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Re: National Grid 2011/12 Initial Shrinkage Proposals - Representation

Dear Bob

In accordance with the Uniform Network Code Transportation Principal Document Section N 3.1.5(a), National Grid Gas Distribution (NGD) has reviewed representations made by Users (Shippers) in relation to our Initial Proposals for LDZ Shrinkage in 2011/12.

One representation has been received in respect of this year's proposal. This was a joint response to all of the LDZ Shrinkage Proposals for this year. Following discussions between the Distribution Network Operators (DNOs), it is the intention of each DNO to reply individually to the representation. NGD intends to provide comments directly to the respondent and requests that this document be published on the Joint Office Website.

NGD believes the rationale behind the proposals to be robust. Our reasons for this are set out below:

1. The representation raises a concern that the current shrinkage incentive is inadequate and that it is not driving the correct behaviour.

As indicated in our last three Shrinkage Proposals, NGD has made significant investment in Pressure Management Systems, which has delivered improved environmental and shrinkage performance. This is in the knowledge that the cost would be offset by out-performance of both the Shrinkage and Environmental Emissions incentives. In addition, the DNOs have proposed improvements to the leakage model. These improvements, which have led to more accurate leakage and, hence, shrinkage estimation, were subject to consultation with the industry, independent verification and Ofgem approval; it should be noted that no Shipper chose to respond to this consultation. In summary, we believe that the current incentive is driving the correct behaviour.

Leakage and shrinkage performance is reported via the Shrinkage Assessment and Adjustment process as required by UNC TPD Section N3.3. Details of this performance are published on the Joint Office website, <http://www.gasgovernance.co.uk/sf/publications>.

2. The representation raised concerns about the suitability of the current leakage model and, in particular, the use of the 2002/03 leakage rates.

The DNOs review the leakage model annually for its continued applicability for meeting the objectives set out in the Transporters' Licences. The review of the leakage model led to the

modification identified above and we will continue to raise improvements where the validity of any revised methodology can be demonstrated. In August 2010, the DNOs invited representation on the continued applicability of the current leakage model. No representations were received in respect of this; had any issues been raised at this time it may have been possible to take account of them in the 2011/12 Shrinkage Proposals. However, we welcome the respondent's engagement in these proposals and would welcome the opportunity to discuss individual aspects of the leakage model; we propose that the Shrinkage Forum be reconvened to address such issues for future proposals.

With regard to the continued applicability of the leakage rates, although these were established nine years ago there is no evidence that these represent an under-estimate of leakage. The current leakage model uses leakage rates that are consistent with those used to set the incentive targets and, hence, there are no inappropriate incentive windfall gains or losses associated with this. We would support an appropriately funded update of these rates and would welcome the views of stakeholders on the benefit to consumers of a more up-to-date leakage rate calculation, which, if considered beneficial and economic, could be included in RIIO-GD1. The 2002/03 National Leakage Test programme cost NGD's predecessor, Transco, in the order of £10m to complete. In the current price control period, the primary focus has been to reduce the amount of leakage for environmental reasons. A new leakage test programme will not by itself reduce actual leakage and, consequently, does not have any environmental benefit. Therefore, we would seek stakeholders' views as to whether a new test programme would deliver a benefit commensurate with the likely £10m - £15m that it might cost to complete.

3. The representation raises concerns about the level of detail included in the Shrinkage Proposals.

Firstly, as specifically requested, we can confirm that the 2002/03 National Leakage Test programme was a national exercise that tested in the order of 850 mains that were randomly selected across all thirteen LDZs. It should be noted that Shippers were informed of the details of 2002/03 National Leakage Tests and were included in the development of the sampling plan for the test programme. The test results, workings of the leakage model and details of its accuracy have been shared with the shipper community via the Shrinkage Forum. However, unfortunately, the Shrinkage Forum ceased to convene due to lack of industry participation and it would appear that the continuity of knowledge in the industry in respect of shrinkage as a whole might have declined as a result.

The level of detail provided in the shrinkage proposals has remained consistent for a number of years and we believe this to be commensurate with the significance of the individual shrinkage elements; in particular, the gas lost through recorded incidents referred to in the representation only represents around 0.2% of the overall leakage. However, we would welcome the opportunity to discuss the useful level of detail to be provided for future proposals at a Shrinkage Forum.

4. The representation raises concerns with regard to the level of Theft of Gas and an apparent inconsistency between the DNOs' proposals in respect of this matter.

The Transporter Responsible Theft of Gas (ToG) factor was subject to discussion at the Shrinkage Forum in 2005. The DNOs proposed a reduction from the enduring 0.03% factor to 0.01% based on recorded ToG statistics. Some Shippers, including the respondent, raised this as an issue in their representations to the 2005/06 Initial Proposals. Consequently, and in recognition of the overall uncertainty in this area, a compromise factor of 0.02% was included in the Final Proposals.

We can confirm that there is no inconsistency between the DNOs in respect of Theft of Gas; all DNOs use the 0.02% factor that was established for the reasons given above.

The 0.02% factor has been used in subsequent shrinkage proposals and was used in the determination of the Shrinkage Incentive baseline levels. Therefore, without further evidence of increased levels of Transporter Responsible theft, we believe the continued use of this factor is appropriate.

We would welcome the opportunity to discuss this issue at a Shrinkage Forum where we could review the impact on shrinkage of any Shipper evidence on Transporter Responsible theft, together with any relevant output from other industry discussions on this issue.

5. As identified above, the DNOs have tried to engage with the Shipper community through publishing our shrinkage proposals each year, the Leakage Model Modification consultation in May 2009 and the request for representations on the applicability of the current leakage model in August 2010. The UNC Shrinkage Proposal process has quite a tight timescale around it and is reflective of the existence of an active Shrinkage Forum, meeting on a regular basis and where all parties are 'up-to-speed' on the relevant issues. Accordingly, we do not believe that there would be sufficient time within the current, 2011/12, proposal process to now consider these issues at a Shipper forum. However, we welcome the opportunity to engage with Shippers on this issue and, therefore, propose that these issues be considered at a Shrinkage Forum in preparation for the 2012/13 proposals.

We trust that this information is helpful in consideration of the issues raised.

As you are now probably aware, the DNOs have initiated a Shrinkage Forum for 8 March 2011, at which we hope to discuss with stakeholders the development of Shrinkage and achieve an early resolution of any issues in time for the 2012/13 proposals.

Please contact me via the contact details above should you require any further information.

Yours sincerely,

Roy Malin