

Impact Assessment Form

<p>Title: Review into the price control treatment of Fleetwood</p> <p>Division: Networks Team: RIIO Gas Networks</p> <p>Type of IA: Qualified under Section 5A UA 2000</p> <p>Associated documents: Review of the Fleetwood entry point in gas transmission.</p> <p>Coverage: Indicate full or partial coverage of policy decisions in the associated documents.</p>	Impact Assessment (IA)
	Source of intervention: Ofgem
	Type of measure: Price control, NTS entry capacity mechanism
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Summary: Intervention and Options**What is the problem under consideration? Why is Ofgem intervention necessary?**

National Grid Gas Transmission (NGGT) is licenced by us to operate the high pressure gas national transmission system (NTS) in Great Britain. The licence requires NGGT to provide capacity at various entry points to the NTS. Gas shippers must buy entry capacity in order to flow gas into the NTS.

NGGT's licence includes an obligation to provide 650 GWh/d of entry capacity at the Fleetwood entry point. This obligation was created by us in 2006, following a signal received from Canatxx, a developer of a new gas storage facility in the area. However, the original storage project did not proceed.

Another developer then submitted plans for a smaller project at Fleetwood. In the RIIO-T1 price control we allowed £277.5 million¹ funding on the basis of expenditure forecasts provided by NGGT. However, no investment has taken place since April 2012, and no investment is forecast to take place during the remainder of the current price control period.

If we did nothing now, from 1 April 2017 consumers will start paying for investment that has not taken place and is not currently needed. We are now reviewing the allowances made for the period from April 2012.

We are also looking into the licence obligation to provide entry capacity at the Fleetwood entry point. We have previously said that the funding and capacity obligations go hand in hand.

Moreover, we think there are other good reasons for reviewing the capacity obligation at the same time as the funding. These relate to risks to consumers from the lack of user commitment for the capacity at Fleetwood. Please see the consultation document for a more detailed discussion of these risks.

¹ All amounts in this document are expressed in 2009/10 prices to make them consistent with the RIIO T1 final proposals.

What are the policy objectives and intended effects including the effect on Ofgem's Strategic Outcomes?

The policy objectives are as follows:

To protect consumers from the risk of funding investment that is not needed. This would lead to lower bills for consumers than would otherwise have been the case.

To ensure an appropriate and fair balance of risk between consumers and shippers requiring entry capacity, by preserving the user commitment principle.

To provide clarity and certainty for all stakeholders about the treatment of funding and the capacity obligation at Fleetwood.

What are the policy options that have been considered, including any alternatives to regulation? Please justify the preferred option (further details in Evidence Base).

On the treatment of the price control allowance, we have considered the following options:

Option 1: Do nothing.

Option 2: True up the price control allowance to actual and currently forecast expenditure over the relevant period now.

Option 3: True up the price control allowances of £277.5 million to actual expenditure over the relevant period later (at the end of the RIIO T1 period).

Our preferred option is to true up the allowance now (option 2). If we did nothing (option 1), consumers would pay for investment that has not been incurred, and is not expected to be incurred in the future. Option 2 delivers the benefit of our action to consumers sooner compared to option 3.

On the capacity obligation, we have considered the following options:

Option 1: Do nothing now.

Option 2: Remove the capacity obligation at Fleetwood.

Option 3: Amend the capacity obligation at Fleetwood to reduce the level of obligated entry capacity (eg to 350 GWh/day).

We think the choice between the three options is finely balanced. However, our initial view is that removing the capacity obligation altogether now (option 2) would best protect the interests of current and future gas consumers.

Further details are provided in the Evidence Base section.

Preferred options - Monetised Impacts (£m)

Business Impact Target Qualifying Provision	Non-qualifying
Business Impact Target (EANDCB)	Not applicable
Net Benefit to consumers	£277.5 million through the funding adjustment
Explain how was the Net Benefit monetised, NPV or other	
<p>The net benefit is the amount by which NGGT’s funding would be reduced under our preferred option. Consumers would receive the benefit of this reduction through reduced network charges spread over 45 years. This is expressed in 2009/10 prices to be consistent with the RIIO T1 Final Proposals.</p>	

Preferred option - Hard to Monetise Impacts

Describe any hard to monetise impacts, including mid-term strategic and long-term sustainability factors following Ofgem IA guidance.

