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*Promoting choice and
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Dear Steve

Approval of modifications to National Grid Gas Distribution's Connection Charging Methodology SLC 4B

On 24 March 2014, you submitted to us¹ a number of modifications to your connection charging methodology.

Having reviewed your submission, we have decided not to veto the majority of these modifications. This letter sets out these modifications, the background to our approval, and explains the rationale for our decision.

Your submission also proposed a modification to the conditions when an Advanced Reservation of Capacity Agreement (ARCA) is required. Given the potential impact of this change on large connection customers we have decided that there is a need for a further consultation on this issue, which we will publish shortly. Therefore at this stage we are not approving the modification to the ARCA requirement. Following the consultation we will be in a position to make a final decision on this change.

Background

In accordance with paragraph 3 of Standard Condition 4B (SLC4B), of the Gas Transporter (GT) licence, you have an obligation to determine and comply with an approved connection charging methodology.

Paragraph 6 of SLC4B says that you shall not make a modification to the connection charging methodology unless we receive a report setting out the terms of the modification and how the proposed modification would better achieve the relevant objectives.²

¹ The terms 'the Gas and Electricity Markets Authority', 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

² Found within SLC 4B paragraph 5 of the Gas Transporter licence which are:

- (a) compliance with the connection charging methodology facilitates the discharge by the licensee of the obligations imposed on it under the Act and by this licence;
- (b) compliance with the connection charging methodology facilitates competition in the supply of gas, and does not restrict, distort, or prevent competition in the transportation of gas conveyed through pipes;
- (c) compliance with the connection charging methodology results in charges which reflect, as far as is reasonably practicable (taking account of implementation costs), the costs incurred by the licensee in its transportation business and, where the Act enables, to charge a reasonable profit;
- (d) so far as is consistent with sub-paragraphs (a), (b) and (c), the connection charging methodology, as far as is reasonably practicable, properly takes account of developments in the licensee's transportation business; and
- (e) compliance with the connection charging methodology ensures that the licensee shall not show any undue preference towards, or undue discrimination against, any person who operates, or proposes to operate, a pipeline system in relation to the connection of that system to the pipeline system to which this licence relates.

The modifications

You submitted the following modifications to your connection charging methodology on 24 March 2014:

1) *The depreciation method applied with the Economic Test*

The Economic Test is a financial assessment tool that ensures that Gas Distribution Networks (GDNs) meet their obligations under the Gas Act 1986 (the Act) to develop and maintain an efficient and economical pipeline system.

The Economic Test is used to identify new requests for capacity on the gas distribution network where the level of investment would be considered 'uneconomic', and so avoids current customers on the distribution network subsidising the new load. The test compares the cost of distribution network reinforcement and additional operating costs of accommodating the new load with the additional transportation revenue from the load. The methodology used to calculate Economic Test is specified in the connection charging methodology.

You are proposing to amend your connection charging methodology to change the Economic Test depreciation method from straight-line³ to sum-of-digits⁴, to be consistent with the approach used for RIIO-GD1.⁵

2) *Economic test parameters*

You also propose to change the discount rate used in the Economic Test to 4.94%, to match the pre-tax weighted average cost of capital (WACC) assumed in the derivation of the RIIO-GD1 price control.⁶

3) *Fuel-poor test parameters*

Those eligible for a connection under the fuel-poor network extension scheme receive a voucher value equal to the Net Present Value (NPV) of the transportation revenue for a typical domestic customer.⁷ You propose to change the domestic consumption rate used from 19,000 kWh per annum to the Typical Domestic Consumption Value (TDCV) for a medium-sized domestic load (currently 13,500 kWh per annum)⁸

4) *Removing redundant references*

You propose to remove references to interruptible transportation arrangements as they no longer exist.

Our decision

After reviewing the revised methodology and the modification report, we are satisfied that it would better achieve the relevant objectives set out in Standard Licence Condition (SLC) 4B paragraph 5 (a) (c) and (d) and that its impact on the other relevant objectives is neutral. We are also satisfied that not vetoing the modification is consistent with our principal objective and statutory duties.

³ A straight line method of depreciation is a standard approach to depreciation which is based on the assumption that assets depreciate on a uniform basis across an asset's life.

⁴ A sum of digits method of depreciation is an accelerated depreciation technique which is based on the assumption that assets depreciate more in the early years of an asset's life and less in the later years.

⁵ [RIIO-GD1: Final Proposals - Finance and uncertainty supporting document](#)

⁶ [RIIO-GD1: Final Proposals - Finance and uncertainty supporting document](#)

⁷ [Final position on the non-gas fuel poor network extension scheme](#) June 2011

⁸ [Decision: New typical domestic consumption values](#) September 2013

(a) compliance with the connection charging methodology facilitates the discharge by the licensee of the obligations imposed on it under the Act and by this licence;

The proposed modifications to the Economic Test will better align the assessment of connection requests under the Act, with the financial arrangements agreed during RIIO-GD1.

(c) compliance with the connection charging methodology results in charges which reflect, as far as is reasonably practicable (taking account of implementation costs), the costs incurred by the licensee in its transportation business and, where the Act enables, to charge a reasonable profit;

The modification to the fuel-poor test parameters will more closely reflect the level of transportation revenue likely to be generated by an average domestic load and therefore should result in a more appropriate level of discount for a fuel-poor connection.

(d) so far as is consistent with sub-paragraphs (a), (b) and (c), the connection charging methodology, as far as is reasonably practicable, properly takes account of developments in the licensee's transportation business;

These modifications update the connection charging methodology to reflect arrangements for RIIO-GD1 (which came into effect on 1 April 2013) and removes redundant references to interruptible transportation.

Decision Notice

In accordance with Standard Condition 4B of the Gas Transporters' licence, the Authority has decided not to veto these modifications to the connection charging methodology of National Grid Gas plc.

Yours sincerely



Dora Guzeleva

Head of Distribution policy

Signed on behalf of the Authority and authorised for that purpose by the Authority.