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Interested parties and  
stakeholders

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Date: 5 August 2015

Dear Stakeholder,

**Consultation on our minded-to position for the determination of revised connections target and associated additional allowed expenditure for Fuel Poor Network Extension Scheme under RIIO-GD1 price control uncertainty mechanism**

This letter sets out our minded-to position to change to the Fuel Poor Network Extension Scheme (FPNES) (the "Scheme") connections targets for the Gas Distribution Companies (GDNs) RIIO-GD1 price control<sup>1</sup>. This follows on from our review<sup>2</sup> of the Scheme using the uncertainty mechanism provided in RIIO-GD1 for this review.

We would welcome your response to the following two specific questions:

**Questions 1: Do you agree with our assessment of revised connections target for the GDNs for the Scheme?**

**Questions 2: Do you agree with our assessment of the additional allowed expenditure for the GDNs to facilitate additional connections under the Scheme?**

The deadline for the response is 3 September 2015 and it should be sent to Rupika Madhura ([rupika.madhura@ofgem.gov.uk](mailto:rupika.madhura@ofgem.gov.uk)).

## **Our minded-to position**

Subject to consideration of the consultation responses, we are minded to revise the total connections target to 91,203, which is 18 per cent more than the current total number of connections of 77,450 committed to be delivered in RIIO-GD1. We are also minded to increase the allowed expenditure by £15.9 million<sup>3</sup> to reflect the potential increase in the connections target.

## **Background to the Scheme**

The Scheme enables eligible households to switch to natural gas by helping towards the cost of connecting to the gas network.

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<sup>1</sup> RIIO-GD1 is the current price control (2013-2021). RIIO stands for Revenue = Incentives and Innovation and Outputs.

<sup>2</sup> The final proposals documents can be found here: <https://www.ofgem.gov.uk/network-regulation-riio-model/riio-gd1-price-control>

<sup>3</sup> All financial prices are in 2014-15 price base.

One of the principal social outputs for GDNs under the current price control period<sup>4</sup> is the connection of fuel poor households to the gas grid. Currently, GDNs are expected to deliver a total of 77,450 new fuel poor connections under RIIO-GD1. In administering the Scheme, GDNs need to work with a partner organisation, approved by us.

The key principle of the Scheme is that each connection is self-financing, i.e. in time the cost of providing the connection will be recovered from the fuel poor household connected to the gas network and won't require cross subsidy from the generality of consumers. The cost of the connection is recovered by the GDN over the regulatory life time of the asset<sup>5</sup> through the gas bills paid by the household connected under the Scheme.

The Scheme provides a discount to eligible households against the cost of connecting to the gas network in the form of a "voucher". To be eligible for a voucher, a household must qualify as per our eligibility criteria for the Scheme.<sup>6</sup>

The maximum value of the voucher is equal to the net present value (NPV) of the future gas transportation revenue for a typical domestic gas household. If the value of the voucher is less than the actual cost of making the connection, then the household must fund the difference. If the value of the voucher is equal to, or higher, than the cost of making the connection then the household does not have to make an up-front payment to be connected. For clarity, if the cost of the connection is lower than the NPV of future gas transportation revenue, the voucher value is capped at the cost of the gas connection.

## Our review of the Scheme

Special Condition 3F of the GDN's gas transporter licences allows us<sup>7</sup> to review the Scheme once during RIIO-GD1 period. We said we would use this power to review the Scheme during the price control period to ensure that it is in line with the wider government energy and fuel poverty strategies. We launched our review in August 2014 seeking views on how well the scheme is aligned with government policy, whether any changes are required to maximise the scheme's benefits to households eligible for our Scheme, and if any administrative updates were required such as changes to the eligibility criteria and assumptions used to calculate the voucher value<sup>8</sup>.

We published our conclusions from the review of the Scheme in March 2015.<sup>9</sup> Our conclusions were:

- a. the Scheme will continue for the remainder of RIIO-GD1
- b. the GDNs can connect more eligible households in RIIO-GD1, than originally envisaged
- c. strengthening incentives on GDNs to incentivise them to outperform connection targets under the Scheme and therefore a new incentive would be placed on GDN's
- d. the scheme could be extended to support district heating solutions<sup>10</sup>

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<sup>4</sup> The Scheme is delivered by the Gas Distribution Network (GDN) companies. It was introduced in the previous price control period (GDPCR 1) during which the GDNs connected 43,615 fuel poor households.

