

**Annex 3:****ES Pipelines Limited – Infill Business Development**

Thank you for taking the time to respond to our questions.

We hope all the questions are clear, but if you have any difficulties please email [rupika.madhura@ofgem.gov.uk](mailto:rupika.madhura@ofgem.gov.uk).

Once you have completed the questionnaire please send it back to us to the email address above. You need to return the completed response template to us by **31 October 2014**.

**Part 1 - About you**

<b>Question</b>	<b>Your response</b>
<i><b>What is your name?</b></i>	Adam Pearce
<i><b>What is your position?</b></i>	Regulatory Compliance Manager
<i><b>What are your contact details?</b></i>	<a href="mailto:adamp@espipelines.com">adamp@espipelines.com</a> 01372 225 506

**Part 2 - About your business**

<b>Question</b>	<b>Your response</b>
<i><b>What is your company's name?</b></i>	ESP Utilities Group Ltd
<i><b>What is the nature of your company's business? Please state if this involves Fuel Poor Network Extensions Scheme, or Fuel Poverty related work.</b></i>	<p>ESP Utilities Group "ESP" comprises 4 iGT licences - ES Pipelines Ltd, ESP Connections Ltd, ESP Networks Ltd, ESP Pipelines Ltd. Through Utility Infrastructure Provider ("UIP") partners, ESP builds, adopts, and maintains "last mile" gas networks.</p> <p>Part of ESP's business focuses on extending the gas network to existing houses that were not previously using natural gas as their primary heating source (termed "infill"). Typically, these infill networks are built in conjunction with registered social landlords, and are often extended to householders who are classified as 'fuel poor'.</p> <p>Over the last 18 months, ESP has been working with a number of the Gas Distribution Networks ("GDNs") on an informal basis, in order to combine the GDNs' access to the Fuel Poor Network Extension Scheme with ESP's exceptional service and expertise in bringing gas to fuel poor customers who wouldn't have otherwise had access to the distribution network.</p> <p>ESP is an active member of the National Energy Action ("NEA") Business Supporter Group and Energy Action Scotland (EAS), regularly feeding in to workshops and initiatives which seek to reduce fuel poverty. ESP also provides data to the FPAG Off-Grid Working Group.</p>
<i><b>What areas of the country does your business operate in?</b></i>	Nationally, in England, Scotland and Wales.

## Part 3 – FPNES review questions

### ***Q1 Do you think the Scheme effectively interacts with the UK heating Strategic Framework and Scotland's Heat Generation Policy Statement? How might it be improved to better align with wider activity? Please evidence your answer.***

Both the UK Heating Strategic Framework and Scotland's Heat Generation Policy Statement:

- focus on reducing carbon emissions using (where possible) sources of renewable energy;
- acknowledge the fact the gas is the most widely used and cost-effective energy for heating;
- state that, given the current cost of renewable energy and limitations in technology, gas will remain at the forefront of the UK's energy mix into the 2020s and 2030s.
- acknowledge that the infrastructure used in the distribution of natural gas can be upgraded to distribute 'green energy' such as biomethane or hydrogen.

Given this, ESP feels that it is appropriate for FPNES to continue to focus on extending the national gas network to existing properties as a means of bringing people out of fuel poverty. We do believe that the scheme could be expanded to better facilitate the objectives of both the Scheme, and the Framework and Policy Statement. The scope of the FPNES could be expanded to include funding of in-house measures.

One method of reducing carbon emissions is to reduce the demand for energy. Both the UK Heating Strategic Framework and Scotland's Heat Generation Policy Statement state the need to reduce the demand for energy by improving in-house measures, such as energy efficient boilers and insulation. In order to ensure the Scheme better aligns with the Strategic Framework, Ofgem may wish to consider extending the scope of the funding to include financial support which incentivises end users to install energy efficient boilers, or a contribution towards insulation measures.

This may only be practical to do in instances where the value of the voucher is greater than the cost of the connection, leaving a surplus which, rather than be applied to measures that could lead to reduced energy bills and lower carbon emissions, remains unspent. We would welcome any Ofgem proposal around how a customer may use any unspent funding to fund in-house measures, appreciating the challenges Ofgem faces with aligning such measures with the requirements of the Gas Act.

The government has identified District Heating Schemes as a means of reducing carbon emissions in the production of heat. ESP supports the installation of heat networks where it is cost effective to do so, however it has been ESP's experience that social landlords have replaced district heat networks with gas networks and boilers. This has been the case in recent network extension projects with certain social landlords, who gave complexity for customers and high on-going costs associated with operating a heat network as reasons for the replacement. ESP supports any changes to the FPNES scheme that give social landlords and householders the choice of how they heat their homes.

