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value for all customers*

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Date: 2 November 2012

Dear Steve,

### **Approval of revised Connection Charging Methodology 4B: National Grid Gas plc**

On 12 October 2012, you submitted to us<sup>1</sup> a modification to your connection charging methodology. The modification proposes two changes -

- **Amendment 1:** This adds a note to the description of the economic test (Section 5) to clarify the treatment of the Exit Capacity Network (ECN) transportation charge introduced on 1 October 2012.
- **Amendment 2:** This extends the description of charging arrangements for new System Entry and Storage Connections (paragraph 3.11.1) to make explicit that additional equipment may be required to facilitate these connections and will be charged for along with the connection charge.

Having reviewed the modification, we have decided not to veto it. This letter sets out the background and explains the reasons for our decision.

### **Background**

#### *Amendment 1*

#### Gas Distribution Economic Test

The economic test is a financial assessment tool that ensures that Gas Distribution Networks (GDNs) meet their obligations under the Gas Act 1986 (the Act) to develop and maintain an efficient and economical pipeline system and to comply with any reasonable request to connect to their system any premises or any pipeline system operated by an authorised transporter.

The economic test is used to identify new requests for capacity on the GDN where the level of investment would be considered 'uneconomic'. The test compares the cost of distribution

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<sup>1</sup> The terms 'the Gas and Electricity Markets Authority', 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

network reinforcement and additional operating costs of accommodating the new load with the additional distribution transportation revenue from the load.

#### Changes to Exit capacity charges

Following changes to the National Transmission System (NTS) Exit Capacity regime from 1 October 2012, the charging methodology will change so as to introduce a new ECN transportation charge. There are no further changes to the GDN transportation charges.

#### *Amendment 2*

#### Anticipated Increase in Entry and Storage Connections

As noted in National Grid Gas's Methodology Change Report, an increase in the distributed supply of gas, particularly biomethane, is foreseen in the coming years, and a corresponding increase in the overall rate of distributed gas entry and storage connections is expected. It is therefore of particular importance to ensure that the details of the charging methodology relating to these connections are set out clearly.

#### Entry and Storage Connection Charging Methodology

The charging methodology for new entry and storage connections is outlined under Section 3.11 of National Grid Gas's connections charging methodology, to comply with the objectives set out in Section 4B of the Standard Licence Conditions. Section 3.10 of the charging methodology states that all entry and storage connections are considered to be Sufficiently Complex Connections, and hence subject to the associated, prescribed quotation and charging procedures. However, this is not stated under Section 3.11.

Two additional types of equipment which will be charged for are already itemised in paragraph 3.11.1. However, this section currently makes no mention of the potential requirement for further equipment to facilitate these types of connections.

### **Revisions to National Grid Gas's Charging Methodology 4B**

#### *Amendment 1*

Following the introduction of the new ECN transportation Charge, you have inserted a note above paragraph 5.12 under the description of the economic test (Section 5) to clarify that the costs associated with additional exit capacity bookings and the revenue from the new ECN charge are excluded from the Gas Distribution Economic Test. This is because GDNs are allowed to fully recover their costs, and revenue and costs are therefore assumed to be equal with no cost impact for the individual load.

This addition does not alter the connection charging methodology, it merely provides clarification of the treatment of the ECN charge.

#### *Amendment 2*

In consideration of the anticipated increase in distributed gas entry and storage connections you have also inserted a note under paragraph 3.11.1 to clarify the charging methodology relating to these connection types. This addition makes it clear that the costs associated with additional equipment required to facilitate a new system entry or storage connection will be charged for along with the connection itself.

This addition does not alter the connection charging methodology; it merely provides clarification of the treatment of additional equipment charges which may be required.

## Our Decision

On 12 October 2012, you submitted this modification to your connection charging methodology to us, along with a modification report. After reviewing the revised methodology and the modification report, we are satisfied that it would better achieve the relevant objectives set out in Standard Licence Condition (SLC)4B paragraph 5 (a), (c) and (d) and that its impact on the other relevant objectives is neutral. We are also satisfied that not vetoing the modification is consistent with our principal objective and statutory duties.

*SLC 4B paragraph 5 (a) Compliance with the connection charging methodology facilitates the discharge by the licensee of the obligations imposed on it under the Act and by the license.*

Amendment 1 of the modification clarifies the treatment of the ECN charge for the purposes of the economic test.

Amendment 2 makes it clear that additional equipment may be required to facilitate new system entry or storage connections, and that this will be charged for along with the standard connection charges under the existing methodology.

*SLC 4B paragraph 5 (c) Compliance with the connection charging methodology results in charges which reflect, as far as is reasonably practicable (taking account of implementation costs), the costs incurred by the licensee in its transportation business and, where the Act enables, to charge a reasonable profit.*

Amendment 1 clarifies how the new charge is treated and that it reflects the costs incurred by National Grid Gas in its transportation business.

Amendment 2 clarifies the fact that equipment costs you incur in establishing new entry or storage connections will be incorporated in the connection charge. This charge reflects the overall costs you incur in establishing the new connection in question.

*SLC 4B paragraph 5 (d) so far as is consistent with sub-paragraphs (a), (b) and (c), the connection charging methodology, as far as is reasonably practicable, properly takes account of developments in the licensee's transportation business.*

Amendment 1 updates your charging methodology to reflect the new exit capacity arrangements which came into effect on 1 October 2012.

Amendment 2 clarifies your charging methodology in relation to entry and storage connections, in anticipation of an increase in distributed gas connections in the coming years.

## Decision Notice

**In accordance with Standard Condition 4B of the Gas Transporters' licence, the Authority has decided not to veto this modification of the connection charging methodology of National Grid Gas plc.**

Yours sincerely



**Andrew Burgess**

**Associate Partner, Transmission and Distribution Policy**

Signed on behalf of the Authority and authorised for that purpose

3 of 3