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for energy consumers

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Date: 23 October 2013

Dear Mr Blackburn,

Approval of Generic Entry and Exit Revenue Driver Methodology Statement

On 30 August 2013, you submitted National Grid Gas¹ Generic Entry and Exit Revenue Driver Methodology Statement (the "GRDM Statement") for our² approval. The submission was pursuant to Special Condition 9C (the "SC9C") of the gas transporter licence (the "Licence") of National Grid Gas Plc (the "Licensee"). Having regard to our principal objective and statutory duties³, we have decided to approve the GRDM Statement.

This letter contains the reasons for our decision, and notes aspects to be addressed at the next iteration of the GRDM Statement.

Background

Under the terms of the Transporter Licence, you are required to respond to users' signals for capacity in excess of the required baseline levels – ie to provide Incremental Obligated Entry and Exit Capacity⁴.

Revenue Driver is a mechanism which increases your allowed revenue automatically where you have accepted an incremental capacity obligation⁵. The increased revenue provides the funding for a range of activities necessary to deliver additional system capability. Revenue Drivers are defined in the Licence as "Additional Totex allowances in respect of the release of Funded Incremental Obligated Entry Capacity" and "Additional Totex allowances in respect of the release of Funded Incremental Obligated Exit Capacity".

¹ National Grid Gas is the owner and operator of the NTS. The terms 'you' and 'National Grid Gas' are used interchangeably in this document.

² Ofgem is the Office of the Gas and Electricity and Markets Authority. The terms 'Ofgem', 'the Authority', and 'we' are used interchangeably in this document.

³ Set out in section 4AA of the Gas Act 1986, as amended.

⁴ Specific obligations in respect of the release of incremental Obligated Entry and Exit Capacity are set out in Special Condition 5F and 5G of Gas Transporter Licence.

⁵ Entry Capacity Release Methodology Statement and Exit Capacity Release Methodology Statement set out the processes National Grid must follow to determine the quantity on Incremental Entry/Exit Capacity. Under Special Condition 9B, the Licensee must prepare and submit these methodologies to the Authority for approval.

Prior to RIIO-T1, we set Revenue Drivers for all existing and anticipated entry/exit points at the beginning of the price control period. Additional requests were considered on an individual basis. The process for setting Revenue Drivers, including the determination of the modelling assumptions, was a bilateral discussion between Ofgem and National Grid Gas Plc.

In the RIIO-T1 business plan⁶ you submitted to us in 2012, you expected a continued demand for incremental capacity requiring National Transmission System investment and, hence, the setting of Revenue Drivers. We recognised the difficulty you would have in forecasting additional capacity demands over a longer price control period, and the likely additional workload associated with unforeseen requests for capacity.

Consequently, in our Final Proposals⁷ we set out our view that a *generic methodology* for determining Revenue Drivers would result in a process that is more efficient, consistent and transparent. A new condition was introduced in the Licence to that effect. SC9C places an obligation on National Grid Gas to prepare and submit the GRDM Statement for our approval, by 1 September 2013.

You consulted on a draft of the GRDM in October 2012, prior to a final decision on RIIO-T1. You then updated the draft methodology in light of the subsequent Licence changes, and consulted with the industry and stakeholders again, in July 2013. One response to the consultation was submitted (by EDF Energy).

You submitted the GRDM Statement for our approval on 30 August 2013. In your covering letter you note that the consultation responses were reflected in clarifications and corrections to the terminology used in the GRDM Statement. The methodology is intended to come into force on 1 November 2013.

Reasons for our decision

We have carefully considered your submission. In our view, the GRDM Statement is consistent with your obligations under SC9C of your Transporter Licence and your statutory duties. However, we identified areas which would benefit from further attention in subsequent revisions, to ensure straightforward and accurate interpretation of the methodology by its readers.

Our View

Unit Costs Library

The calculation of the Revenue Drivers will be based on the RIIO Unit Cost Library, agreed during the RIIO-T1 process. The Library contains unit costs for the building pipelines and compressors.

Following RIIO-T1 discussions, you raised a concern that some costs associated with building physical infrastructure were not captured by the Unit Costs Library. We would like to take the opportunity to clarify our position on this issue.