To successfully implement lower carbon energy generation, customers need to see financial savings. Social landlords opting to replace (and forgo the investment in) a relatively new heat network with gas infrastructure, demonstrates that the extension of gas networks is still an effective means of bringing customers out of fuel poverty, reflecting the objectives of the FPNES. To use the FPNES scheme to fund district heat networks may pay for the installation of the network, as it does in gas, but may also leave social landlords and those in fuel poverty with higher energy and maintenance costs.

### ***Q2 Should the Scheme be targeted at certain types of customers/certain locations to maximise long term benefits (eg over a period of 15-45 years)? If so who/which locations should be targeted and how might this best be achieved?***

Figure 1 in the consultation document shows a high level overview of the Strategic Framework for low carbon heat in buildings over time. The overview shows that the focus in the short to medium term is to continue to reduce demand for heat across all of the UK's housing stock. In the medium to long term, the strategy is to facilitate the development of heat networks in urban areas and the roll out of electric heat pumps in rural areas, with suburban areas being addressed last (due to the density of high efficiency boilers in suburban housing stock).

Many people in fuel poverty live in rural and urban areas, and whilst the majority of network extension schemes are located in suburban areas, the FPNES should not be limited to those areas only, solely to align with the government's Strategic Framework to reduce carbon emissions.

Specifically to ESP, there are many thousands of customers, both those who live in fuel poverty and those that do not, living near an ESP main who opted not to pay for a gas connection at the time the network was built. In many cases, these customers (many of whom live in fuel poverty) would not have had access to a Fuel Poor voucher at the time the network was laid and would not have been able to afford the £1,000-2,000 cost of a

connection. Formalising a process for customers on iGT networks to access FPNES vouchers will ensure customers on iGT networks can access a level of funding that is equal to that received by customers connecting directly to a GDN main.

We have received feedback from social landlords that they have found working with private landlords, in order to have a gas connection installed for the existing householders who live in fuel poverty, problematic (i.e. increases in rent to cover additional cost, or the landlord's refusal to accept a gas connection). If, through other parties' responses, Ofgem finds that this is a significant issue, ESP would welcome measures to facilitate the connection of private householders living in fuel poverty, under the FPNES scheme – particularly in light of the fact that a significant number of householders living in private rented accommodation are in fuel poverty (some research suggests a higher proportion than social tenants).

***Q3 How effectively is the Scheme interacting with these strategies and other forms of assistance? Please explain where the Scheme works well and where there are any issues.***

In ESP's experience, there has been a lack of funding for in-house measures, which has led to network extension schemes to areas with a high density of fuel poor residents not going ahead. Social landlords will apply for funding for in-house measures, only to be told that targets have been met and therefore, no funding is available. Without the funding available for the network extension *and* the in-house measures, councils and householders cannot afford to cover the difference, causing residence to remain in fuel poverty. The following are examples of projects where ESP has been working with Social landlords to extend the gas network, but the projects have been unable to proceed due to the lack of availability of funding for in-house measures, leaving the householders in fuel poverty (the number of fuel poor householders in brackets):

- [List removed for publishing]

The Green Deal is primarily aimed at private tenants and homeowners. Many people living in fuel poverty live in social housing and may be restricted as to the measures they can take under the Green Deal.

ESP would welcome any steps Ofgem or DECC take to:

1. better align the funding available for in-house measures with the FPNES funding to ensure that all householders and social landlords who require assistance can access both types of funding; and
2. ensure that suppliers are taking a variety of measures to meet their ECO targets, not just addressing the 'low hanging fruit', such as boiler replacements.

***Q4 Are there any changes we could make to the Scheme that would better align it to these strategies and forms of assistance?***

As alluded to above, ESP would like to see any surplus in the fuel poor vouchers be made available to the customer to apply to the cost of in-house measures.

Currently, the sheer number and complexity of the funding schemes available is a barrier, making it difficult:

- for customers and other parties to successfully apply for the appropriate funding; and
- to align the funding of in-house measures with the FPNES.

ESP believes that simplifying and formally aligning the two funding programmes will bring more customers out of fuel poverty than the existing approach, which is both complex and disjointed. We appreciate that mandating or incentivising suppliers to provide ECO funding to customers who are receiving a connection through the FPNES may be difficult, but ESP welcomes Ofgem's view on what steps can be taken to better align the forms of assistance available to customers living in fuel poverty.

