

**Distribution Charging Methodology Forum Minutes**  
**Tuesday 23 October 2012**  
**ENA, 52 Horseferry Road, London. SW1P 2AF**

**Attendees**

Tim Davis (Chair)	(TD)	Joint Office
Mike Berrisford (Secretary)	(MB)	Joint Office
Andrew Green	(AG)	Total
Bernard Kellas	(BK)	SSE
Ben Tucker	(BT)	EDF Energy
Binoy Dharsi	(BD)	EDF Energy
Clare Cattle-Jones*	(CJ)	ENA
Colette Baldwin	(CB)	E.ON UK
David Chalmers	(DC)	National Grid Distribution
Gareth Evans	(GE)	Waters Wye Associates
George Moran	(GM)	British Gas
Jens Martin	(JM)	E.ON UK
Joanna Campbell	(JC)	Ofgem
Joanne Parker	(JP)	Scotia Gas Networks
Joel Martin	(JM)	Scotia Gas Networks
John Edwards	(JE)	Wales & West Utilities
Jonathan Wisdom	(JW)	RWE npower
Steve Armstrong	(SA)	National Grid Distribution
Will Guest	(WG)	Northern Gas Networks

\* via teleconference

Copies of all papers are available at: [www.gasgovernance.co.uk/dcmf/231012](http://www.gasgovernance.co.uk/dcmf/231012) and [www.gasgovernance.co.uk/0186oct2012](http://www.gasgovernance.co.uk/0186oct2012)

**1. Introduction and Status Review**

**1.1 Review of Minutes**

The minutes of the previous meeting (23/07/12) were accepted.

**1.2 Review of Actions**

No outstanding actions to review.

**DCMF 07/01:** All DNs to consider the inclusion of each Network's maximum allowed revenue for each year.

**Update:** SA explained that the requested information, based on Ofgem's Initial Proposals, is contained within the DN revenue reports.

**Closed**

**DCMF 07/02:** All DNs to consider providing a calculation model to assist understanding how tariffs are calculated.

**Update:** Shippers clarified that provision of a model similar to the equivalent electricity (DCUSA) approach would be beneficial. The model would convert allowed revenues into tariffs. SA suggested the DNs would look further into the best way of addressing this, but indicated that the present models were not fit for publication and each DN has its own model. Development of a common, user friendly, model is unlikely to take place before 2013 due to the need to focus on the implications of the RIIO Final proposals. Shippers requested that, if possible, the model covers a range of years in order to provide a projection of possible tariff levels.

**Carried Forward**

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## 2. Allowed and Collected DN Revenue (UNC0186 Reports)

### 2.1 National Grid Distribution

SA confirmed that the figures based on NGD's business plan had not changed significantly since the previous report. SA then provided an overview of the revenue reports, including those based on Ofgem's Initial Proposals.

#### [East of England \(BP based\)](#)

Core Allowed Revenue has not seen a significant change since the July report, but the 2012/13 'k' has changed. The Incentive Revenue and Other Adjustment Forecast has been updated to reflect shrinkage cost changes and the SOQ percentage change now reflects the latest information. Confirmation of the change in SOQs is awaited, but is unlikely to be significantly different to the 4.8% reduction that is in the reports. For later years, an ongoing 3% SOQ reduction (up from 2%) has been assumed. The arithmetic April price change has risen to 10.6% from 9.1%.

SA confirmed that SOQ reductions by market sector had been taken into account, although he did not have the figures to hand. WG pointed out that, as far as the larger load bands are concerned, the smaller sample sizes involved can impact on the size of the apparent variations. JP and JE added that Scotia Gas Networks and Wales & West Utilities had experienced similar variations, although JP observed that Scotland had seen up to an 8% drop.

When asked about Ofgem's proposal that the 'k' factor adjustment be moved to a two year delay, JC advised that this would apply in 2013/14 – this has not been reflected in the DN revenue reports.

Regarding indicative charges to apply from 2013, the DNs indicated that they were planning to release two sets. One would be based on their own assumptions and one on the allowed revenue implied by Ofgem's Initial Proposals. JW suggested it would be better if these could be based on the Final Proposals. SA said the only way to achieve this would be to delay release of the indicative charges – this was not supported. While acknowledging that the timing is beyond the DNs' control, JW remained concerned that the range to be published could be wide, providing little clarity around the likely level of charges. This is inconsistent with the charging volatility proposals. Asked whether Ofgem could provide the 2011/12 background data, JC questioned the value as it is unlikely that the information would be available before Final Proposals are released.

Closing, SA added that the Exit Capacity cost had been updated to take into account National Grid Transmission's Exit (Capacity) latest figures.

#### [London \(BP based\)](#)

There had been no significant changes since the July report although there is a slightly larger 'k' for this year. There is a slightly higher price change as a result of SOQ changes.

#### [North West \(BP based\)](#)

Allowed Revenue for the current year is down slightly and a reduction in SOQ to -6% from -4% in the July report is reflected in the 12.8% price increase, up from 8.8%.