Where you consider that the costs associated with physical infrastructure necessary to meet the incremental capacity signal are completely outside the scope of cost categories in the Library, we would be open to considering an *evidence-based case* for a new cost category to be included in the Unit Cost Library. We will not consider ad hoc requests for additional cost categories specific to individual cases of Revenue Driver calculations.

⁶ *National Grid business plan: Electricity and Gas transmission, July 2012*
<http://www.talkingnetworkstx.com/our-business-plans.aspx>

⁷ *RIIO-T1 Final Proposals for National Grid Electricity Transmission and National Grid Gas – Overview*
<https://www.ofgem.gov.uk/publications-and-updates/riio-t1-final-proposals-national-grid-electricity-transmission-and-national-grid-gas-%E2%80%93-overview>

Determining unit costs can be a complex, time and resource intensive process. Therefore, to minimise delays in Revenue Driver calculations as per GRDM, it is your responsibility to ensure that the Unit Cost Library is up to date and fit for purpose.

Constraint Management Target

You have expressed concerns about the possibility of changes to capacity constraints on the network following incremental capacity release, and the associated process for considering whether a Constraint Management Target adjustment is justified or not. Whilst you have set out the reasons for your concerns, we do not fully agree with your approach to address them in the GRDM.

The process of Revenue Driver *calculation* does not, in itself, change the risk of a network capacity constraint. In some instances, a Revenue Driver may be calculated, but the project does not go ahead; in others, a project may have a negligible effect on network capability, or none at all. A capacity constraint can only materialise when *capacity is allocated* (i.e. a user has made a financial commitment to the project) – which would occur, sometime *after* the Revenue Driver is calculated and included in the Licence⁸.

Network planning, including capacity constraint forecasting, is entirely within your gift. From a regulatory perspective, however, we believe it is more appropriate and efficient to align our consideration of formal requests for Constraint Management Target adjustments with *allocation of capacity*, not Revenue Driver calculation. As such, we consider that current references to constraint management in the GRDM Statement (paragraphs 42 and 63) would sit better in the Entry/Exit Capacity Release Methodology statements.

General clarifications

We note EDF Energy's response to the industry consultation. On the *process* for Revenue Driver calculation trigger (paragraph 26), EDF Energy:

- challenged the meaning of the term "sufficient data"; and
- pointed out that the process described did not reflect correctly the *existing* arrangements for incremental capacity release. This is because the process was aligned with *proposed* arrangements currently discussed at the industry level⁹.

You are responsible for ensuring that the calculation of the Revenue Driver is triggered, and finalised, in a timely fashion. You should meet users' needs efficiently and allow sufficient time for the new Revenue Driver to be added to the Licence.

The next iteration of the GRDM would benefit from clarifying to users:

- a) the timing of Revenue Driver calculation (currently referred to as "late enough" in paragraph 31); and
- b) the gas year to be used in the network analysis (paragraph 49).

Finally, you note (in paragraph 77) that where, having carried out new analysis, you consider that the funding previously agreeing for a project is insufficient (eg due to changes in scope/capability requirements), it may be necessary to include further costs in the Revenue Driver calculation. For the avoidance of doubt, we note that where new analysis points to agreed funding in excess of project requirements, Revenue Driver costs will be decreased accordingly.

⁸ Under current arrangements, the lead time for delivering capacity is 42 months (on entry) and 38 months (on exit); industry consultation on new arrangements will bring this forward to 2 years at the earliest in some cases.

⁹ UNC Modification 0452: Introduction of the Planning and Advanced Reservation of Capacity Agreements (PARCA) <http://www.gasgovernance.co.uk/0452>

The Authority's decision

Following consideration of the documentation you provided pursuant to SC9C of the Licence, and having regard to our principal objective and statutory duties, we approve the GRDM Statement as submitted on 30 August 2013.

This document also constitutes notice for the purposes of section 38A of the Gas Act 1986 in relation to the decision.

If you have any queries in relation to the issues raised in this letter, please contact Alena Aliakseyeva on 0203 263 2714 or via email at alena.aliakseyeva@ofgem.gov.uk.

Yours sincerely

Andrew Burgess
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