***Q5 Does the Scheme provide an opportunity to address these issues? What changes could be made to the Scheme to help address these issues?***

ESP supports the work being carried out by groups such as the Fuel Poverty Advisory Group ("FPAG") Off-Gas Grid Working Group and the Scottish Fuel Poverty Forum, and is interested to see the output of their work. We note that one of the recommendations of the Scottish Fuel Poverty Forum was to *ensure "that the Scottish Government HEEPS programme better serve those that are not connected to the gas grid"*.

Whilst we would like to see all energy related funding policy reviewed to ensure that it sufficiently caters for customers who are not connected to the gas grid, we maintain that the most cost effective solution for these customers is to connect them to the gas grid (using the FPNES, where applicable). However, as described above, the structure of ECO and other funding initiatives do not always facilitate the needs of those customers who are in fuel poverty, not connected to the gas grid, but are looking to be connected. ESP would welcome consideration by groups such as FPAG and the Scottish Fuel Poverty Forum, as to how the various funding policies also work for customers in fuel poverty who are not connected to the gas grid, but are looking to be connected.

**Q6 Are there any other changes you would like to see made to the Scheme?  
If yes, what benefits do you think these changes will deliver?**

For many years, ESP has specialised in network extension (“infill”) projects, often to housing developments where a high proportion of residents live in fuel poverty. Part of our approach is to identify areas or individuals living in fuel poverty, and work with them in order to determine whether ESP can economically extend the gas network to reduce householders’ energy bills.

Despite the introduction and on-going development of the FPNES, ESP has found it increasingly difficult to deliver projects to those in fuel poverty for a number of reasons. These reasons are detailed below; ESP would appreciate an Ofgem view on each of the following issues:

**1. Ensuring arrangements between iGTs and GTs are formalised**

Over the past 18 months, ESP has been working in partnership with some of the GDNs on a trial of Fuel Poor Network Extension Schemes, where ESP (as the iGT) owns the network. This has been on a bi-lateral basis, with Ofgem aware of and supporting the partnership(s). These partnerships were developed without knowledge of the arrangements Ofgem put forward in its 2011 final position paper (<https://www.ofgem.gov.uk/ofgem-publications/47856/final-position-non-gas-fuel-poor-network-extension-scheme.pdf>).

Some GDNs, who have expressed a desire to work in partnership with ESP, have chosen not to, due to a perceived absence of a formal Ofgem framework, facilitating such an arrangement. Because of this, the benefits of the FPNES aren’t being fully extended to customers seeking to connect to an iGT network, and therefore the potential reach of the scheme isn’t being fulfilled.

Appendix 3 of Ofgem’s final position paper outlined the mechanism for how the FPNES should operate on iGT networks. This included a methodology for calculating the GDN discount (the value of the voucher), the responsibilities on iGTs and instructions stating that both GDNs and iGTs should amend their licences. ESP notes that neither GDNs nor iGTs amended their Connection Charging Statements to include Ofgem’s proposed insertions.

While the framework provided a mechanism that supported the inclusion of iGTs in the FPNES, it did not formally place obligations on the GDNs to work with an iGT where a customer is to be connected to the iGT’s network. The language used suggests a GDN has the option to refuse to provide an iGT with a FPNES voucher.

In order to improve the FPNES, ESP asks Ofgem to consider:

- a) Mandating that iGTs and GDNs make the amendments, put forward in the 2011 final position document, to their Connection Charging Statements by 1<sup>st</sup> April 2015;
- b) Making clear that the process set out in the 2011 final position document is the formal framework that should be adhered to in all instances where a customer on an iGT network seeks to apply for a FPNES voucher;
- c) Clarifying that any percentages used in examples in Annex 3 are for illustrative purposes only, and that the value of the voucher should be based on the NPV of the GDN’s future transportation income;
- d) Clarifying that customers awarded a FPNES voucher on an iGT network count towards the relevant GDN’s RIIIO FPNES target.

Making these or similar amendments will ensure:

- Fuel Poor customers connecting to an iGT network receive the same level of financial assistance as they would on a GDN network;
- Would ensure consistency for all customers across GDN areas; and,
- Increased GDN/iGT collaboration, leading to an increase in the number of viable iGT led FPNES across Great Britain.

**2. Use of GDN FPNES voucher in conjunction with the iGT surcharge**

In part f, Annex 3 of Ofgem’s final position paper, in relation to an iGT connection that is eligible for the FPNES, Ofgem stated that “iGTs will not be able to apply the RPC surcharge to these schemes”. No reasoning was provided with this decision.