The impacts of the options relating to the capacity obligation at Fleetwood are hard-to-monetise. Our initial view is that removing the capacity obligation is the option which best protects consumers. The main impact of this option is better protection for consumers against the risk of being exposed to high investment costs in the future.

This option also removes a potential distortion of competition between future users of capacity at Fleetwood and future users of capacity elsewhere on the network.

Key Assumptions/sensitivities/risks

There are two key unknown factors that could affect the balance of costs and benefits for our options.

These are:

- NGGT’s future investment costs (both actual and deemed). The deemed cost of NTS investment needed to provide new entry capacity at Fleetwood is uncertain. The deemed cost also affects the amount of user commitment required by shippers wanting to trigger the release of entry capacity.
- The future auction clearing prices for entry capacity at Fleetwood. It is difficult to predict whether the cost of the fresh user commitment would be higher or lower than the cost of buying an equivalent amount of capacity at auction under the status quo.

Will the policy be reviewed?
No

If applicable, set review date: month/year

Quality Assurance Status

Evidence Base

The price control funding

Overview of the options considered

On the price control funding, we have considered three options:

Option 1: Do nothing.

Option 2: True up the price control allowance to actual and currently forecast expenditure over the relevant period now.

Option 3: True up the price control allowances of £277.5 million to actual expenditure over the relevant period later (at the end of the RIIO T1 period).

Option 2 is our preferred option because we think it would deliver the most benefits for consumers, and it would do so sooner than option 3.

Monetised costs and benefits

The price control funding for the capacity obligation at Fleetwood takes the form of expenditure allowances based on forecasts, which in turn leads to phased additions to NGGT's regulatory asset value (RAV). The expenditure forecasts were written into the RIIO-T1 gas transmission price control financial model (PCFM).

We provided total funding of £277.5m through RAV additions based on expenditure forecasts provided by NGGT.² This is made up of:

- £9.2m for the year 2012-13 as part of the fourth Transmission Price Control Review (TPCR4) rollover price control.
- £268.3m for the period 2013 to 2020 as part of the RIIO-T1 price control.

Although the allowance was based on forecast expenditure starting in 2012-13, the actual additions to NGGT's RAV are being made from 2017-18 onwards with a five year lag. This is consistent with the arrangements in place at the time the capacity obligation was originally released (in 2007-08). Under both options 2 and 3, we would "true up" the allowed expenditure based on forecasts to actual expenditure, which is zero. This adjustment would lead to a reduction in NGGT's RAV of £273.3m (spread over three years). The reduction in NGGT's RAV leads to a reduction in NGGT's allowed annual revenues, which is recovered from shippers, and ultimately consumers, through NGGT's transportation charges.

² The relevant expenditure forecasts are set out in rows 391 and 392 in the "NonCore" worksheet of the RIIO-T1 GT PCFM. The latest version of the PCFM is available [here](#).

The table below summarises the profile of allowances, RAV additions and the impact of the changes proposed under option 2 and 3, relative to the status quo (option 1).

Table 1: Summary of changes to NGGT's RAV

All figures in £m, 2009/10 prices	Year	Allowed expenditure based on forecasts	Planned RAV additions (Status quo – Option 1)	RAV additions under option 2 and 3
TPCR4 rollover	2012-13	9.2	-	-
RIIO-T1	2013-14	12.6	-	-
RIIO-T1	2014-15	24.1	-	-
RIIO-T1	2015-16	67.5	-	-
RIIO-T1	2016-17	106.4	-	-
RIIO-T1	2017-18	55.4	215.6	0
RIIO-T1	2018-19	2.3	55.4	0
RIIO-T1	2019-20	12.6	2.3	0
RIIO-T1	2020-21	24.1	-	-
Total		277.5	273.3*	0

*The RAV additions exclude allowed depreciation during the period 2013-14 to 2016-17, which is £4.2m.

The difference between options 2 and 3 is in the timing, both of the adjustment to RAV additions and of the consequential impact on NGGT's revenues. In both cases, the effect on NGGT's revenues would be the same in net present value terms. However, under option 2, consumers will benefit sooner. The timing differences between options 2 and 3 are summarised in the table below.