<sup>5</sup> The regulatory lifetime of all assets is 45 years for RIIO-GD1

<sup>6</sup> The current eligibility criteria are set out in paragraph 2.5 of our 2011 decision letter – this is available here: <https://www.ofgem.gov.uk/ofgem-publications/47856/final-position-non-gas-fuel-poor-network-extension-scheme.pdf>. New eligibility criteria that will apply from 1 April 2016 are set out in appendix 5 of the March 2015 consultation document which can be found here: <https://www.ofgem.gov.uk/gas/distribution-networks/gb-gas-distribution-network>

<sup>7</sup> The terms 'the Authority', 'Ofgem', 'us' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

<sup>8</sup> A copy of the August 2014 review can be found here: <https://www.ofgem.gov.uk/publications-and-updates/fuel-poor-network-extension-scheme-review-consultation-letter>

<sup>9</sup> A copy of the March 2015 document can be found here: <https://www.ofgem.gov.uk/publications-and-updates/findings-our-review-fuel-poor-network-extension-scheme>

<sup>10</sup> This refers to district heating projects that are connected to a mains gas supply only.

- e. we revised the eligibility criteria (to be applicable from 1 April 2016) to make it consistent with the changing landscape of other schemes offering assistance to low income and vulnerable consumers
- f. we would introduce a voucher calculator GDNs can apply to consistently calculate eligible funding.

In March 2015, we also sought further views on changes to the Scheme required to take forward some of our conclusions. In particular, we asked for comments on:

- a. how the voucher calculation should be changed to encourage district heating connections
- b. what gas consumption and asset life assumptions should be included in the voucher calculation for district heating projects
- c. if the eligibility and partnership criteria should be changed to enable district heating connections
- d. how the scheme can be modified to better enable gas connections for eligible households located on network adjacent to a GDN operated by Independent Gas Transporter (iGT) networks
- e. views on using the medium gas Typical Domestic Consumption Value as the average gas consumption value in the fuel poor voucher calculation
- f. views on the introduction of the new fuel poor incentive mechanism.

Our decisions on the issues that we consulted on in March 2015 will be published in September 2015.

### **Our request to the GDNs to resubmit the connection numbers**

We concluded in March 2015 that the GDNs can connect more households under the Scheme than their current target of 77,450 set under RIIO-GD1. This is because:

- a. GDNs have accumulated experience of delivering the Scheme and are now better placed to revise that forecast
- b. we propose to extend the Scheme to include district heating
- c. revisions we have made to the eligibility criteria
- d. recent announcements made by us and government to assist off-gas grid low income and vulnerable consumers should facilitate more connections.

We used the uncertainty mechanism provided under RIIO-GD1 to request that the GDNs re-submit their business plan on connection numbers.

We requested that the GDNs should provide supporting evidence, analysis and the rationale they have used to revise their connection forecasts. At the very minimum the submission had to:

- a. include evidence and a description of stakeholder engagement activities the GDNs have undertaken and are likely to undertake in the future, in order to identify and deliver the potential connections to eligible households. This included engagement with social housing agencies and iGTs
- b. take into account changes to the Scheme highlighted in the March 2015 document and provide a forecast including and excluding district heating connections
- c. take into account recent announcements for increased funding for off-gas grid vulnerable households.

We acknowledged that some of the updates to the Scheme were not finalised in time for the GDNs to re-submit their revised forecast of connection numbers. This may have made it more difficult for GDNs to forecast with certainty how many eligible households they can

connect under the Scheme. However, we believe our proposal to apply a fuel poor output incentive mechanism mitigated this risk of uncertainty.<sup>11</sup>

## GDNs' submissions

Following our review of the Scheme we asked the GDNs to submit revised fuel poor connections forecasts for the RIIO-GD1 period, as set out in Table 1.

