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13 March 2008

Dear Colleague,

Revised Section 23 Notice for National Grid Gas's SO incentives from 1 April 2008

On 27 February 2008 the Authority published its final proposals and statutory consultation for the system operator (SO) incentive schemes for NGET (National Grid Electricity Transmission plc) and NGG (National Grid Gas plc) to apply from 1 April 2008.

It has come to our attention that there is a minor error in the proposed licence modification for the gas SO incentive scheme which is contained in the notice issued under section 23 of the Gas Act 1986¹ (the "Notice").

This minor error is in the drafting of the uplift for the shadow price of carbon included in the shrinkage incentive. The intent of our final proposals (as consulted on) was to use the shadow price of carbon to further incentivise NGG to reduce the use of NTS compressors recognising the environmental impact of using fuel for compression purposes. The licence drafting contained in the original section 23 Notice did not achieve this intent as the shadow price of carbon was applied to all shrinkage volumes in the incentive target (rather than compressor usage) and was applied to the absolute target volume rather than the difference between target and outturn. The revised drafting applies the shadow price of carbon to the difference between target and outturn compressor fuel volumes such that if NGG runs compressors less than forecast there is an additional benefit to it through the incentive. Correspondingly, if NGG runs compressors more than forecast there is an additional cost to it through the incentive. Thus the revised drafting creates the appropriate additional incentives relating to the environmental impacts of operating compressors.

Accordingly, the Authority is issuing a revised section 23 Notice (the "revised Notice") in order to address these issues.² The revised Notice is provided with this

¹ The Notice can be found here:

<http://www.ofgem.gov.uk/Markets/WhlMkts/EffSystemOps/SystOpIncent/Documents1/Gas%20Licence%20Modification%20Notice.pdf>

letter. We draw your attention to paragraph 4(d) of the Schedule to the revised Notice which sets out the new proposed modification in relation to the uplift for the shadow price of carbon included in the shrinkage incentive. The revised drafting is as follows (the drafting is marked up in this letter in order to show the difference between the new proposed modification and the modification proposed in the Notice):

For sub-paragraph (e) (The NTS SO gas cost incentive target (GCIT_t)) substitute:

(e) The NTS SO gas cost incentive target (GCIT_{t,q})

- (i) For the purposes of paragraph 2(c) of this condition, the NTS SO gas cost incentive target (GCIT_{t,q}) (in £) in respect of relevant quarter year q in formula year t shall be derived from the following formula:

$$GCIT_{t,q} = (GCRP_{t,q} \times GVTP_{t,q} \times 10,000) + (ECRP_{t,q} \times EVTP_{t,q} \times 10,000) + (GECVT_{t,q} - GECVP_{t,q}) \times SPCU_{t,q} + DUOS_{t,q} + TNUOS_{t,q}$$

- (ii) For the purposes of the formula set out in sub-paragraph (e)(i) above:

GCRP_{t,q} means the NTS SO gas cost reference price in respect of relevant quarter year q and shall be calculated in accordance with paragraph 2(f) of this condition;

GVTP_{t,q} means the NTS SO gas target volumes in respect of relevant quarter year q, and is derived from the following formula:

$$GVTP_{t,q} = GSVTP_{t,q} + GCVVP_{t,q}$$

where,

GSVTP_{t,q} means NTS SO shrinkage gas target volumes in GWh in respect of relevant quarter year q. In respect of formula year t=7, GSVTP_{t,q} is derived from the following table:

SFAF _t (mcm/day)	GSVTP _{t,q} q=1	GSVTP _{t,q} q=2	GSVTP _{t,q} q=3	GSVTP _{t,q} q=4
SFAF _t < 85	1108	944	1149	1205
85 ≤ SFAF _t < 90	1306	1103	1357	1427

² For the avoidance of doubt, the Authority does not intend to direct to modify NGG's Gas Transporter licence to implement the amendments set out in the Notice published on 27 February 2008.

$90 \leq \text{SFAF}_t < 95$	1386	1167	1441	1516
$95 \leq \text{SFAF}_t < 100$	1465	1231	1524	1605
$100 \leq \text{SFAF}_t < 105$	1545	1295	1608	1694
$\text{SFAF}_t > 105$	1719	1435	1791	1890

$\text{GCVVP}_{t,q}$ means NTS SO CV shrinkage gas performance volume in respect of the relevant quarter year q and is defined as the aggregate volume of shrinkage gas (GWh) in respect of the relevant quarter year q that arises as a consequence of the calculation of daily calorific values – alternative method, under section 4A(1)(b) of the Gas (Calculation of Thermal Energy) (Amendment) Regulations 2002 which is directly attributable to any or all of the offtakes ROSS, DYFFRYN CLYDACH, COWPEN BEWLEY and/or as a result of gas entering a Distribution Network without passing through the NTS;