Table 2: Timing effects of the change to NGGT's RAV and revenues

	Status quo (Option 1)	Option 2	Option 3
Timing of RAV additions	RAV additions would take place over three years starting from 1 April 2017.	RAV additions for the first year (2017-18) would be removed with retrospective effect in 2018-19. The scheduled RAV additions for 2018-19 and 2019-20 would not happen.	The RAV additions for all three years would happen as scheduled. The RAV additions would be removed retrospectively at the end of the current price control, ie in the

			year 2021-22.
Timing of revenue impacts	The RAV additions would feed through to NGGT's revenues from 1 April 2017, and would continue until the RAV addition is fully depreciated.	<p>NGGT's revenue for 2017-18 would include some funding for Fleetwood.</p> <p>The 2017-18 revenue would be offset by making an equivalent reduction to revenue in 2018-19.</p> <p>The revenues for 2018-19 onwards would no longer include funding for Fleetwood.</p>	<p>The revenue for all years from 2017-18 to 2020-21 would include funding for Fleetwood.</p> <p>The revenue impacts for these years would be reversed by making an equivalent reduction to revenue in 2021-22.</p>

Hard-to-monetise costs and benefits

The table below summarises the hard-to-monetise costs and benefits of the three options.

Table 3: Hard-to-monetise costs and benefits

	Status quo (Option 1)	Option 2	Option 3
Costs	<p>Doing nothing would mean NGGT would receive funding even though it has incurred no expenditure.</p> <p>This would undermine the credibility of the current price control.</p>	None identified.	<p>Delaying the adjustment until the end of the price control period would mean that the revenue effect in 2021-22 would be large, as it would reflect the cumulative impact across the remaining four years of the RIIO-T1 price control.</p>
Benefits	No benefits identified	<p>By tying funding to delivery of entry capacity, we would maintain the integrity of the price control.</p>	<p>Waiting until the end of RIIO-T1 would allow the adjustment to reflect actual expenditure over</p>

		Consumers and other stakeholders can have confidence that Ofgem will act to protect the interests of consumers.	the entire T1 period, instead of being based on our current view of that expenditure.
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Distributional impact of the options

The proposed adjustment to NGGT’s allowances for Fleetwood would lead to a reduction in NGGT’s annual revenues, which in turn would lead to lower network charges, and that is expected to be passed on to consumers via shippers and suppliers. This is a financial transfer from NGGT to consumers.

NGGT’s network charges are currently recovered from shippers through a combination of capacity and commodity charges. The impact on different consumer groups is unlikely to be uniform. The impact on different consumer groups is difficult to quantify, and depends on a number of factors, including the structure of network charges and the choices made by shippers/suppliers on how to pass on reductions in network charges to consumers.

The capacity obligation at Fleetwood

Overview of the options considered

We are considering the following options as part of our review:

- **Option 1:** Do nothing now. Leave the capacity obligation at Fleetwood as it currently stands (650 GWh/day).
- **Option 2:** Remove the capacity obligation at Fleetwood now.
- **Option 3:** Amend the capacity obligation at Fleetwood to reduce the level of obligated entry capacity (eg to 350 GWh/day).

Our current view is that option 2, ie to remove the capacity obligation now, would best protect the interests of current and future consumers. However, we think the options are finely balanced, and we are seeking the views of stakeholders on the relative merits of the different options.

Hard-to-monetise costs and benefits

Under option 1, NGGT will continue to offer the capacity for sale at auctions to shippers. NGGT runs a range of auctions to sell entry capacity, from short term auctions (eg within day) to long term auctions (for three-monthly periods up to 16 years ahead).

If the capacity is purchased at auction, NGGT is exposed to the risk that it would need to either reinforce its network or undertake constraint management actions if a shipper is able to nominate flows at Fleetwood. NGGT would expect to be funded through its price control for taking on this risk if we were to remove the funding already provided (options 2 or 3 in the previous section).

It is difficult to estimate the funding requirement precisely. At the time of setting the RIIO-T1 price control in 2012, NGGT forecast that it would need to invest £269 million to support the capacity obligation at Fleetwood. However, network conditions and demand may have changed since then. This means that NGGT's costs in the future are highly uncertain.