**Table 1: Revised fuel poor connections for RIIO-GD1**

GDN	RIIO-GD1 original total targets	Additional proposed connections	RIIO-GD1 revised total targets	Increase %	District heating
East of England	10,080	1,966	12,046		0
London	2,880	0	2,880		0
North West	13,330	0	13,330		0
West Midlands	8,360	0	8,360		0
<b>National Grid Gas</b>	<b>34,650</b>	<b>1,966</b>	<b>36,616</b>	<b>6%</b>	<b>0</b>
<b>Northern Gas Networks</b>	<b>12,000</b>	<b>2,500</b>	<b>14,500</b>	<b>21%</b>	<b>21</b>
Scotland	11,000	6,130	17,130	56%	557
Southern	9,000	1,367	10,367	15%	345
<b>Scotia Gas Networks</b>	<b>20,000</b>	<b>7,497</b>	<b>27,497</b>	<b>37%</b>	<b>902</b>
<b>Wales and West</b>	<b>10,800</b>	<b>1,790</b>	<b>12,590</b>	<b>17%</b>	<b>18</b>
<b>Industry total</b>	<b>77,450</b>	<b>13,753</b>	<b>91,203</b>	<b>18%</b>	<b>941</b>

### National Grid Gas Distribution (NGGD)

NGGD estimate they can undertake an additional 1,966 connections in the RIIO-GD1 price control period. That would increase their connection target by 6 per cent from 34,650 connections to 36,616 connections. All of the additional gas connections would occur in the East of England Network

NGGD also forecast that they will not take forward any district heating connections during the RIIO-GD1 price control period.

NGGD supported their reforecasts of connection numbers by providing evidence of stakeholder engagement they undertook. In particular, NGGD stated that they have sought stakeholder views through engaging directly with them for example using their annual engagement survey and otherwise through their fuel poor delivery partner, Affordable Warmth Solutions to gain expert input.

NGGD stated that the environment for delivering fuel poor connections is not certain. They consider there is uncertainty around funding due to tightening local authority budgets and because no long term funding strategy is in place.

They are also concerned that some changes to the Scheme – such as the average gas consumption value – will mean the funding available to fuel poor households will not cover connection costs in rural areas and complex areas like London. Customers in these areas will need to make a contribution to cover connections costs for much shorter lengths of network connection in comparison to less complicated areas. This is reflected in the connection targets submitted by NGGD where additional connections are forecast in the East of England

<sup>11</sup> A description of the fuel poor incentive mechanism can be found in our March 2015 document which is available here: <https://www.ofgem.gov.uk/publications-and-updates/findings-our-review-fuel-poor-network-extension-scheme>

area only. For their other network areas, they believe that there is not enough evidence to conclude that demand for connections will increase much more from the present levels.

They also note it is more difficult to find new schemes and connections as more fuel poor customers are connected to the network.

On district heating, although NNGD welcomed our decision to extend the Scheme, they state there is significant uncertainty around the availability of funding to deliver in-house measures necessary for district heating installations. Furthermore their external engagement in this area suggests that even though there is interest in greater use of heat networks the knowledge in this area is limited. Due to this feedback and evidence, they have not provided any numbers on district heating connection.

Given these uncertainties in their view, NNGD requested another opportunity to reforecast the connection numbers at end of 2016-17.

### Northern Gas Networks (NGN)

NGN estimate they can take forward an additional 2,500 gas connections during the RIIO-GD1 price control period. That would increase their connection target by 21 per cent from 12,000 connections to 14,500 connections.

They also estimate they can take forward 21 district heating connections during the price control period.

NGN provided evidence of stakeholder engagement they carried out to reforecast the connection numbers. They noted this engagement takes different forms including holding direct discussions, engaging through workshops and using social media to promote the scheme.

NGN contacted local authorities and social landlords directly about the changes to the Scheme and availability of funding. As a result, a number local authorities bid for DECC's Central Heating Fund.<sup>12</sup> They note private landlords are a more difficult group to access but NGN are attempting to increase engagement through third sector organisations and local authority fuel poverty leads.

NGN also outline four factors they took into account when calculating the revised forecasts. This included changes to the percentage of most deprived eligible for the Scheme, using the Hills Reports criteria to assess fuel poverty, assuming some local authorities will be successful with bids for funding DECC's central heating fund, and additional connections that may become available as a result of National Energy Action's "redressing the balance" programme.

