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NTS Shrinkage Incentive Methodology Statement

Dear customer,

Thank you for your contributions to the dialogue we have had on establishing the appropriate incentive regime for NTS Shrinkage gas and electricity procurement from April 2013.

The key stages in the development process, which began in June 2011, are set out in Appendix A and have recently culminated with Ofgem's notification of a change to our gas transporter licence¹ (published on 31st January 2013) to implement the final SO incentive proposals.

Under the new regime, National Grid is required to publish a Shrinkage Methodology Statement outlining the principles and approach to be followed in calculating certain Shrinkage incentive parameters specified within the licence.

As part of the consultation on the Shrinkage arrangements, on 5th September 2012 National Grid published a consultation on a Methodology Statement for calculation of relevant parameters with specific values for Incentive Year 2013/14 as the forward price reference period had already commenced.

This Methodology Statement has now been updated to align with the enduring regime outlined in Ofgem's Final Proposals (published on 17th December 2012) and the associated Section 23 notice (published on 31st January 2013).

The material changes made are:

- Removal of both gas and electricity swing target cost methodologies as Ofgem's Final Proposals set a fixed annual target cost allowance.
- To aid transparency, the methodology statement has been linked to defined Licence terms.

Yours sincerely,

Mr Mike McCluskey
Market Operations

¹ Notification pursuant to Section 23 of the Gas Act 1986 – the 'section 23 notice'

Appendix A

Incentives from 2013: Development timetable (key stages)

- 14 Jun 2011: Ofgem Principles and Policy Initial Views
(<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=244&refer=Markets/WhIMkts/EffSystemOps/SystOpIncent>)
- 31 Jan 2012: Ofgem Principles and Policy conclusion
(<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=277&refer=Markets/WhIMkts/EffSystemOps/SystOpIncent>)
- 31 May 2012: National Grid Business Plan
(<http://www.nationalgrid.com/NR/ronlyres/28596737-CA03-42C7-A66F-EE2EA68856D4/54365/GasSystemOperatorExternalIncentivePlan.pdf>)
- 27 Jul 2012: Ofgem Initial Proposals
(<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=306&refer=Markets/WhIMkts/EffSystemOps/SystOpIncent>)
- 05 Sep 2012: National Grid Shrinkage Methodology Consultation
(<http://www.nationalgrid.com/NR/ronlyres/848DCA70-B912-4518-BD32-411A989E06AC/56259/ShrinkageIncentiveMethodologyStatementConsultationv1.pdf>)
(<http://www.nationalgrid.com/NR/ronlyres/679EC475-33B9-45AE-B3DB-7FA96CC0A855/56260/AddendumtoShrinkageIncentiveConsultationDraftStatementv1.pdf>)
- 17 Dec 2012: Ofgem Final Proposals (and draft section 23 notice)
(<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=320&refer=Markets/WhIMkts/EffSystemOps/SystOpIncent>)
- 31 Jan 2013: Ofgem section 23 notice
(<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=331&refer=Markets/WhIMkts/EffSystemOps/SystOpIncent>)