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Date: 20 April 2012

Decision letter: Determining new revenue drivers for South East exit capacity

In December 2011, we[1] consulted[2] on our preferred approach to setting two new revenue drivers to support potential investment for new exit capacity in the South East (SE) quadrant of the gas National Transmission System (NTS). This consultation was in response to anticipated demand for new capacity from a number of potential combined cycle gas turbine (CCGT) and gas storage developments in the SE area.

Revenue driver conditions set out in National Grid Gas's (NGG's) gas transporter licence in respect of the NTS (the Licence) allow NGG's revenues to increase where analysis shows that system reinforcement is required to meet customer demand for new capacity. At the fourth Transmission Price Control Review (TPCR4), which covered the period 2007-2012, we set revenue drivers for all existing and anticipated gas entry points to the NTS. Since then, provision has been made in the Licence for several new revenue drivers at both entry and exit points which were not anticipated previously.

The December consultation set out how, and invited comments on how, we proposed to calculate the new revenue driver values for the SE quadrant and the methodology used to determine network reinforcement requirements. We have considered the responses to the consultation and, having regard to our principal objective and statutory duties[3], and for the reasons set out in this letter, we propose to set revenue drivers for the potential CCGT and storage site developments in a manner consistent with the consultation.

This letter sets out -

- A summary of our consultation proposals
- A summary of the consultation responses
- Our views and final decision.

[1] Ofgem is the Office of Gas and Electricity Markets Authority. The terms 'Ofgem' and 'the Authority' are used interchangeably.
[2] 'Determining revenue drivers for South East exit capacity', Ofgem, 19 December 2011. A copy can be found on the Ofgem website: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=SE Revenue driver consultation document.pdf&refer=Networks/Trans/GasTransPolicy/RevenueDrivers
[3] In particular those set out in section 4A of the Gas Act 1986, as amended.

Background and consultation proposals

Following earlier dialogue, in July 2011, NGG asked us to approve two new revenue drivers in its licence to support the potential release of new exit capacity in SE quadrant of the NTS. The two proposed revenue drivers related to the potential development of a number of CCGT power stations and gas storage projects respectively.

As part of its submission NGG provided a report with its analysis of the network reinforcement and associated costs necessary to support the potential incremental capacity requests. Given the proximity of the potential CCGT developments, and the proximity of the potential storage site developments, NGG proposed that two generic revenue driver values should be inserted into the Licence, one covering each type of development. We reviewed NGG's analysis of the reinforcement work necessary for delivering these projects with our consultants, Poyry Energy Consulting. In December 2011, we published a consultation document seeking views on the proposed approach, including the cost assumptions used and the supply and demand modelling assumptions used.

In the consultation we set out our view that NGG's proposed approach was appropriate. This approach involves introducing a 'banded' revenue driver to accommodate the potential CCGT incremental capacity signals and a revenue driver specific to the potential incremental capacity signals at the proposed storage site developments. The use of different revenue drivers for the CCGT and storage site developments reflects the different operational requirements both types of offtake may place on the NTS. NGG also expected that the storage sites will be clustered around the Bacton terminal which is geographically different from the anticipated location of the CCGTs. This places different investment requirements on NGG to meet the potential incremental exit capacity demand signals.

We also set out our view that the supply and demand assumptions NGG had used in modelling the reinforcement requirements of the proposed developments were appropriate. We explained that for the storage site revenue driver it was appropriate to adopt the 400 mcm/day demand level rather than the 350 mcm/day demand level which had also been modelled. We considered that since it was possible that one or both storage facilities could have a fast cycle capability, it was possible that they might seek to offtake gas under conditions of high demand. Full details of the supply and demand modelling assumptions used in calculating both revenue drivers are set out in chapter three of our December consultation.

We explained our view on the timing of the proposed licence changes necessary to implement the new revenue drivers, given the need for the changes to be in place ahead of the July 2012 capacity application window. In the past and where possible, revenue driver values have been established in the Licence at the time of the price control review. Consultations on the current transmission price control, RIIO-T1, will conclude towards the end of 2012 for implementation from 1 April 2013. We explained in our consultation document that setting SE revenue drivers as part of the RIIO-T1 process would not be compatible with allowing project developers to book incremental exit capacity during the July 2012 application window[4] and that the two new revenue drivers were therefore being considered separately from the RIIO-T1 process.

Consultation responses

We received six responses to our consultation. None of the responses were marked confidential and each can be found on our website.[5]

[4] In order to participate in the July application window for Enduring Annual NTS Exit (Flat) Capacity at a particular exit point, the specific exit point must be included in the Licence and (in normal circumstances) a revenue driver should also be included in the Licence.

[5] Copies of the responses can be found on our website: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=SE Revenue driver consultation document.pdf&refer=Networks/Trans/GasTransPolicy/RevenueDrivers

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There was a consensus amongst respondents that the proposed revenue drivers were the correct mechanism to reimburse NGG for network investment related to the proposed projects. Respondents also agreed that the modelling assumptions and unit costs used to derive the revenue drivers were appropriate, and that it was appropriate to implement the revenue drivers to a timescale which allowed the new capacity to be booked in the July 2012 application window.