NGN found it difficult to forecast the number of district heating connections due to their lack of experience to date in delivering such projects. The forecast they submitted was therefore a small number of 21 such connections based on discussions with local authorities and Registered Social Landlords to establish if they have plans to develop district heating schemes.

### Scotia Gas Networks (SGN)

SGN estimate they can take forward an additional 7,497 gas connections during the RIIO-GD1 price control period. That would increase their connection target by 37 per cent from 20,000 connections to 27,497 connections. Most of these additional connections (6,130) would take place in the Scotland gas network – this equates to a 56 per cent increase in connections on this network.

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<sup>12</sup> A description of fund can be found on DECC's website: <https://www.gov.uk/government/policies/household-energy>

SGN also estimate they can make 902 district heating connections during the price control period. The majority of the district heating connections (557) will be made in the Scotland network with a further 345 being made in the Southern network.

SGN note that the revised connection targets they submitted were based on discussions with stakeholders. This engagement included contacting stakeholders including District Councils and Housing Associations about the changes being made to the Scheme. They also assumed that a percentage of local authorities in their Southern Network will access funding for in-house measurers through DECC's Central Heating Fund.

SGN's district heating connection target was calculated based on the stakeholder engagement activity described above. SGN note they have already carried out a significant number of district heating schemes in both the GDPCR1 and RIIO-GD1 price controls.

### Wales and West Utilities (WWU)

WWU forecast they can make an additional 1,790 gas connections during the RIIO-GD1 price control period. This would increase their connection target by 17 per cent from 10,800 connections to 12,590 connections.

WWU also estimate they can make 18 district heating connections during the price control period.

WWU supported their forecasts of connection numbers by providing evidence of the stakeholder engagement they undertook. Their response listed the direct discussions they held with a range of stakeholders, including energy suppliers, local authorities, housing associations and fuel poverty charities to identify vulnerable consumers and the potential connecting eligible customers.

These discussions with their stakeholders identified several themes. Firstly the availability of funding to enable fuel poor connections is uncertain. WWU's connection forecasts assume stakeholders are able to access existing and new funding sources which will allow them to take forward projects. WWU have also assumed some local authorities will be successful in receiving support for in-house works through DECC's Central Heating Fund.

WWU's stakeholders also highlighted to them the success of the NEST scheme, which aims to reduce fuel poverty in Wales and runs until March 2016. WWU have discussed the potential for this particular scheme to continue beyond March 2016 with the Welsh Government.

On district heating, WWU received very little interest from their stakeholders. They consider this may be because their area contains a low number of high rise buildings, and potential eligible households without a gas supply have had other energy efficiency measures installed. As a result they forecast 18 such connections to be made. WWU confirm they are involved in pilot studies and working with partners to deliver district heating connections. This includes building a model to better understand the costs of conventional gas mains compared to a district heating connection.

## **Our minded-to decision**

Subject to consideration of the consultation responses, we are minded-to set the total connections targets to 91,203 as shown in table 2 below. This would mean a total of 91,203 connections will be delivered in RIIO-GD1 - an 18 per cent increase in the total number of connections committed to be delivered at the start of the price control period (77,450). This decision is explained below.

**Table 2: RIIO- GD1 connection Targets (Original and Revised)**

<b>GDN</b>	<b>RIIO-GD1 original total targets</b>	<b>Additional proposed connections</b>	<b>RIIO-GD1 revised total targets</b>
East of England	10,080	1,966	12,046
London	2,880	0	2,880
North West	13,330	0	13,330
West Midlands	8,360	0	8,360
<b>National Grid Gas</b>	<b>34,650</b>	<b>1,966</b>	<b>36,616</b>
<b>Northern Gas Networks</b>	<b>12,000</b>	<b>2,500</b>	<b>14,500</b>
Scotland	11,000	6,130	17,130
Southern	9,000	1,367	10,367
<b>Scotia Gas Networks</b>	<b>20,000</b>	<b>7,497</b>	<b>27,497</b>
<b>Wales and West</b>	<b>10,800</b>	<b>1,790</b>	<b>12,590</b>
<b>Industry total</b>	<b>77,450</b>	<b>13,753</b>	<b>91,203</b>

The revised connection figures in Table 2 are a combination of one-off and community connections that we believe can be delivered by GDNs and do not include district heating connection and connections made on iGT networks. The reason for excluding district heating connections and connections made on iGT networks by GDNs as well as the explanation of our mechanisms to continue to support delivery of these excluded connections by GDNs are set out in the sections below.

