery the GDNs will retain 33-36% of the surplus capex and the rest will be shared by all customers.

We also consider that allowing the full NPV to be put into the RAV would have the following benefits:

- avoids administrative costs of recording the different amounts of discounts being put into the RAV;
- GDNs would be incentivised to continue connecting premises once the cost the mains had been recovered; and
- It would avoid creating an incentive for GDNs to underestimate the expected number of connections to protect against potential downside that actual uptake is lower. If the GDN under-estimates the number of connectees who are to share the mains cost, initial connectees may be charged more than they would have done if the number of connectees had been correctly estimated.

One-off connections

[9] On an NPV neutral basis.

[10] Taking appropriate account of discounting. i.e. if the GDN spends £1500 in year 2 of the price control period, an NPV equivalent amount can be added to the RAV at the time of the next price control

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In the case of one-off connections, where the GDN is only installing a service pipe, the cost of the connection is likely to be less than the NPV of revenues in many cases. Additionally, the recovery of service pipe costs from one-off connectees is relatively risk free compared to community based schemes where the cost of the mains has to be recovered and the extent of recovery will depend on the number of connections. Therefore allowing the GDN to recover an amount equivalent to the NPV irrespective of the cost of the service pipe connection would be too generous to GDNs. Hence, the GDN will only be able to put into the RAV the lesser amount of the NPV or the gross cost of the connection, which will be determined by the standard connection charge(s) and the 10m free allowance, if the premise is within 23m of the relevant main. Therefore, in the example where the NPV is £1,500, and the gross cost of a service pipe for a one-off connection is £800, the GDN will only be able to put £800 in the RAV.

b. Recovery of administration costs

In our GDPCR document we made it clear that a discretionary reward scheme (DRS) with awards of up to £4m per annum, would be made available to GDNs who participated in the network extension scheme. 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. This incentive was not intended to cover administration costs.

However, we recognise that GDNs may incur a charge by their partners for delivering the scheme on their behalf, which could include costs associated with administering the voucher scheme, including checking eligibility. Therefore, we consider that the GDNs should be able to factor reasonable administration costs into the project and recover them in the RAV. For community based schemes, as GDNs will be able to put the NPV of future transportation income into the RAV, we would expect in some cases the £1,500 per premise would cover both the cost of the connection plus the administration costs. Where it doesn't, (e.g the cost of the connection is £1,480 and admin cost is £30) the GDN would only be able to recover both costs up to the NPV, so in this example only £20 of the admin costs would be recovered through the RAV and the remaining £10 will be incurred by the GDN.

In the case of one-off connections, GDNs can put the £30 into the RAV, subject to the combined cost of the fuel poor discount and administration costs not exceeding the NPV. So where the service pipe costs are £800, the GDN can put £830 into the RAV.

c. Examples of fuel poor discount and RAV funding

Below we set out some worked examples, showing the fuel poor discount given to customers and the amount of funding that GDNs can put in the RAV in different illustrative cases.

1. Community scheme, all customers eligible, cost per premise < NPV

Expected uptake = 100 premises (all eligible customers)
Cost of mains = £100,000
Cost of mains per premise, based on expected uptake = £1,000
Cost of service pipe per premise = £350
Actual uptake = expected uptake
Total costs per premise = £1,350
NPV of future transportation income = £1,500

Within the first five years of the scheme, each premise will receive a fuel poor discount in the form of a voucher up to the value of the NPV of future transportation income. As this amount covers the cost of the connection, each premise gets the connection for free and thus no customer contribution is required. As this is a community scheme, the GDN is able to put the NPV of future transportation income into the RAV (100 x £1,500 = £150,000).

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2. Community scheme, all customers eligible, cost per premise > NPV

Expected uptake = 100 premises (all eligible customers)
Cost of mains = £100,000
Cost of mains per premise, based on expected uptake = £1,000
Cost of service pipe per premise = £600
NPV of future transportation income = £1,500

Using the above assumptions we have set out three different outturn scenarios below where the actual number of connections is equal to, higher than and lower than the expected number of connections:

i. *Actual number of connections equals expected number of connections*

- In this example, the cost of the connection is now £1,600. However, each premise can only receive a full poor discount up to the NPV of future transportation income, i.e. £1,500. Each premise is therefore required to make a contribution of £100 to meet the shortfall in the cost of the connection.

- As this is a community scheme, the GDN is able to put the NPV of future transportation income into the RAV (100 x £1,500 = £150,000).

ii. *Actual number of connections exceeds expected number of connections*

- Assume 150 premises rather than 100 premises actually connect within the first years of the scheme, all of whom are eligible for the fuel poor discount.

- The cost of connecting the first 100 connectees is £1,600 per premise as in example 2i above, and each of these customers therefore has to contribute £100 of their own money

- As the cost of the mains had already been recovered by the first 100 premises, the extra 50 premises connecting afterwards are only required to pay the cost of the service pipe, so their connection cost is equivalent to £600. As this is less than the
- NPV of future transportation income, they are not required to pay a connection contribution.

