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Dear Stephen

Approval of modifications to Northern Gas Network's Connection Charging Methodology SLC 4B

On 23 May 2014, you submitted to us¹ a number of modifications to your connection charging methodology.

We note that we recently decided not to veto several changes to National Grid Gas Distribution's Connection Charging Methodology. The changes were almost identical to your proposed changes, except for the proposed modification to the Economic Test discount rate.² We consider that your proposed changes better meet the relevant objectives. To help develop a common and consistent approach to connection charging, we would encourage all GDNs to discuss prospective changes with each other, before submitting them to us.

Having reviewed your submission, we have decided not to veto the modifications. This letter sets out these modifications, the background to our approval, and explains the rationale for our decision.

Background

In accordance with paragraph 3 of Standard Condition 4B (SLC4B), of the Gas Transporter (GT) licence, you have an obligation to determine and comply with an approved connection charging methodology.

Paragraph 6 of SLC4B says that you shall not make a modification to the connection charging methodology unless we receive a report setting out the terms of the modification and how the proposed modification would better achieve the relevant objectives.³

¹ 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.

² NGGD updated the Economic Test discount rate, to match the pre-tax weighted average cost of capital (WACC) assumed in the derivation of the RII0-GD1 price control. You proposed updating the Economic Test discount rate, to match the pre-tax WACC in our latest Annual Iteration Process.

³ Found within SLC 4B paragraph 5 of the Gas Transporter licence which are:

- (a) compliance with the connection charging methodology facilitates the discharge by the licensee of the obligations imposed on it under the Act and by this licence;
- (b) compliance with the connection charging methodology facilitates competition in the supply of gas, and does not restrict, distort, or prevent competition in the transportation of gas conveyed through pipes;
- (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;
- (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; and

The modifications

You submitted the following modifications to your connection charging methodology on 23 May 2014:

1) *Economic Test parameters*

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.

The Economic Test is used to identify new requests for capacity on the gas distribution network where the level of investment would be considered 'uneconomic', and so avoids current customers on the distribution network subsidising the new load. The test compares the cost of distribution network reinforcement and additional operating costs of accommodating the new load with the additional transportation revenue from the load. The methodology used to calculate Economic Test is specified in the connection charging methodology.

You are proposing to amend your connection charging methodology to change the Economic Test depreciation method from straight-line⁴ to sum-of-digits⁵, to be consistent with the approach used for RIIO-GD1.⁶

You also propose to change the discount rate used in the Economic Test, to match the pre-tax weighted average cost of capital (WACC) in our latest Annual Iteration Process. You also provide a definition of the "Annual Iteration Process".

2) *Fuel-poor test parameters*

Those eligible for a connection under the fuel-poor network extension scheme receive a voucher value equal to the Net Present Value (NPV) of the transportation revenue for a typical domestic customer.⁷

You propose to update the WACC used to calculate the voucher value, to match the WACC in our latest Annual Iteration Process.

You also propose to change the domestic consumption rate used from 19,000 kWh per annum to the Typical Domestic Consumption Value (TDCV) for a medium-sized domestic load (currently 13,500 kWh per annum).⁸

3) *Removing references to independent systems*

You propose to delete any references to independent systems⁹ because there are no longer any independent systems within your network area.

(e) compliance with the connection charging methodology ensures that the licensee shall not show any undue preference towards, or undue discrimination against, any person who operates, or proposes to operate, a pipeline system in relation to the connection of that system to the pipeline system to which this licence relates.

⁴ A straight line method of depreciation is a standard approach to depreciation which is based on the assumption that assets depreciate on a uniform basis across an asset's life.

⁵ A sum of digits method of depreciation is an accelerated depreciation technique which is based on the assumption that assets depreciate more in the early years of an asset's life and less in the later years.

⁶ [RIIO-GD1: Final Proposals - Finance and uncertainty supporting document](#)

⁷ [Final position on the non-gas fuel poor network extension scheme](#) June 2011

⁸ [Decision: New typical domestic consumption values](#) September 2013

⁹ Across Great Britain there are several independent gas systems that are not connected to the main gas grid, and instead inject gas into the system via Liquefied Petroleum Gas or Liquefied Natural Gas.

4) General Administration Updates

You also propose several administrative changes to the Connection Charging Methodology (eg formatting and punctuation changes, updating contact information and updating the connection charging examples provided in the annex).

Our decision

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) (b) 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.

(a) compliance with the connection charging methodology facilitates the discharge by the licensee of the obligations imposed on it under the Act and by this licence;

The proposed modifications to the Economic Test will better align the assessment of connection requests under the Act, with the economic parameters stated in RIIO-GD1 and the Annual Iteration Process.

(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;

The modification to the fuel-poor test parameters will more closely reflect the level of transportation revenue likely to be generated by an average domestic load and therefore should result in a more appropriate level of discount for a fuel-poor connection.

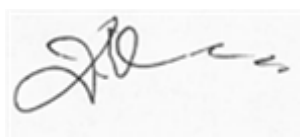
(d) so far as is consistent with sub-paragraphs (a), (b) and (c), the connection charging methodology, as far as is reasonably practicable, properly takes account of developments in the licensee's transportation business;

These modifications update the connection charging methodology to reflect the economic parameters stated in RIIO-GD1 and the latest Annual Iteration Process. It also removes redundant references to independent systems.

Decision Notice

In accordance with Standard Condition 4B of the Gas Transporters' licence, the Authority has decided not to veto these modifications to the connection charging methodology of Northern Gas Networks Limited.

Yours sincerely



Dora Guzeleva

Head of Distribution policy

Signed on behalf of the Authority and authorised for that purpose by the Authority.