Modification proposal:	Joint GDN charging modification proposal DNPC06 – LDZ Exit Capacity Charges		
Decision:	The Authority[1] directs that this proposal be made[2]		
Target audience:	Gas Transporters, GDNs, Gas Shippers, Gas Suppliers, Gas Customers and other interested parties		
Date of publication:	11 November 2010	Implementation Date:	1 October 2012

Background to the modification proposal

National Grid (NG) National Transmission System (NTS) currently levies NTS Exit Capacity and Commodity Charges directly to Gas Distribution Network (GDN) Shippers. However, following the implementation of UNC 0195AV[3] on 1 October 2012, NG (NTS) will cease to levy NTS Exit Capacity Charges direct to shippers and will instead levy them upon GDNs. GDNs are therefore in turn proposing to introduce new LDZ Charges to shippers to recover the NTS Exit Capacity Charges.

On 18 January 2010 the GDNs published a "Pricing Consultation Paper" (DNPC06)[4] with proposals for Local Distribution Zone (LDZ) Charges to recover NTS Exit Capacity Costs. Four proposals were consulted on.

Modification proposal ("the proposal")

On 15 October 2010, the GDNs submitted a Pricing Consultation Report on DNPC06[5] to the Authority for a decision. The report recommended that the Gas Transportation Charging Methodology for <u>all</u> GDNs be changed as follows:

- Introduce a new charge to be levied on Shippers called LDZ Exit Capacity NTS (ECN) Charges to recover the cost of using the upstream transmission network;
- This will be a pence per peak day kWh rate per day applied to the measure of capacity of the Supply Point (System Offtake Quantity)[6];
- The LDZ ECN charge will have a single uniform rate within each Exit Zone[7];
- The DNs will introduce a separate "K" factor for the LDZ ECN Charge for the purposes of setting the levels of this new charge. The "K" factor is the adjustment mechanism that will be used to cover any under/over recovery of charges. It will correct any over/under recovery of charges for the LDZ NTS Offtake each year.

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[1] The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.
[2] This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.
[3] UNC195AV: Introduction of Enduring NTS Exit Capacity Arrangements
[4] Distribution Networks Pricing Consultation Report on DNPC06 - Proposals for LDZ Charges to Recover NTS Exit Capacity Costs which can be found here: http://www.gasgovernance.co.uk/dnpc06
[5] This can be found here: http://www.gasgovernance.co.uk/dnpc06
[6] This is the maximum volume of gas in GWh that a customer can take off the network in a day
[7] This defined within the UNC (Section A 1.3). These are exit points on the LDZ which are grouped together for NTS charging purposes.

- The level of the LDZ ECN charges across Exit Zones will be set each year to reflect the forecast average unit NTS exit capacity costs for capacity at NTS/LDZ Offtakes within each Exit Zone for the forthcoming year plus or minus the appropriate K ECN under or over recovery. For the initial LDZ ECN charges applicable from 1 October 2012, the charges will reflect the forecast costs for the period October 2012 to March 2013 inclusive;

- The new LDZ ECN charge will become effective from 1 October 2012.

The Authority's decision

The Authority has considered the issues raised by DNPC06 and the subsequent report[8] submitted 15 October 2010. The Authority has concluded that:

1. The implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the methodology[9]; and

2. A decision not to veto the proposal is consistent with the Authority's principal objective and statutory duties[10].

The Authority has therefore decided **not to veto** the proposed modification.

Reasons for the Authority's decision

We note that all of the respondents to the consultation supported the introduction of this charge. We have captured supporting comments against each of the relevant objectives below.

compliance with the charging methodology results in charges which reflect the costs incurred by the Licensee in its transportation business – SSC A5(5)(a)

The GDNs consider that this proposal better meets the relevant objective because setting the rate of LDZ ECN charges by Exit Zone will provide the optimum cost-reflectivity as it will more closely reflect the charges which GDNs will be paying to the NTS than a LDZ ECN charge set at network level.

We agree as the proposal would result in charges to shippers that closely reflect the NTS exit charges that will be imposed on GDNs from October 2012 and therefore better meet the relevant objective SSC A5(5)(a).

In addition, we note that the great majority of respondents have supported the application of the levying of Exit charges by Exit Zone rather than by network. Network level charges would be less cost reflective.

compliance with the charging methodology facilitates effective competition between gas shippers and between gas suppliers SSC A5(5)(c)

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[8] The report and representations can be viewed on the Joint Office of Gas Transporters website at www.gasgovernance.com
[9] As set out in Standard Special Condition A5(5) of the gas transporters licence.
[10] The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986.

GDNs consider the proposed change would probably have little impact on competition between shippers but would do nothing to discourage it and, therefore, do not consider that it has an effect on this objective.

We agree the proposal would have little impact on competition as the charges will closely reflect the existing structure of NTS Exit Charges that are currently charged directly to shippers.

There may be some benefit to shippers because the GDNs are not proposing to align the timing of changes in the LDZ ECN charge to changes of the Exit Capacity charges on the NTS. The GDNs are proposing to set indicative and final charges for the LDZ NTS Exit Capacity charges in April 2012, for application with effect from 1 October 2012. This will mean greater predictability about the LDZ ECN charges the Shippers will bear each year as shippers will have greater foresight of upcoming changes to charges. We consider this increase in predictability may lead to marginal benefits in competition between shippers and, therefore, the proposal better achieves relevant objective SSC A5(5)(c).

the charging methodology properly takes account of developments in the transportation business SSC A5(5)(b)

We note the proposal reflects the fact that NTS Exit Capacity charging reform from UNC 0195AV means that GDNs will be charged exit charges from October 2012 and must establish a method for passing these onto shippers. We, therefore, consider the proposal takes account of these developments in its transportation business so better achieves relevant objective SSC A5(5)(b).

Decision notice

In accordance with Standard Special Condition A5 of the Gas Transporters Licence, the Authority has decided not to veto charging proposal DNPC06: Methodology for determining the Balance of Revenue recovery between LDZ System Charges and Customer Charges.

Rachel Fletcher
Partner, Distribution
Signed on behalf of the Authority and authorised for that purpose.