In particular, respondents noted that the banded revenue drivers for the proposed CCGTs would provide an appropriate balance between allowing for the uncertainty of how much capacity would be signalled at these sites and ensuring that NGG was sufficiently remunerated for any necessary reinforcement work. Respondents also agreed that capacity specific revenue drivers were required for the proposed storage sites as these would have different operational and gas requirements from the NTS.

A few respondents questioned aspects of the proposals relating to the transparency of the network modelling. These questions concerned:

- incomplete information about the location of the CCGT incremental capacity signals being modelled;
- absence of information about the type of storage projects being developed; and
- explanation of supply and demand assumptions.

Information about the location of CCGT signals being modelled and the type of storage projects being modelled

Some respondents considered that incomplete information about the location of the CCGT incremental capacity signals and absence of information about the type of storage projects being developed made it difficult for them to fully analyse the network modelling presented. In our view, the level of information provided was appropriate to protect the commercial confidentiality of the developments and more information about the specific location of the CCGT developments within the SE area would not have altered the robustness of the supply and demand modelling assumptions used.

In respect of the storage developments, a higher demand assumption of 400 mcm/d was used to reflect the potential that the storage facilities could be fast cycle storage facilities, and may need to offtake gas on days close to peak. This is consistent with the potential behaviour of other facilities of this nature, but NGG was not in a position to reveal the proposed commercial operation of the development ahead of the project being commissioned.

Explanation of supply and demand assumptions

Several respondents indicated that they would have preferred more information about the interactive and non-interactive demand assumptions used by NGG in the network modelling. A number of respondents also had reservations about the assumption that supplies would increase at Aggregated System Entry Points (ASEPs) in the Northern Triangle[6] to meet increased demand in the South East.

The methodology employed by NGG to derive the CCGT and storage site revenue drivers was consistent with the derivation of previous revenue drivers. This included the classification of NTS points as being interactive and non-interactive based on their geographical proximity to the site requiring a revenue driver. In this regard, we are content with the network modelling undertaken by NGG. We note that the assumption that supplies increase at ASEPs in the Northern Triangle to meet increased demand in the SE is used to establish the most onerous supply and demand conditions the network could face and is not intended as a supply and demand balancing forecast.

[6] The Northern Triangle consists of the St Fergus, Teesside and Barrow entry points.

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The significance of the interactive and non-interactive zones is that booked capacity levels are typically assumed for points within interactive zones, whereas the diversified 1 in 20 peak day demand forecast is used for non-interactive zones. We consider that this approach is appropriate as the risk that interactive points may flow close to their full capacity booking cannot be diversified in the same manner as for non-interactive points, and will impact on NGG's ability to support the incremental capacity under a credible gas flow scenario.

Based on its knowledge of the NTS, NGG does apply a level of discretion over which points are interactive and non-interactive. We note that work is being developed under the RIIO-T1 framework to establish a generic revenue driver methodology statement. We urge NGG to be as transparent as possible about the methodology adopted to define interactive and non-interactive points in this document.

Decision

After reviewing the modelling work undertaken by NGG and considering the responses to the consultation, we propose to set revenue drivers for the potential CCGT and storage site projects in the South East quadrant in a manner consistent with our December 2011 consultation. The table below sets out the financial values of the revenue drivers in £/GWh/year.

Table 1: Revenue driver values

Type	Increment (GWh/day)	Annual revenue driver value (£/GWh/year)
CCGT	50	266,866
	100	260,086
	150	284,328
	200	317,815
	250	328,908
Storage site	353	131,004
	657	99,104
	1010	101,905

The total amount of revenue NGG can accrue through the revenue drivers is unchanged from the proposals in the December consultation paper. However, there are several areas in the section 23 notice and accompanying licence drafting which we wish to highlight to interested parties. These are -

- The revenue drivers are now expressed in units of £/GWh/year. In the December consultation they were expressed in £million/GWh/month. NGG asked us to make this change to maintain consistency with existing exit revenue drivers. It will not change the amount of revenue NGG will recover through the application of the revenue drivers and did not require us to recalculate the revenue driver values[7].
- The licence drafting defines the SE quadrant by reference to existing exit points. New exit points falling within the SE quadrant will be added to this list.
- We have proposed removing existing revenue drivers for exit points in the SE quadrant which have not yet received a signal for incremental exit capacity. In our view, not to do so would result in two revenue drivers being applicable for any incremental exit capacity signalled at these points.[8]

[7] To change the units from monthly to yearly, we undid the final step of dividing the annual revenue driver amount by 12.
[8] This was presumed, though not expressly stated, in our consultation.

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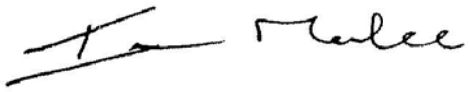
The legal drafting and a full description of the licence changes necessary to implement the proposed revenue drivers can be found in the section 23 Gas Act 1986 Notice which accompanies this letter.

Representations on the modifications proposed in the Notice should be made to the address set out at paragraph 7 of the notice. Please note that representations must be made by 18 May 2012. Subject to any representations, we intend to modify the licence condition by issuing a decision notice and a direction before the end of May 2012.

Yours faithfully



Ian Marlee
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Signed on behalf of the Authority and authorised for that purpose

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