#### [West Midlands \(BP based\)](#)

Apart from a slight change to the SOQ reduction, little had changed since the previous report.

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Regarding the reports based on Ofgem's Initial Proposals, SA noted that it had been assumed that a 'k' adjustment would apply in 2013/14.

GM asked whether the DNs could provide an explanation of the assumptions used on a year-by-year basis in order to translate Ofgem's Initial Proposals into annual revenue allowances in the reports. The DNs agreed to provide this to the Joint Office in due course.

**DCMF 10/01: DNs to illustrate assumptions used to move from Initial Proposals to allowed revenue in 0186 reports**

Asked whether or not actual SOQ changes are becoming any clearer, WG indicated that he believes the accuracy is in the region of minus 1 to 2% whilst SA advised that, having looked closely at average SOQ changes, he currently remains uncertain of the actual level of fluctuations involved.

When asked whether the DNs could provide a view of SOQ changes by AQ band and their potential impacts upon tariffs, the DNs indicated that they would look to provide the information, but warned that it is unlikely to be available before the end of November, early December. It was acknowledged that once the Ofgem Final Proposals are published, the DNs would be focused on assessing the implications and producing actual charges.

**DCMF 10/02: DNs to consider providing a view of SOQ changes by AQ band and the potential impact on charges**

In closing, SA explained that, as far as indicative figures are concerned, the DNs propose providing an indication of the percentage change to their charging rates (inc. tariff elements). System and customer methodologies would not be changing. However, the DNs would be looking at the LDZ commodity/capacity split to ensure that the methodology still works. Asked if this information would be helpful, all indicated that it would be.

## **2.2 Northern Gas Networks**

WG explained that the NGN report is split into two elements, one based on their Business Plan and the other on Ofgem's Initial Proposals.

WG advised that the 'k' factor is not expected to make a significant impact on the figures whilst the 2013/14 Arithmetic April Price % varies from 6.4% under the business plan to 4.5% for initial proposals. Shrinkage is indicating a steady increase. Asked what last year's figure was, WG indicated that this was in the region of 1.8%.

SA observed that the level of charge variations appear odd which makes prediction very difficult, hence the Project Nexus rolling AQ and fixed SOQ proposals – these proposals can help with pricing certainty. GE questioned how the proposals would actually add value and certainty and whether it would improve forecasting - he does not believe they would provide any more significant year ahead pricing certainty. SA disagreed, believing the proposed changes should help to improve predictability.

WG believed his 2015/16 figures included an IRS allowance, but agreed to double check and advise if this was not the case.

## **2.3 Wales & West Utilities**

JE noted that the WWU report shows the Business Plan and Initial Proposals implications side-by-side – this presentation was welcomed.

JE advised that the slight over recovery being carried over into 2012/13 reflects the fact that the 2011/12 data had not fully closed out when he compiled the July report.

JE said the SOQ reduction is running higher than the other DNs, around the 6.5% to 7% range which has resulted in a 2013/14 Arithmetic April Price percentage increase of 6.2% - a breakdown explanation has been provided within the report.

The RPI information is based on the latest Treasury figures.

Closing, JE explained that he had examined the Initial Proposals carefully before stripping out shrinkage. He anticipates that there could be changes to how shrinkage costs are dealt with under RIIO (reflecting the revised pass-through approach for reducing volatility). SA observed that, should this prove to be the case, there would be potentially significant impacts upon DN cash flows.

## 2.4 Scotia Gas Networks

### Southern

JP advised that SGN would provide a set of figures based on Initial Proposals in due course. She explained that the £700k increase in allowed revenue for 2012/13 reflected improved forecasts, whilst SOQ changes have impacted the 2013/14 carry over. The 2013/14 Arithmetic April Price % had increased to 13.7% from 8.0% in the July report, due in part to the impact of SOQ movements. Should the 'k' recovery be delayed for 2 years, as Ofgem have proposed, this would have an impact on prices.

### Scotland

JP explained that Collected Revenue is up circa £800k due in part to SOQ impacts, whilst the 2012/13 carry forward is also up by around £500k. The 2013/14 Arithmetic April Price % had increased to 9.8% from 7.9% in the July report. JP expected Initial proposals based figures to be similar to those provided in July.

**DCMF 10/03: Scotia Gas Networks (JP) to update 0186 Report to include figures based on Initial Proposals.**

## 3. Any Other Business

### Ofgem RIIO–GD1: network charging volatility

JC said Ofgem propose implementing three of the five options for mitigating charging volatility on which they had consulted, plus a fourth in part.

With regard to option 1, improved information, JC encouraged the DNs to consider views put forward in consultation responses and also the various suggestions made at DCMF. When asked, JC suggested that Ofgem would be publishing their financial model as-is.

For option 2, the proposal is to restrict charging changes to April. JC indicated that a non-April change could be considered to cater for extraordinary circumstances, and is a stronger requirement than the best endeavours obligation in present Licence conditions. Discussions are ongoing with National Grid NTS about an April only price change.

