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Gas Distribution Networks and
other interested parties

Direct Dial: 020 7901 1851
Email: dora.guzeleva@ofgem.gov.uk

Date: 17 December 2014

National Grid Gas Distribution (NGGD) modification to the gas price used to calculate Shrinkage Allowance

Background

As part of the RIIO-GD1 Price Control, Gas Distribution Network Operators (GDNs) were set a Shrinkage Allowance based on the environmental output. This allowance is to provide funds for gas distributors to replace the gas lost from the network through leakage, theft and gas used in transportation. These are collectively known as shrinkage outputs and incentives. The output incentives are intended to incentivise GDNs to reduce the volume of gas lost through shrinkage.

Special Condition 1F of the Gas Transporter Licence (the "Licence") allows gas distributors to propose amendments to the gas price used to calculate their Shrinkage Allowance. While the price used is trued up for actual average prices at the end of the RIIO-GD1 price control period, adjusting the price at an earlier stage in the price control period will reduce the charging volatility at the end of the price control period. This letter is to inform stakeholders that we have received a request from NGGD to amend the Shrinkage Allowance set out in Appendix 1 of Special Condition 1F. We are minded to accept this request and seek stakeholders views on our minded to position.

NGGD's Notice

NGGD has requested that we use an updated forecast gas price to calculate the Shrinkage Allowance for all its licensees. NGGD has made this request under Special Condition 1F.38 of the Licence. It has requested that the amended gas price be used to calculate the Shrinkage Allowance for the Formula Year 2016/17 and for the remainder of the price control period (ie until Formula Year 2020/21).

NGGD fulfilled the requirements of the Licence by providing a notice to the Authority in accordance with Special Condition 1F.39 and proposing a revision to the allowance in respect of shrinkage costs pursuant to Special Condition 1F.40. The gas price it has proposed comes from the 23 July 2014 Heren National Balancing Point (NBP) Price Assessment Offer prices for the Summer 2016 and Winter 2016. These are 56.85p/therm and 63.85p/therm respectively, giving an average of 60.35p/therm (or £20,591/GWh) for the 2016/17 Formula Year. Based on the revised Shrinkage Volume we directed as part of

our decision dated 16 September 2014 on Modification Number Four of the Shrinkage and Leakage Model¹, NGGD have calculated an updated Shrinkage Allowance.

The annex to this letter shows how the unit price above has been used to calculate the proposed revision to the shrinkage cost allowances for NGGD's licensees and how these were calculated. The change will only take effect from the Formula Year 2016/17 or $t=4$.

Minded to position

We are minded to approve NGGD's request to amend its Shrinkage Allowance based on an updated forecast of the gas price in 2016. If you have any concerns regarding the amendment and our minded to position please contact us by email at gasdistribution@ofgem.gov.uk.

Associated issues

Modification Number Four of the Shrinkage and Leakage Model

On 16 September 2014 we published our decision² on Modification Number Four to the Shrinkage and Leakage Model (SLM). This decision amended the Shrinkage Volume for all licensees from 2014/15 onwards. This meant that the Shrinkage Allowance for all licensees also changed. We are currently consulting on correcting these figures. When corrected, the allowance set out in our amended decision will apply to NGGD for Formula Years 2014/15 and 2015/16. NGGD's request will, subject to any responses to this letter, come in to force in Formula Year 2016/17.

Consistent unit price for gas

We consider that the unit price for gas used to calculate licensees' Shrinkage Allowance should be consistent for all licensees. At this time only NGGD have requested a change to their allowance to reflect lower forecast gas prices. We therefore encourage licensees to make a joint request under Part H of Special Condition 1F to use an updated forecast. We would be happy to discuss this approach with licensees.

Next steps

We welcome your views on the issues we have raised in this letter by **19 January 2015**. Responses should be sent, preferably by email, to gasdistribution@ofgem.gov.uk or in writing to:

Neil Copeland
Ofgem - Glasgow
107 West Regent Street,
3rd Floor,
Cornerstone,
Glasgow
G2 2BA

¹ <https://www.ofgem.gov.uk/publications-and-updates/modification-number-four-shrinkage-and-leakage-model-%E2%80%93-proposed-amendment>

² <https://www.ofgem.gov.uk/publications-and-updates/decision-letter-regarding-modification-number-four-shrinkage-and-leakage-mode>

Should you wish to discuss the issues raised in this document, please contact Neil Copeland at neil.copeland@ofgem.gov.uk or on 020 7901 7193.

Yours faithfully,



Dora Guzeleva,
Head of Networks Policy: Local Grids

Annex

Proposed revision to the shrinkage cost allowance

Distribution Network	Shrinkage allowance (£m 2009/10 prices)							
	t=1	t=2	t=3	t=4	t=5	t=6	t=7	t=8
NGGD East of England	11.8	10.8	10.7	7.92	7.74	7.55	7.36	7.18
NGGD London	6.1	5.5	5.4	4.30	4.19	4.07	3.96	3.85
NGGD North West	9.0	8.4	8.3	5.76	5.59	5.40	5.24	5.08
NGGD West Midlands	7.0	6.8	6.8	5.01	4.88	4.77	4.67	4.54

The Shrinkage Allowances from year t=4 onwards was calculated by multiplying the corresponding shrinkage volume (duplicated below for your information) by the unit price of £20,591/GWh /GWh, ie:

Shrinkage Allowance for East of England in year t=5:

= 479*£20,591

=£7.74m

Distribution Network	Shrinkage volume (GWh) (Based on SLM v1.4, from t=2 onwards)							
	t=1	t=2	t=3	t=4	t=5	t=6	t=7	t=8
NGGD East of England	569	515	503	490	479	467	455	444
NGGD London	317	282	274	266	259	252	245	238
NGGD North West	407	378	367	356	346	334	324	314
NGGD West Midlands	335	323	316	310	302	295	289	281