In arriving at our decision, our analysis considered viability of the revised connection numbers submitted by each GDN and we gave due consideration to the supporting evidence provided by the GDNs. On balance, we accepted the forecasts provided by the GDNs.

NGGD did request an opportunity to reforecast the number of connections they could make at the end of 2016-17. We understand why NGGD would like this opportunity as it would allow NGGD to submit targets, which take into account greater certainty of funding and experience of delivering projects under the revised Scheme. However, Special Condition 3F of the GDN's gas transporter licences only allows one opportunity to reset the connection targets during RIIO-GD1. As a result, we cannot allow GDNs to submit revised numbers again in this price control period. We are keen for the GDNs to outperform the targets we are minded to set and we consider our proposed incentive mechanism that we consulted on in March 2015 is sufficient to incentivise outperformance by GDNs.

### **District heating connections**

Based on the information submitted by the GDNs, we think it is not appropriate to include district heating connection in the total connections targets for each GDN for the Scheme for RIIO-GD1.

This is because NGGD, WWU and NGN are likely to make either no connections or a very low number of such connections. They highlight lack of experience of delivering district heating projects, uncertainty over funding and lack of interest as some of the reasons why it is difficult to forecast a greater number of connections with certainty. On this basis, we believe it is not appropriate to set targets for district heating connections.

Even though we are not setting a specific target for district heating connections in RIIO-GD1, we do continue to believe it is appropriate for the Scheme to cover district heating where it is beneficial for fuel poor and vulnerable households. We acknowledge that SGN has already made a number of district heating connections in RIIO-GD1 price control to assist fuel poor and vulnerable households and are forecasting to connect more. We welcome SGN's ability and commitment in this area. We note that SGN's ability to facilitate these connections is

helped by Scottish Government's targets to increase heat networks in Scotland, availability of associated funding and SGN's considerable past experience in delivering such connections.

We acknowledge the potential for district heating to help alleviate fuel poverty and to encourage GDNs to facilitate such beneficial connections, we will allow GDNs to add efficient costs of connections made under the Scheme to Regulatory Asset Value (RAV) at the end of RII0-GD1. GDNs would need to demonstrate that any district heating connections efficient costs that are eligible for addition to RAV also meet the following criteria:

- a. the connection benefits fuel poor consumers who are eligible under our eligibility criteria for the Scheme and has been delivered using an approved partner
- b. the connection is made post 1 April 2016<sup>13</sup>
- c. the fuel poor connection is self-financing – the GDNs supplying gas to a district heating scheme recovers the cost of connection used in the voucher calculation from the fuel poor connected customer
- d. the voucher value is calculated using the Ofgem standardised voucher calculator. We will publish this calculator as part of our final decision in September 2015.

### **Connections on iGT network**

Our March 2015 consultation document sought views on how the Scheme could be modified to enable more connections for eligible fuel poor households located adjacent to iGT networks.

We received a joint response from GDN and iGT, which proposed a process to facilitate more connections on iGT networks. The process was developed jointly by the iGTs and GDNs. The joint response stated the steps both iGTs and GDNs would take to assess and agree the fuel poor voucher amount. This included who would undertake the validity check, calculate the voucher value, complete any necessary work, and invoicing and cost pass through arrangements. We held a meeting with iGT and GDN representatives to discuss the process described in their joint submission more in detail.

Six other respondents to the consultation commented on this issue as well. One of the respondents suggested we need to review how the voucher costs are passed between GDNs and iGTs, and the treatment of single household customers on iGT networks to improve the number of connections.

We are committed to ensuring the needs of vulnerable households are met, regardless of whether they connect to a GDN or iGT network. We have explained previously (in Appendix 3 of our 2011 decision) how iGTs can participate in the Scheme.<sup>14</sup> We stated that "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." The GDN contribution should be based on a proportion of the cost of the connection based on the GDN share of the NPV of future gas transportation revenue. The contribution is used by the iGT to discount the cost of connecting eligible households. The GDN is able to recover its contribution in subsequent price controls by adding its contribution to its RAV, at the end of the current price control in which the connection is delivered.