GE was concerned that the practical implementation may mean this is no different to the present circumstances with uncertainty remaining since a second price change could occur. He suggested that Ofgem could address this by publishing criteria that would have to be met if a second change was to be permitted. While he accepted JC's assurance that Ofgem would not expect to agree to a second price change in a year, he noted that this did not provide confidence in the medium term as those responsible at the time may reach a different interpretation of the Licence conditions. JC confirmed that Ofgem do not anticipate providing criteria – if a DN approaches Ofgem requesting a second

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price change, Ofgem would consider the merits at the time. Non-April changes in recent years had been designed to ensure collected revenue was within the band set out in the Licence, and JC would not expect a request for changes of this nature (based on over or under recovery) to be accepted in future.

In considering option 4, lagging adjustments, JC advised that Ofgem is proposing REPEX (pass through) lags and that an allowance would be applied to cater for 2013. When asked whether or not the DNs would be expected to reflect (absolute) 2 years previous NTS exit charge costs, JC suggested this should be the subject of additional discussions between Ofgem and the DNs. However, she believes the current charging methodologies should still be applicable – Ofgem’s proposals would change the level of allowed revenue rather than the basis for converting this into charges. SA was concerned that the level of NTS Exit cost variations could potentially impact upon DN cash flows, and enquired whether a fixed allowance would be set across the eight year price control period to reflect NTS Exit costs. JC acknowledged that exposure could increase over the eight year period.

As far as option 5 is concerned, caps and collars, JC advised that Ofgem view this as adding complexity to the price control mechanisms, especially re-opener aspects, and emphasised that the proposed November financial model is not subject to a lagging mechanism. JC encouraged the DNs to reflect anticipated financial model impacts within their 0186 Reports – while the model is finalised in November, earlier indications of the likely outcome would be available.

JW remained of the view that the Ofgem proposals would not provide a significant increase in market price transparency nor predictability relative to the current arrangements. Responding, JC explained the consultation focused on the RIIO Price Control Framework and implications for volatility in allowed revenue. It was not a pricing methodology review. While supporting the general principles behind the Ofgem proposals, JW remained concerned by aspects associated with the level of uncertainty around re-openers and their potential impacts on predictability.

GE highlighted his frustration that during the development of Modification 0368, Smoothing of Distribution Charge Variation, Ofgem had indicated that the modification should not be developed further as the option would be included within their consultation, which clearly has not been the case. Ag indicated that he would wish to consider what had been put forward today before deciding whether to continue with Modification 0368 as it stands, to amend it, or to withdraw it.

On a more general point, SA enquired as to what was meant by the term “additional penalties” within Ofgem’s proposals as he remains concerned about NTS Exit costs and various ‘k’ factor aspects. JC suggested that the exact arrangements would be considered as part of the formal consultation process and acknowledged that, whilst allowed revenues for NTS Exit Capacity would be predictable, the actual costs could be different. WG felt that consideration of the NTS Exit impacts was not made clear within the consultation process.

When asked whether there was an innovations update, JC thought that this would be included within next week’s consultation on RIIO Licence Condition changes, although Ofgem are awaiting DECC Gas Act feedback. JC agreed to identify the timescales involved in providing the innovations update.

**DCMF 10/05: Ofgem (JC) to ascertain whether an innovations update would be included as part of the RIIO Licence consultation and, if not, what timescale is involved.**

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Modification 0428 "Single Meter Supply Points"

SA advised that the next Workgroup meeting is scheduled to take place on Thursday 25 October 2012 at 31 Homer Road, where various charging impacts and implications would be considered. Shippers may wish to manage attendance accordingly.

**4. Diary Planning for Workgroup**

*Details of planned meetings are available at: [www.gasgovernance.co.uk/Diary](http://www.gasgovernance.co.uk/Diary).*

It was agreed that the next meeting would be scheduled to take place as early as practical in January 2013.

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**Action Log**

Action Ref	Meeting Date	Minute Ref	Action	Owner	Status Update
DCMF 07/01	23/07/12	2.2	DNs to consider the inclusion of each Network's maximum allowed revenue for each year.	All DNs	Update provided. <b>Closed</b>
DCMF 07/02	23/07/12	3.	DNs to consider providing a calculation model to assist understanding how tariffs are calculated.	All DNs	Update to be provided. <b>Carried Forward</b>
DCMF 10/01	23/10/12	2.1	Illustrate assumptions used to move from Initial Proposals to allowed revenue in 0186 reports.	All DNs	Update to be provided in due course.
DCMF 10/02	23/10/12	2.1	Consider providing a view of SOQ changes by AQ band and the potential impact on charges.	All DNs	Update to be provided in due course.
DCMF 10/03	23/10/12	2.1	Update SGN 0186 Report to include figures based on Initial Proposals.	Scotia Gas Networks (JP)	Update to be provided in due course.
DCMF 10/04	23/10/12	3.	Ascertain whether an innovations update would be included as part of the RIIO Licence consultation and, if not, what timescale is involved	Ofgem (JC)	Update to be provided in due course.