It is ESP’s view that the FPNES voucher and the surcharge are not mutually exclusive, and could be used in conjunction with one another.

The FPNES voucher is applied based on the GDN’s revenue only, regardless of whether the iGT owns and operates the ‘last mile’ of the network. It is a capitalised amount, based on an AQ of 19,000kwh and is recovered by the GDN over a 5 year period through increased charges to all shippers. Once the five year recovery period finishes, theoretically, the average transportation charge across all the relevant GDN’s supply points decreases but the GDN continues to charge the relevant shipper transportation charges for the supply point connected using the FPNES voucher. The purpose of the FPNES voucher is to aid in bringing energy consumers out of fuel poverty.

The iGT infill surcharge is based only on the iGT's revenue, applied to projects/connections where the iGT owns and operates the 'last mile' of the network. It is a per kwh supplemental transportation charge made to an individual supply point based on the actual consumption of gas at a given property (i.e. a lower consumption than the 19,000kwh used to calculate the value of a FPNES voucher), lasting no more than 20 years. The purpose of the surcharge is to allow for an increased investment from an iGT, to make previously uneconomical network extension schemes viable.

Where the GDN owns and operates a new network, fuel poor householders connecting to the network benefit from a voucher based on 100% of transportation revenues (based on 19,000kwh consumption). Where the same fuel poor customer connects to a network owned by an iGT, the customer can only benefit from a connection which is discounted based on either:

- a. the iGT surcharge (based on actual consumption); or
- b. an FPNES voucher, equivalent to the value of the GDN's transportation charges to the CSEP (60% is used as an illustration in Ofgem's final position paper).

This position creates a disparity between the abilities of GDNs and iGTs to discount the cost of a customer's connection. The figures below are from a recent project where ESP was in talks with a GDN around applying a FPNES voucher:

(1) Mains and service cost per customer*:	<i>£[figures in confidential response]</i>
(2) GDN FPNES voucher (to CSEP, 60%):	<i>£[figures in confidential response]</i>
(3) iGT Surcharge investment:	<i>£[figures in confidential response]</i>
(4) GDN CSEP FPNES voucher + Surcharge (2 + 3):	<i>£[figures in confidential response]</i>
(5) GDN FPNES voucher** (all the way, 100%):	<i>£[figures in confidential response]</i>

\*Standard iGT contribution already deducted from cost to customer (approx. *£[figures in confidential response]*).

\*\*Approximate figure, based on (2) being 60% of NPV of transportation income.

Currently, iGTs have the option to deduct either (2) or (3) from the cost of the customer's connection. If the network extension were to be carried out by the GDN, the customer would benefit from a deduction approximately equal to the sum of (5) – a disparity of £1,108 ((5) – (2)). Allowing the iGT to apply both the GDN FPNES voucher and the iGT surcharge, wouldn't completely remove this disparity, but it would close the gap in the financial support offered to customers on GDN and iGT networks.

ESP asks Ofgem to consider:

- a) Allowing an iGT to apply the infill surcharge to its charges, in instances where the GDN has applied the FPNES voucher to charges to the CSEP; and,
- b) Clarify 2(a) in a formalised framework (referred to in 1(a/b) above).

Enabling this will ensure:

- There is less disparity between the connection subsidy received by a customer connecting to a GDN network and 'like-for-like' customer, connecting to an iGT network;
- That one funding mechanism supports the other, with both objectives of extending the gas network (surcharge) and bringing energy consumers out of fuel poverty (FPNES voucher) being achieved.

### 3. FPNES vouchers applied to one-off connections (with supplemental charge)

ESP has identified over 6,500 properties near an ESP main that do not currently have a gas service in to the premises. Many of these properties are located in areas where fuel poverty is particularly prevalent and therefore, householders were unable to fund the cost of a connection to their property at the time the mains network was installed. ESP invested in the vast majority of these networks on the basis of applying the infill surcharge to all connected properties.

With the introduction of FPNES vouchers, customers in a similar position near a GDN network are able to receive a (circa.) £1,500 voucher towards the cost of their connection. By contrast, a customer on an iGT network receives a small contribution towards the cost of a connection (on average £220). The iGT makes this contribution to customers out of the transportation revenue that it earns, taking in to account the considerable contribution the iGT will have already made towards the cost of laying the original mains network.