Under option 2, we would amend NGGT's licence to remove the existing capacity obligation at Fleetwood.

This changes the balance of risks, ie NGGT would no longer be obliged to offer entry capacity at Fleetwood and would not be exposed to the costs associated with it.

If any user requires entry capacity at Fleetwood, they would still be able to trigger the release of new capacity in the future. In order to do so, the user would have to make a user commitment to pay, through capacity charges, at least 50 per cent (in net present value terms) of the deemed cost of network investment required to accommodate the capacity requirement. The deemed cost is calculated by NGGT in accordance with a published methodology when a request for new capacity is made.

If that were to happen, NGGT would be exposed once again to the risk of having to reinforce its network or undertake constraint management activities. However, the presence of a user commitment means that 50 per cent of the associated costs would be met through capacity charges. This assumes that NGGT's actual expenditure is in line with deemed expenditure.

It is impossible to predict whether the expected income from capacity charges with a user commitment would be higher than capacity charge income under the status quo (option 1). These depend on a number of factors including the auction clearing price (which is the outcome of a competitive process) and the deemed cost of network investment when the capacity is required.

However, we consider that option 2 offers better risk protection for consumers by linking the user commitment to the deemed cost of investing in the network. Under the status quo, capacity charge revenue is set by auction completely independent of the cost of investing in the network.

The table below summarises the impact of the options on consumers and shippers. This assumes that we true up the current allowance to actual expenditure now.

	Status quo (Option 1)	Option 2 (remove capacity obligation)	Option 3 (reduce capacity obligation)
<p>Impact on consumers</p> <p>Consumers will fund the cost of any network investment required, less any income from the capacity auction (whether or not backed by a user commitment).</p>	<p>The cost of investment could be up to £270m based on the most recent estimate.</p> <p>Income from capacity auctions is uncertain. It could be as low as £1m a year (based on the price achieved for one quarter in 2025).</p>	<p>The cost of investment could be up to £270m based on the most recent estimate.</p> <p>Income from capacity charges with user commitment is uncertain. If the deemed cost of investment is £270m, the user commitment needed to trigger the release of capacity could be £135m on an NPV basis.</p>	<p>The cost of investment for the lower level of obligated capacity is likely to be somewhere between zero and £270m.</p> <p>Income from capacity auctions is uncertain. It could be as low as £1m a year (based on the price achieved for one quarter in 2025).</p>
<p>Impact on shippers that require entry capacity at Fleetwood</p>	<p>Shippers would buy capacity at Fleetwood at auction. The auction price is uncertain, but it could be as low as £1m a year.</p>	<p>Shippers would have to trigger the release of new entry capacity by making a user commitment linked to the deemed investment cost.</p> <p>If the deemed cost of investment is £270m, the user commitment needed to trigger the release of capacity could be £135m on an NPV basis.</p>	<p>Shippers can buy up to the reduced level of entry capacity at Fleetwood at auction. The auction price is uncertain, but it could be as low as £1m a year.</p> <p>If they want capacity in excess of the reduced level they will need to trigger the release of new entry capacity by making a user commitment, which will vary with the amount of capacity sought.</p>
<p>Impact on other shippers</p>	<p>No impact, assuming all network charges are passed through.</p>	<p>No impact, assuming all network charges are passed through.</p>	<p>No impact, assuming all network charges are passed through.</p>

Option 2 has the added benefit of removing a potential distortion of competition between potential users of capacity at Fleetwood, and users of other entry points on the NTS. Users requiring new capacity elsewhere on the network have to make a user commitment in order to release new entry capacity. If we were to retain the capacity at Fleetwood without a user commitment, we could be giving users who are in a position to utilise capacity at Fleetwood an undue competitive advantage over other new users.

Distributional impact of the options

Any funding provided to NGGT would be recovered from consumers via their shippers through annual network charges.

NGGT's network charges are currently recovered from shippers through a combination of capacity and commodity charges. The impact on different consumer groups is unlikely to be uniform. The impact on different consumer groups is difficult to quantify, and depends on a number of factors, including the structure of network charges and the choices made by shippers/suppliers on how to pass on reductions in network charges to consumers.