We were encouraged that iGTs and GDNs showed commitment to helping the fuel poor and vulnerable household and worked in collaboration to respond to our consultation.

However, we consider that the process proposed by the GDNs and iGTs, would break the self-financing principle of the Scheme (described earlier in this letter). This is because their

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<sup>13</sup> Although if, following our final proposals in September 2015 on revised connections targets, GDNs are able to make district heating connections between October 2015 and 1 April 2016, we will consider efficient cost of such connections for RAV additions where they also meet the additional criteria (a), (c), (d) set out on this page.

<sup>14</sup> A copy of our 2011 decision document can be found here: <https://www.ofgem.gov.uk/ofgem-publications/47856/final-position-non-gas-fuel-poor-network-extension-scheme.pdf>



proposal could result in the cost incurred to connect eligible households under the Scheme to be subsidised by the generality of GDN consumers.

We have therefore decided to reject this proposal. Our existing policy in this area, including the self-financing principle of the Scheme, will continue to apply.

### Question 1: Do you agree with our assessment on revised connections target for GDNs for the Scheme?

#### Our decision on additional allowed expenditure

We are minded to propose an overall adjustment to allowed expenditure of £15.9 million<sup>15</sup> to facilitate delivery of additional 13,753 connections under the Scheme.

The increased allowed expenditure will have a neutral impact on the bills of the generality of GDN consumers. This is because the self-financing principle of the Scheme means the additional allowed expenditure will be paid for by the newly connected gas network consumers under the Scheme over a 45 year time period.

Table 3 shows our proposal on adjustment to additional allowed expenditure by GDN.

**Table 3: Proposed adjustment to allowed expenditure in RIIO-GD1**

GDN	Adjustment to totex (£m)
East of England	2.3
London	-
North West	-
West Midlands	-
<b>National Grid Gas</b>	<b>2.3</b>
<b>Northern Gas</b>	<b>2.9</b>
Scotland	7.0
Southern	1.7
<b>Scotia Gas Networks</b>	<b>8.7</b>
<b>Wales and West</b>	<b>2.0</b>
<b>Industry total</b>	<b>15.9</b>

We have calculated an efficient unit cost based on the GDNs' actual data submitted to us in their 2013-14 Regulatory Reporting Packs (RRPs), which ranged from £1,013 to £2,141.<sup>16</sup>

Consistent with our approach used in setting allowed expenditure for RIIO-GD1, we have set a unit cost based on the upper quartile GDN and consider the efficient unit cost to be £1,181<sup>17</sup> per connection.

### Question 2: Do you agree with our assessment on adjustment to the allowed expenditure of GDNs to facilitate additional connections under the Scheme?

#### Next steps

<sup>15</sup> All financial values are in 2014-15 price base.

<sup>16</sup> We adjusted the GDN 2013-14 RRP unit costs for regional factors consistent with those used in setting RIIO-GD1 final proposals.

<sup>17</sup> Adjusted for regional factors.

We will publish our final decision by the end of September 2015 on revised connection targets for the Scheme and associated adjustment to allowed expenditure.

We will also conclude on the remaining policy questions on the Scheme by the end of September 2015 for the revised Scheme to apply from 1 April 2016. In addition, our decision will be accompanied by a consultation on changes to the associated licence condition.

## **Responses and consent to share information**

Responses to this consultation should be sent by 03 September 2015 to:

**Rupika Madhura**  
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Smarter Grids and Governance  
Ofgem  
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London, SW1P 3GE  
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Unless clearly marked as confidential, all responses will be published by placing them in Ofgem's library and on its website ([www.ofgem.gov.uk](http://www.ofgem.gov.uk)). Respondents may request that their response, or part of response is kept confidential and those who wish to do so should clearly mark their documents to that effect and include reasons for confidentiality. Ofgem shall respect this request, subject to disclose requirements, for example, under the freedom of Information Act 2000 or the Environment Information Regulations 2004. It would be helpful if responses could be submitted electronically and/or in writing.

Yours faithfully,



**Paul Branston**  
Associate Partner, Gas Networks