$\text{ECRP}_{t,q}$ means the NTS SO electricity cost reference price in respect of relevant quarter year q in formula year t=7 and shall be calculated in accordance with paragraph 2(fA) of this condition;

$\text{EVTP}_{t,q}$ means the NTS SO shrinkage electricity target volumes in GWh in respect of relevant quarter year q and in respect of formula year t=7, is derived from the following table:

SFAF_t (mcm/day)	$\text{EVTP}_{t,q}$ for q=1	$\text{EVTP}_{t,q}$ for q=2	$\text{EVTP}_{t,q}$ for q=3	$\text{EVTP}_{t,q}$ for q=4
$\text{SFAF}_t < 85$	1	2	43	46
$85 \leq \text{SFAF}_t < 90$	1	2	53	56
$90 \leq \text{SFAF}_t < 95$	2	2	57	61
$95 \leq \text{SFAF}_t < 100$	2	2	61	65
$100 \leq \text{SFAF}_t < 105$	2	2	65	69
$\text{SFAF}_t > 105$	2	3	73	78

$GECVT_{t,q}$ means the NTS SO compression volume target in GWh in respect of relevant quarter year q and in respect of formula year t=7. $GECVT_{t,q}$ is dependent on $GSVTP_{t,q}$ and $EVTP_{t,q}$ (which are derived from the tables above for the appropriate value of $SFAF_t$) and is given by the following formula:

$$GECVT_{t,q} = GSVTP_{t,q} - GCVVT_{t,q} - GUAVT_{t,q} + (3 \times EVTP_{t,q})$$

where:

$GCVVT_{t,q}$ means the NTS SO calorific value shrinkage gas volume target in GWh which in respect of each relevant quarter year q in respect of formula year t=7 shall take the value 37.5GWh; and

$GUAVT_{t,q}$ means the NTS SO unaccounted for gas volume target in GWh which in respect of each relevant quarter year q in respect of formula year t=7 shall take the value 244.5GWh.

$GECVP_{t,q}$ means the volume of gas in GWh and electricity in gas-equivalent GWh (that is volume of electricity multiplied by a factor of 3) purchased for the purpose of compression energy in respect of relevant quarter year q in formula year t;

$SPCU_{t,q}$ is the uplift required to reflect the shadow price of carbon which in respect of each relevant quarter year q in formula year t=7 shall take the value 0.533 p/kWh and in respect of each relevant quarter year q in formula year t=8 shall take the value 0.543 p/kWh;

~~$SPCUG_{t,q}$ is the uplift required to reflect the shadow price of carbon in the gas cost reference price which in respect of each relevant quarter year q in formula year t=7 shall take the value 0.533 p/kWh and in respect of each relevant quarter year q in formula year t=8 shall take the value 0.543 p/kWh;~~

~~$SPCUE_{t,q}$ is the uplift required to reflect the shadow price of carbon in the electricity cost reference price which in respect of each relevant quarter year q in formula year t=7 shall take the value 0.593 p/kWh;~~

$DUOS_{t,q}$ means the Distribution Use of System charge incurred by the licensee in operating its electric driven compressors and in respect of relevant quarter year q is derived from the table below:

DUOS _{t,q} (£)	q=1	q=2	q=3	q=4
t=7	221,107	339,957	505,529	505,529

TNUOS_{t,q} means the Transmission Network Use of System charge incurred by the licensee in operating its electric compressors and in respect of relevant quarter year q is derived from the table below:

TNUOS _{t,q} (£)	q=1	q=2	q=3	q=4
t=7	350,426	350,426	350,426	350,426

SFAF_t means the average daily gas flows through the St. Fergus terminal in mcm/day in the formula year t commencing on 1 April 2008, calculated as:

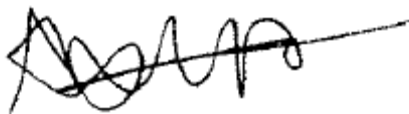
$$\frac{\text{(Total annual volumetric flow through St Fergus terminal)}}{365}$$

We have in addition identified a typographical error in the Notice concerning the derivation of the gas cost reference price. In the Notice the uplift factor of 0.055p/kWh which is currently included in the licence has been omitted. This error is rectified by the proposed drafting in paragraph 4(f) of the revised Notice.

Any representations or objections to the proposed licence modification in the revised Notice should be made before 10 April 2008.

If you have any queries regarding this letter or the revised Notice please contact me on the above number or contact Kersti Berge on 020 7901 7223 or by email at kersti.berge@ofgem.gov.uk.

Yours sincerely



Andrew Wright
Managing Director, GB Markets