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Dear Ikbal

## **Statutory consultation on RIIO-T1 licence changes to the gas transporter licence held by National Grid Gas Plc with respect to the National Transmission System**

Please find our response to the following documents, issued for statutory consultation on 21 December 2012:

- Proposed modifications to the Gas Transporter licence standard special conditions Part A
- Proposed special conditions to NGGT's gas transporter licence
- RIIO-GT1 Price Control Financial Handbook
- Gas Network Innovation Competition Governance Document
- Gas Network Innovation Allowance Governance Document
- Stakeholder Engagement Reward Guidelines

Our response consists of five separate documents:

- This letter
- A set of tables containing our comments on all of the above documents
- A marked up copy of the special conditions for typographical changes, suggesting re-drafting where appropriate
- A marked up copy of the RIIO-GT1 Price Control Financial Handbook
- A copy of the relevant exit capacity figures for Special Condition 5G to reflect amendments made to capacity obligations throughout the TPCR4 period

We have and continue to correspond with Ofgem on a number of major areas of concern and this formal response should be considered by you alongside that correspondence. Any new issue which has not already been raised with Ofgem is included in italics in the comments on licence drafting and the marked up special condition document which is attached.

Principal concerns with the proposed licence drafting are as follows:

- **Without an agreed unit cost library, the licence as currently drafted does not provide a clear view of funding for incremental capacity**

The Final Proposals and the Decision letter on RPE (194/12 – also published on 21 December) do not provide clarity regarding the funding allowances for incremental capacity. We were expecting to receive a unit cost library from Ofgem as part of the Final Proposals in order to either inform the replacement table of entry revenue drivers in the licence or for the application of the Generic Revenue Driver Methodology. We also now understand that the entries within the unit

cost library will be quoted in 2009/10 prices for RPI purposes, but in 2010/11 prices in terms of RPE, however we would welcome confirmation of this.

Whilst some progress has been made during the last few weeks on this issue, without an agreed unit cost library, the licence as currently drafted does not work as intended as it does not allow us to recover the appropriate sums to fund provision of incremental capacity.

- **We do not agree with the approach being proposed for the entry and exit capacity conditions (Sp C 5F and Sp C 5G).**

The licence drafting now includes tables which detail the baseline, substitution and legacy revenue driver capacity. We believe that this will necessitate the licence being amended via the Section 23 process whenever any change is made to capacity obligations. This is a backward step from the existing licence, and we believe it would be better to include this level of detail within the "Summary report" being produced pursuant to Special Condition 9B. Feedback on the Generic Revenue Driver Methodology informal consultation indicated that Shippers would welcome any streamlining of the existing process, so making this more convoluted does not appear a sensible step.

- **There is an interaction between the permits allowances for the March 2013 QSEC auction and the proposed constraint management scheme for the RIIO-T1 period.**

As outlined within our Business Plan submission, our modelling of the Constraint Management scheme did not include the risks associated with the release of incremental capacity as no signals for incremental capacity for release in the RIIO-T1 period had been received at that point in time. We proposed that revised Permit Arrangements could be introduced to cover the risks from the March 2013 QSEC auction and noted that if Ofgem did not address the risks posed by the current arrangements, we would need to review appropriate parameters for the scheme from October 2016 onwards. Ofgem has stated within Final Proposals that no further review of the permit arrangements will be made relating to the March 2013 QSEC auction.

We therefore maintain that we do not have adequate tools (in terms of Permit Arrangements) necessary to effectively manage lead times and the consequential constraint management costs in the event we were to receive bids. We note that the proposed drafting allows for the target to be varied following the release of incremental capacity within the RIIO-T1 period and suggest that this is broadened to also allow this to take place in response to bids received in the March 2013 QSEC auction.

- **The licence should include details of the permits arrangements post 2013/14.**

In previous discussions and consultation responses we have highlighted the need to have surety of the arrangements that will apply in relation to the release of incremental capacity in the event that the new arrangements currently being discussed within industry are not implemented by 2014. Final Proposals provide for arrangements for formula years 2014/15 to 2016/17 in this event, but this is not reflected in the relevant licence condition. The licence condition should provide for arrangements post 2013/14 to ensure that there is clarity surrounding the capacity release regime and an appropriate set of tools to allow us to manage constraint management costs which may arise in these years.

- **The licence should include a timescale around the setting of Revenue Drivers.**

We have repeatedly asked for a process regarding the timescale to set revenue drivers to be included to ensure that this is carried out in a timely manner which is transparent to all so that it does not unnecessarily delay customer projects. We note that this has also been echoed by industry in response to the Generic Revenue Driver Methodology consultation which has recently

been carried out. Conversations with Ofgem have discussed the possibility of including a process for this within the Generic Revenue Driver Methodology rather than the licence itself. We believe that this needs to be agreed in the near future and look forward to working together to develop this approach further.

