



Making a positive difference
for energy consumers

Company Secretary
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Dear Company Secretary,

Modifications to the NTS Shrinkage Incentive Methodology Statement, pursuant to Special Condition 3D.23 of the Gas Transporter Licence

We¹ have decided not to issue a direction pursuant to Special Condition 3D.22 (SpC 3D.22) that the proposed modifications to the NTS Shrinkage Incentive Methodology Statement shall not be made.

The NTS Shrinkage Incentive Methodology Statement describes the methodology that is employed to calculate specific components of the Shrinkage Incentive Scheme.

Under SpC 3D of the Gas Transporter (GT) Licence, National Grid Gas plc (NGG) is required to undertake a full review of the NTS Shrinkage Incentive Methodology Statement. This review must be conducted in time for any consequential modifications to be introduced prior to the commencement of the Formula Year starting on 1 April 2017.

NGG have conducted a full review of the NTS Shrinkage Incentive Methodology Statement and consulted interested parties on consequential modification proposals, as required by SpC 3D.22.

NGG's review considered the extent to which the NTS Shrinkage Incentive Methodology Statement delivers against three key principles: cost minimisation for customers; delivering appropriate cost risk management; and incentivizing reductions in volumes where NGG is able to influence. The structure of the Shrinkage Incentive Scheme, as defined in the GT Licence, was not part of the review.

NGG consulted on changes to the NTS Shrinkage Incentive Methodology Statement with regards to the Compressor Fuel Usage (CFU), Calorific Value Shrinkage (CVS) and Unaccounted for Gas (UAG) Baselines. NGG also consulted on changes to the CFU and CVS Efficiencies. Full details of the proposed modifications can be found on NGG's website.²

NGG received one formal response to its consultation. Overall, the respondent was supportive of NGG's proposed modifications. For the CFU baseline, it noted that the use of alternative supply drivers, in particular a combination of St Fergus, Bacton and Easington should be reconsidered in the future. NGG also received a limited number of questions during the consultation period. A summary of the formal consultation response and these questions can be found in NGG's Consultation Conclusions Report.³

¹ References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document to refer to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

² <http://www2.nationalgrid.com/uk/industry-information/gas-system-operator-incentives/nts-shrinkage/>

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Following the consultation, NGG submitted a report on the consultation and a proposed modified NTS Shrinkage Incentive Methodology Statement to the Authority on 26 April 2016. This version is proposed to take effect for the 2017/2018 Formula Year.

We have considered the proposed modifications to the NTS Shrinkage Incentive Methodology Statement and the responses received to NGG's consultation. NGG argue that the proposed changes will reduce baseline forecast errors, drive continuous improvement and mitigate windfall cost variances. On the basis of NGG's analysis and the consultation responses, we consider that the proposed changes are appropriate and should deliver value for consumers. We have decided not to issue a direction pursuant to Special Condition 3D.22 that the proposed modifications to the NTS Shrinkage Incentive Methodology Statement shall not be made. The new version of the Shrinkage Incentive Methodology Statement will take effect for the 2017/2018 Formula Year

We note, however, that NGG should continue to review the methodology to ensure it is fit for purpose in the future. In particular, the optimal supply drivers for the CFU baselines should be reviewed in light of changing market dynamics.

Yours sincerely,

Mark Copley – Associate Partner

For and on behalf of the Gas and Electricity Markets Authority