Promoting choice and value for all gas and electricity customers

Gas distribution price control initial proposals 2008-2013

Factsheet 68 27.06.07 www.ofgem.gov.uk

Energy regulator Ofgem has published its initial proposals for price controls for the four companies that run the networks transporting gas to people's homes. The price controls set the maximum revenue that these companies can earn from charges to customers.

First gas distribution review since change of ownership

National Grid (NG) decided to sell four of its eight gas distribution networks (GDNs) to new owners in 2005 which was the biggest change in the corporate structure of gas infrastructure since privatisation in 1986.

Benefits for customers

The sale means that when setting price controls, Ofgem is, for the first time, able to compare the performance of four different owners of gas networks – National Grid Gas, Northern Gas Networks, Scotia Gas Networks and Wales and West Utilities.

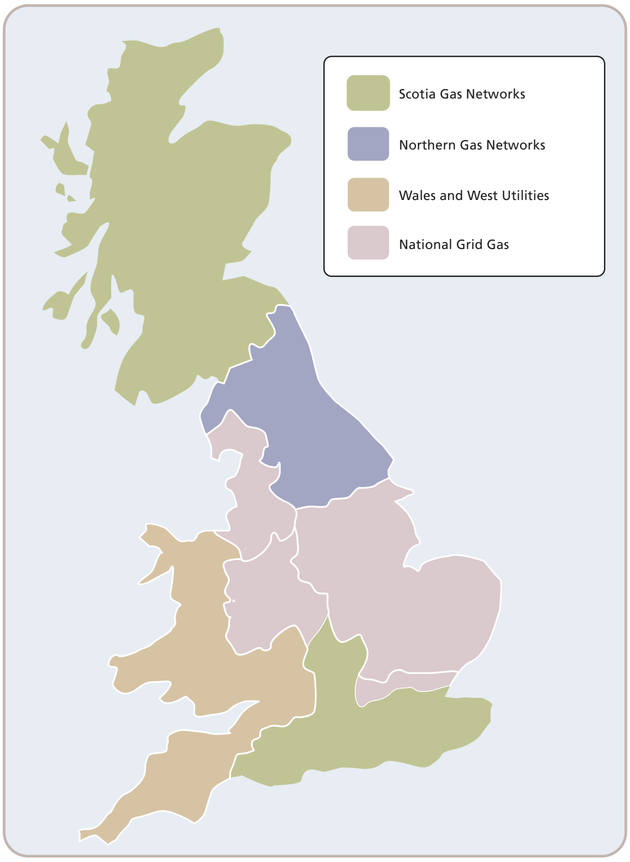
Using these comparisons Ofgem will be in a position to set more challenging price controls to encourage GDNs to operate more efficiently.

A one-year price control was agreed for 2007 to 2008. Delaying the five year control by one year means that a more reliable data set will be available on which to base comparisons when setting the main price control for 2008-2013.

At the time of the distribution network sales, Ofgem identified potential savings for customers of around £225 million over 18 years. It is expected that the majority of these savings will feed through to customers after 2013, when the next price control is set.

In electricity distribution, separate ownership of the networks has allowed Ofgem to compare performance and set tough price controls which have resulted in the costs of electricity distribution being halved since privatisation in 1989.

The map below shows which networks were purchased and which networks NG retained.



Ofgem's initial proposals

Ofgem is proposing a reduction in the GDNs' operating expenditure of 3.3 per cent a year from forecast actual levels in 2006-07 which is a challenging target.

The GDNs face rising costs for an ongoing 30-year programme of mains replacement approved by the Health and Safety Executive to address safety concerns. This programme was introduced in 2002 and means all iron gas mains within 30 metres of homes and premises must be replaced over the 30-year period.

The GDNs need to invest more in their networks to accommodate growth in gas demand. The proposals allow for increases in capital and replacement expenditure compared with the previous price control period (2002-2007) of 26 and 32 per cent respectively.

The GDNs will have a total allowance for capital and replacement expenditure of around £1 billion per year between 2008 and 2013. This includes an average annual allowance of £328 million for capital expenditure and £654 million for mains replacement expenditure.

Nevertheless, Ofgem has protected customers by challenging the GDNs' expenditure forecasts. The average allowance for capital expenditure is 17 per cent less than the companies requested. The average replacement expenditure allowance is also 18 per cent less than the GDNs' forecasts.

Cost of capital

As part of the price control Ofgem sets the rate of return the companies are allowed to recoup when they invest in their networks - this is the cost of capital. Ofgem has yet to complete detailed analysis on cost of capital for the GDNs. The decision on the final figure will not be taken until final proposals. For the initial proposals Ofgem has had to use a modelling assumption which gives a cost of capital of 4.84 per cent representing the amount of cash companies must pay to shareholders and lenders.

Improving customer service

Part of Ofgem's review of the GDNs has focused on considering how they can improve the service they offer customers and also what improvements customers themselves would like to see. The companies have a number of customer service obligations and some of these are to be strengthened.

For example, the ten days GDNs are currently allowed to complete reinstatement at a customer's premises after work has finished on a connection or a pipe has been repaired will be halved to five days. Where a GDN fails to achieve this service standard, domestic customers will receive a payment of £50 and business customers £100. Customers will receive further payments for each additional five working days until the reinstatement work is complete.

Two other existing requirements have been redefined as guaranteed standards of performance. A payment to customers will now be awarded if a GDN doesn't give adequate notice of planned supply interruptions. They will also have to pay customers if they don't give an appropriate response to complaints within 10 days.

Sustainable development of local gas networks

Heating a home using mains gas can be cheaper and can emit less carbon than fuel oil for example. So extending the gas network can in some circumstances help to alleviate fuel poverty and have environmental benefits.

In recognition of this and consistent with its sustainable development duties Ofgem has proposed that upfront connection charges are reduced to help connect up fuel-poor communities. In addition there will be other financial incentives for a GDN that does an exceptional job in facilitating extensions, for example, by coordinating various sources of government funding for central heating systems or insulation.

Timeline for the review:

initial proposals: May 2007 | updated proposals: September 2007 | final proposals: December 2007

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