This £1,280 (approximate) disparity prevents fuel poor customers on iGT networks from obtaining a gas connection.

In order to ensure GDN and iGT customers receive the same level of financial support, ESP asks Ofgem to consider:

- a) For individual customers on existing iGT networks, permitting the use of a GDN Fuel Poor voucher on iGT networks where the infill surcharge is applied, under the framework referred to in 1(a/b) above;

- b) Clarifying 3(a) as part of the framework referred to in 1(a/b);
- c) An alternative proposal to 3(a) above, allowing householders connecting to an iGT network to receive the same level of financial support as those connecting to a GDN main.

Making these, or similar, amendments will ensure:

- All customers living in fuel poverty receive a similar level of financial support, regardless of the GDN/iGT to which they are connecting;
- More customers living in fuel poverty will be connected to the gas network – maximising the reach of the FPNES.

#### 4. FPNES vouchers applied with supplemental charge on 'difficult to reach' projects

ESP specialises in identifying potential 'difficult to reach' infill schemes. ESP has found that potential projects to rural communities become uneconomical where a feeder main of 2km or greater is required to extend the grid to the new area.

In order to reach these communities, further subsidies are required. We are interested to understand whether Ofgem (and industry) believes increasing subsidies for difficult to reach infill schemes is the most cost effective means of helping people living in rural areas out of fuel poverty. ESP believes that a controlled increase in subsidies for gas network extension, applied only to difficult to reach infill projects, and in conjunction with the installation of in-house measures, is the most feasible means of reducing levels of fuel poverty in rural areas.

In order to ensure these 'difficult to reach' projects are economically viable, ESP asks Ofgem to consider one or a number of the following:

- a) Permitting the GDN FPNES voucher to be applied in conjunction with the iGT surcharge on projects;
- b) Allowing a secondary FPNES voucher to be applied specifically to the cost associated with a project's feeder main, where that new main is 2km+ in length.
- c) Permitting a GT to charge a regulated secondary surcharge on projects which include a new feeder main of 2km or more in length;

Introducing such measures will ensure:

- Projects to bring gas to rural communities, with a high density of fuel poverty, will no longer be too costly for customers;
- An increase in the number of customers being taken out of fuel poverty through the FPNES scheme.

#### Q7 Do you agree with the updates to the eligibility criteria suggested in Annex 1? If not, please explain your rationale and any other changes you would like to see?

ESP believes that by increasing the IMD limit from 20% to 25%, energy companies are further encouraged to target customers who can be catered for at the least expense to themselves, rather than focusing their efforts on the areas of real need. We do acknowledge, however, that this increase is being proposed to align the FPNES with the requirements for CSCO.

#### Q8 Do you agree with this change to the average domestic gas consumption value?

ESP agrees with Ofgem that AQs have reduced, however we do not agree that the level of Fuel Poor vouchers should rely on the annual quantity of gas consumption, for the following reasons:

1. Based on the current methodology for calculating the value of a customer's voucher, a decrease in AQ will lead to a decrease in the financial assistance a customer in fuel poverty receives. Given the reduction in assistance, fewer fuel poor customers will be able to pay the residual costs left after the voucher has been applied. As with the majority of methodologies, ESP would expect any change to be considered against the objectives of the relevant methodology. If the objective of the FPNES methodology is to be reflective of transportation revenues, then one could argue that reducing AQs to mirror current consumption does better facilitate that objective. Whereas, an objective to maximise the number of fuel poor customers being connected to the gas grid would not be better facilitated by a reduction in AQ.
2. Networks are designed based on peak flow (SHQ), not on AQ. The cost of connecting two customers that have the same SHQ but one uses 4,000kwh less gas than the other, would be the same (all else being equal).
3. The voucher's value, which is offset against the cost of a connection, is calculated based on transportation revenues. This leads to a discount that (1) is not reflective of the cost of the specific connection and (2) varies from region to region. The effect of this is that a customer in an area where the cost of a connection is high and transportation revenues are low, may end up paying far more for

a like-for-like connection than a customer in an area with a low cost of connection and high transportation revenues. The current methodology, therefore, does discriminate against customers based on where in the UK they live.

ESP believes that the FPNES is a programme that requires only minor, positive amendments to enable it to better serve customers. Reducing the value of the vouchers, for any reason, will be seen as a negative step by Ofgem and industry. Appreciating that the methodology used to calculate the value of vouchers needs to align with the requirements of the Gas Act, ESP would like to see a methodology which is stable and non-discriminatory, for all customers seeking to move out of fuel poverty.