- While the mains cost remains unchanged overall, an extra 50 connections has increased service pipe costs from £60,000 to £90,000 so increasing total capex costs to £190,000.

- The GDN puts £225,000 into the RAV based on connecting 150 premises (150 x £1,500). This amounts to an over recovery of £45,000, which is over and above the net capex cost of connecting 150 premises (£190,000 - £10,000 (customer contributions) = £180,000). Under the sliding scale mechanism, depending on the network the GDN can retain 33-36% of the over recovered amount, £14,850 - £16,200 at the next price control. The rest is shared with the generality of customers.

iii. *Actual number of connections is less than expected number of connections*

- Assume instead that 50 premises rather than 100 premises actually connect within the first five years of the scheme.

- As before, each of the first 50 customers receives a fuel poor discount equivalent to the NPV of future transportation income, and is required to pay £100 contribution towards the shortfall in the connections cost.

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- Based on 50 premises connecting, the GDN only recovers £80,000 (50 x £1,600). The amount it puts into the RAV is £75,000, based on the actual number of connections (50 x £1,500) with the remaining £5,000 being funded directly by customers (50 x £100).

- The GDN has incurred the full cost of the mains (£100,000) plus the cost of 50 service pipes (50 x £600 = £30,000), totalling £130,000. However, after allowing for £5,000 worth of customer contributions, the net cost is £125,000.

- This gives an under recovery of £50,000 (£125,000 - £75,000), of which under the sliding scale mechanism only 33-36% is borne by the GDN and the remainder by the generality of customers at the next price control.

- Please note that for the avoidance of doubt, capex associated with network extensions will be subject to the capex roller, and the examples given above on a scheme by scheme basis are merely intended for illustrative purposes only.

3. Community scheme, some ineligible customers, cost per premise < NPV

Expected uptake = 100 premises
80 premises eligible
20 premises ineligible (i.e non-domestic premises)
Actual uptake = expected uptake
Cost of mains = £100,000
Cost of mains per premise = £1,000
Cost of service pipe per premise = £350
Total costs per premise = £1,350
NPV of future transportation income = £1,500

Each premise (both eligible and ineligible premises) is invoiced £1,350 for the cost of the connection. However, under the voucher scheme eligible premises within the first five years of the scheme would receive a credit equivalent to the fuel poor discount that is used to discount the cost of the connection contribution. So while their contribution is unchanged at £1,350, the voucher enables eligible premises to receive a free connection. Non-domestics pay the £1,350 connection charge. The GDN is only able to put into the RAV the NPV of future transportation income for those eligible premises that received the fuel poor discount (80 x £1,500 = £120,000).

4. One off scheme, standard connection cost < NPV

One premise located 15m away from a relevant main
Gross cost of service pipe (standard connection charge =£300 plus 10m free allowance[11] = £500) = £800
NPV of future transportation income = £1,500
Amount put into RAV = £800

The fuel poor discount would be equivalent to the gross connection cost comprising the standard connection cost and 10m free allowance. As this is less than the NPV of future transportation income, the household gets the connection for free. For one-off connections, the GDN can only put into the RAV the cost that is equivalent to the fuel poor discount, and not the NPV of future transportation income. The GDN is not able to recover both the cost of the fuel poor discount and the statutory connections charge[12] that is given to premises that are within 23 metres of the relevant main.

[11] 10m allowance applicable to premises within 23m of the relevant main
[12] Also known as the Domestic Load Connection Allowance (DLCA)

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Appendix 3

IGTs and Network Extensions

This section clarifies the position with respect to Independent Gas Transporters (IGTs) and network extensions, and the role that GDNs are expected to play to facilitate this.

a. Introduction

When consulting on the form and scope of the Network Extension scheme as part of the Gas Distribution Price Control Review (GDPCR), we stated[13] that the development of any proposals, should as much as possible, create a level playing field for all parties such as Independent Gas Transporters (IGTs) and Independent Connections Parties (ICPs). We also stated that the Gas Distribution Networks (GDNs) would need to consider the arrangements to ensure parties interested in providing network extensions are not disadvantaged.

In line with our policy of promoting the connections market as set out paragraph 5.1 of this letter, GDNs would be able to connect and adopt network extensions built by Independent Connection Providers. With respect to gas transportation, IGTs would be able to compete to own/operate a network extension against GDNs in this market by allowing them to offset the cost of the connection with a contribution received from the GDN.

b. GDN connection contribution

For an IGT connected customer both the GDN and IGT receive the benefit of a future revenue stream, as the:

- IGT receives a share of the transportation charges; and
- GDN receives the remaining share, i.e. the Connected System Entry Point (CSEP) charges.

