



Making a positive difference
for energy consumers

Gas Distribution Networks and
other interested parties

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

Date: 17 December 2014

Modification Number Four to the Shrinkage and Leakage Model – Proposed Amendment

Background

As part of the RIIO-GD1 Price Control we provided a Shrinkage Allowance to Gas Distribution Network Operators (GDNs). 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. The shrinkage allowance is calculated by multiplying the unit price of gas by the licensees allowed shrinkage volume. These terms are collectively known as shrinkage outputs and incentives. The allowed shrinkage volume, is intended to incentivise GDNs to reduce the volume of gas lost through shrinkage.

GDNs use an engineering model to report the volume of gas lost to shrinkage. The modelled results are compared to the allowed shrinkage volume set for the GDNs in RIIO-GD1. GDNs are financially penalised or rewarded according to performance against the outputs and incentives. GDNs are obliged to review the model annually and propose changes to improve the accuracy of the model. When the model is changed, we can also amend the shrinkage outputs and incentives to reflect that the future reporting will be on a different basis to when those outputs and incentives were set. GDNs recently proposed a change to the model which we approved but we made an error when transposing the results of the latest model change to the Shrinkage Allowance. This letter explains this error and the impact on licensees' allowances of correcting the error.

Our decision on Modification Number Four to the Shrinkage and Leakage Model

On 16 September 2014 we published our decision¹ on Modification Number Four to the Shrinkage and Leakage Model (SLM). This followed a submission to the Authority of a modification report.² The report had been subject to a consultation³ which sought respondents' views on the revised SLM and the revised RIIO-GD1 shrinkage outputs and incentives which would result from the modification.

Alongside our decision to approve the modification to the SLM, we published a direction to align the RIIO-GD1 shrinkage outputs and incentives with those contained in the

¹ <https://www.ofgem.gov.uk/publications-and-updates/decision-letter-regarding-modification-number-four-shrinkage-and-leakage-mode>

² <http://www.gasgovernance.co.uk/sites/default/files/Leakage%20Model%20Modification%20Consultation%20No%204%20Report%20v1.pdf>

³ [Shrinkage and Leakage Model Consultation No. 04](#)

modification report. The direction amended the shrinkage outputs and incentives (contained in Special Condition 1F of the Gas Transporter Licence (the "Licence")). The Shrinkage Allowance (Appendix 1 to Special Condition 1F) which is the revenue provided to allow GDNs to replace gas lost to shrinkage. There is also the shrinkage volume which reflects the amount of shrinkage expected (Appendix 2 to Special Condition 1F). The changes we made in the direction should have reflected those outlined in the modification report. However, the changes to Appendix 1 to Special Condition 1F contained an error.

Paragraph 1F.26 states that where the Authority considers that a modification set out in a modification report would better facilitate the objective set out in Special Condition 1F.13⁴, it may issue directions requiring the licensee and other GDNs to revise the allowance for shrinkage costs to account for any revisions made to shrinkage volumes that have been amended in line with the report. As a result of our error in transposing the results of the changed model, we do not consider that the direction we issued on 16 September 2014 gives effect to the changes proposed by the modification report.

Subject to any comments we receive from interested parties, we intend to reissue the direction to correct this error. Annex 1 to this letter shows the corrected Shrinkage Allowance. Licensees would not benefit from this beyond the end of the current price control period. However, we consider it appropriate to amend these allowances as soon as practicable.

The differences between the figures in our original decision and the figures contained in Annex 1 of this letter are small for most licensees. However, for some licensees the change is substantial over the length of the current price control period, up to £1.85m. Annex 2 to this letter shows the difference between the corrected Shrinkage Allowance and the one outlined in our original direction.

Licensees and other interested parties who have any comments regarding our proposal to reissue the direction dated 16 September 2014 using the corrected values should let us know in writing or by sending an email to gasdistribution@ofgem.gov.uk.

Unit price of gas

At the same time as we were considering our position regarding this amendment, NGGD submitted a request to use an updated forecast for the gas price under Special Condition 1F.38 of the Licence. We have also published a letter⁵ today setting out our minded to position on this request. We are minded to approve NGGD's request.

We consider that it is appropriate that the same gas price is used to calculate all GDNs' allowances. 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.

⁴ Special Condition 1F.13 of the Licence states: "The Shrinkage and Leakage Model must be designed to facilitate the accurate calculation and reporting of gas Shrinkage and gas Leakage in or from each Distribution Network operated by the Licensee."

⁵ <https://www.ofgem.gov.uk/publications-and-updates/national-grid-gas-distribution-nggd-modification-gas-price-used-calculate-shrinkage-allowance>

Next steps

We welcome responses to 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

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 1

Corrected Shrinkage Allowance

Distribution Network	Correct Allowance (£m 2009/10 prices)							
	t=1	t=2	t=3	t=4	t=5	t=6	t=7	t=8
NGGD EoE	11.80	10.80	10.67	10.44	10.24	10.01	9.88	9.68
NGGD Lon	6.10	5.46	5.35	5.23	5.13	5.02	4.83	4.72
NGGD NW	9.00	8.38	8.27	8.05	7.85	7.62	7.42	7.22
NGGD WM	7.00	6.79	6.79	6.59	6.47	6.37	6.27	6.15
Northern Gas Networks Ltd	10.00	9.61	9.39	8.99	8.87	8.77	8.55	8.35
Scotland Gas Networks plc	5.20	4.80	4.70	4.60	4.47	4.37	4.25	4.14
Southern Gas Networks plc	13.30	13.10	13.00	12.68	12.48	12.28	12.06	11.56
Wales & West Utilities Ltd	8.80	8.62	8.62	8.42	8.32	8.22	8.02	7.82

Annex 2:

Change to Shrinkage Allowance from the direction of XX

Distribution Network	Difference (£m 2009/10 prices)								
	t=1	t=2	t=3	t=4	t=5	t=6	t=7	t=8	Total
NGGD EoE	0.00	-0.10	-0.13	-0.06	-0.16	-0.19	-0.12	-0.02	-0.79
NGGD Lon	0.00	-0.04	-0.05	0.03	0.03	0.02	-0.07	-0.08	-0.16
NGGD NW	0.00	-0.02	-0.03	0.05	-0.05	-0.08	-0.08	-0.08	-0.30
NGGD WM	0.00	-0.11	-0.01	-0.11	-0.13	-0.13	-0.13	-0.05	-0.66
Northern Gas Networks Ltd	0.00	0.01	0.09	-0.01	-0.03	-0.03	-0.05	-0.05	-0.07
Scotland Gas Networks plc	0.00	0.00	-0.10	-0.10	-0.13	-0.13	-0.15	-0.16	-0.77
Southern Gas Networks plc	0.00	-0.20	-0.20	-0.22	-0.22	-0.22	-0.24	-0.54	-1.85
Wales & West Utilities Ltd	0.00	-0.18	0.02	-0.18	-0.18	-0.18	-0.28	-0.38	-1.34