- **We do not agree with the inclusion of the full list of secondary assets in the Network Output Measures Methodology condition.**

We were surprised to see the inclusion of the full list of secondary assets in the NOMs methodology licence condition via the link to an excel spreadsheet as previous discussions with Ofgem indicated a willingness to include a 'rolled up' table, such as that included in the 'Outputs' part of our Business Plan submission. We understand that this table will be replaced when Ofgem issues the decision to change the licence and welcome the clarification we have received on this from Ofgem but would appreciate formal confirmation.

- **Various capacity-related definitions are incorrect and therefore do not work together.**

Currently a number of the capacity-related definitions are incorrect and thus don't interact correctly. These need rectifying within Ofgem's decision to change the licence in order that the correct terms can be included in the methodology statements that are being updating for the RIIO-T1 period and we have suggested changes in the marked-up word copy of the Special Conditions.

- **Carrying out multiple statutory consultations on the same licence conditions is confusing.**

We are concerned that two separate statutory consultations (for RIIO-T1 and for the ring-fencing consultation) are being carried out in relation to Special Condition C1 as this can cause confusion as to the modifications that are being proposed. We understand that the RIIO modifications will be directed first followed by the ring-fencing modifications and would welcome clarity in Ofgem's relevant decisions to change the licence to avoid confusion amongst stakeholders.

We will set out our main concerns with the Price Control Financial Handbook in separate correspondence. Some of our more significant concerns include:

- **Chapter 3 on pension allowances has changed substantially since the last version and contains a large number of material errors and omissions.**

In arriving at EDE and SOEDE values, the current drafting applies an incorrect Time Value of Money Adjustment and adopts an incorrect treatment of corporation tax which is inconsistent with the subsequent treatment of these allowances in the Price Control Financial Model. In addition, the costs (and allowances) associated with contingent asset costs have been omitted from the determination process such that the allowances calculated would be inconsistent with Final Proposals. The process for determining values by 30 November 2017 also fails to take into account the deficit true up adjustments determined by 30 November 2014 which would still have a further 9 years to run, and makes incorrect statements such as the view that if the pension scheme is in surplus there will be no EDE / SOEDE allowance. This is evidently not the case if efficiently occurred deficit payments in excess of allowances require true up adjustments to be made.

- **The description of the legacy gearing level and interest cost adjustment is incorrect and inconsistent both with our understanding of Ofgem's policy and the calculations set out in the legacy calculations workbook.**

During the RIIO-T1 period, an adjustment is made if gearing exceeds the notional assumption used in calculating the WACC and actual interest costs exceed those in the Financial model.

This policy is applied in the legacy calculations workbook but the handbook applies a different test by comparing actual gearing to the closing 2012-13 modelled gearing. The drafting also confuses the situation by saying an adjustment is performed if both the gearing level and positive (interest) benefit test are met when the paragraphs for those tests describe situations where no adjustments would be made.

We also have a number of comments and corrections that should be made to the Price Control Financial Model and legacy adjustment calculation workbook. These comments will be provided in separate correspondence.

We note the following points of clarity that have been received relating to Final Proposals following discussions with Ofgem but believe written confirmation is still required in some cases:

- **Final proposals are unclear over the treatment of Agency costs.** Final Proposals contained contradictory statements regarding the funding of Agency costs. In subsequent discussions, Ofgem has clarified that the costs are not to be treated as 'non-controllable' but to be included within the ex-ante allowance for the SO control, but that the SO allowance will be re-set once the new arrangements for xoserve are in place.
- **Funding for audits and independent directors.** From previous discussions our understanding was that Ofgem were minded to provide funding for the increased audit obligations that have been added to the licence following our Business Plan submission. In addition, the current statutory consultation in relation to ring-fencing states that a mechanism should be included in the price control conditions to allow for the costs of independent directors. We understand from discussions with Ofgem that a consideration of an adjustment was made for the audit costs; however we have been unable to identify this funding. Additionally, it has been proposed that the costs relating to independent directors will be logged up and funded in RIIO-T2. We would welcome written clarification of this.
- **Table 2 of SpC 7E does not match the figures within the published Financial Model.** We welcome clarification from Ofgem that the figures within the Section 23 notice are incorrect and that they will be amended within Ofgem's decision to change the licence to match the figures relating to 'Non-variant allowed asset replacement capex expenditure' within the Financial Model.

NGGT currently holds a number of consents pursuant to its National Grid Gas plc Gas Transporter Licence, some of which are due to expire on 31 March 2013. We expect these to be renewed prior to the start of the RIIO-T1 period.

If you wish to discuss any of the issues raised within this consultation response further, please contact either Elaine Calvert on 01926 654574 ([elaine.b.calvert@nationalgrid.com](mailto:elaine.b.calvert@nationalgrid.com)) or Claire Spedding on 01926 655915 ([claire.spedding@nationalgrid.com](mailto:claire.spedding@nationalgrid.com)).

Yours sincerely



**Pauline McCracken**

By email