As the GDN receives a share of the future transportation revenue from a new IGT connected customer, we would expect the GDN to pay a contribution to the IGT towards the cost of the fuel poor discount. The amount paid should be a proportion of the cost of the connection based on its share of the NPV of future transportation revenue. This contribution will then be used by the IGT to discount the cost of the connection for eligible households. The GDN is then able to capitalise the discount, and recover it via additions to its Regulatory Asset Value (RAV) at the subsequent price control in the same manner that it is able to so if the GDN undertook the network extension itself.

Where the cost of the connection is less than the NPV of future transportation income, the GDN will be able to put into the RAV the amount that is equal to its share of the NPV of future transportation income multiplied by the cost of the connection (see examples 1 and 3 below). If the cost of the connection on a community based scheme exceeds the NPV of future transportation income, the GDN will put into the RAV its share of the NPV of future transportation income (see example 2 below).

Examples for the three scenarios are given below:

Example 1: Community based project connecting to an IGT where cost of connection is less than NPV of future transportation income

Cost of mains and services (per customer) = £1,200
NPV of future transportation income = £1,500
IGT receives 40% of NPV of future transportation income = £600
GDN receives 60% of future transportation income = £900
GDN connection contribution to IGT = £1,200 x 60% = £720
Amount put into RAV = £720

[13] GDPCR Initial Proposals Document – Impact Assessment Appendices, May 2007

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The GDN will be expected to give to the IGT a contribution of £720 towards the fuel poor discount, which the IGT will use to discount the cost of the connection. This leaves a shortfall of £480 in the cost of the connection, which the IGT can meet by offering a connection discount to the customer.

Example 2: Community based project connecting to an IGT where cost of connection is more than NPV of future transportation income

Cost of mains and services (per customer) = £1,600
NPV of future transportation income = £1,500
IGT receives 40% of NPV of future transportation income = £600
GDN receives 60% of future transportation income = £900
GDN connection contribution to IGT = 1,500 x 60% = £900
Amount put into RAV = £900

The GDN will be expected to give to the IGT a contribution of £900 towards the fuel poor discount, which the IGT will use to discount the cost of the connection. This leaves a shortfall of £600 in the cost of the connection, which the IGT can meet by offering a connection discount to the customer.

Example 3: One-off connection to an IGT

One premise located 12m away from the relevant main
Gross cost of service pipe (standard connection charge = £300 plus 10m allowance = £500) = £800
NPV of future transportation income = £1,500
IGT receives 40% of NPV of future transportation income = £600
GDN receives 60% of future transportation income = £900
GDN connection contribution to IGT = £800 x 60% = £480
Amount put into the RAV = £480

The GDN's connection contribution to the IGT is £480, which leaves a shortfall of £320 in the cost of the connection, which the IGT can meet by offering a connection discount to the customer.

We reserve the right to revisit this approach for determining the GDN connection contribution in the future if we consider it to be no longer appropriate.

c. Treatment of GDN fuel poor discounts to IGTs

The GDN is able to capitalise the fuel poor discount, and recover it via additions to its Regulatory Asset Value (RAV) at the subsequent price control in the same manner that it is able to so if the GDN undertook the network extension itself. This is subject to Ofgem being satisfied that the fuel poor discount was efficiently incurred and met the eligibility criteria. Ofgem will determine the efficient level of fuel poor discount to be refunded to the IGT as part of the Price Control Review, and to be added to the GDN RAV.

d. Responsibilities of IGTs

Responsibility for determining the eligibility of the customer to receive the fuel poor discount resides with the gas transporter undertaking the network extension. So where the IGT is undertaking the network extension, it will need to determine the eligibility of the household. With respect to the approval of IGT partners and requirement to work with partners, the terms set out in Section 4 of this final position paper is applicable to all GTs, IGTs included.

Where fraudulent activity is identified on an IGT network (i.e fuel poor discounts are given to ineligible households), Ofgem will not sanction for inclusion into the GDN RAV connection contributions owing to the IGT for connections made on the IGT network in question.

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Therefore, the IGT will receive no connection contributions from the GDN for any connection made on the network where the fraud was committed. The IGT will incur the full cost of the connection in the same way, as if the scheme had been a non Network Extension one.

e. Amendment to GDN 4B connection charging statement

GDNs should insert the following paragraph into the charging statement:

Where an IGT is proposing to undertake a network extension to a fuel poor community on receipt of the relevant data the GDN will calculate the level of the fuel poor discount that would apply up to the CSEP. The fuel poor discount would be equal to the lower of either the proportion of the cost of the connection based on the GDN share of the present value of future transportation revenues to be received by the GDN (i.e. the present value of CSEP charges) or the share of the NPV of the transportation revenue. Worked examples are shown in Appendix xx. The level and timing of any payments to be made by the GDN to the IGT will be determined by Ofgem at the next Price control Review 2013-18.

Amendment to the IGT 4B connection charging statement

IGTs should amend their charging statement to take account of the Network Extension scheme.

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