

## **2014/15 Shrinkage Proposals**

**Briefing Note: Decision required in respect of the leakage model version to be used.**

**Shrinkage Forum 19 February 2014**

### **Summary**

The Gas Distribution Networks (GDNs) are required by UNC to provide an estimate of Shrinkage for the coming formula year, 2014/15, by 1 March 2014. The Shrinkage estimate will be used in the RbD process and the GDNs will procure the volume of gas commensurate with this estimate.

The GDNs have proposed a change to the Shrinkage and Leakage Model (SLM) that they believe will become the approved model by the time that the actual level of Shrinkage for the formula year is assessed in July 2015.

It is estimated that an adjustment of 116GWh (£2.6m) would result if the Shrinkage Assessment is based on a different version of the SLM than the Shrinkage Proposals. This would only have an impact on cash-flow for RbD Shippers. There is no impact for non-RbD Shippers. Therefore, the GDNs are seeking the opinion of the RbD Shipper community as to which version of the SLM they would like the Shrinkage Proposals for the 2014/15 Formula Year to be based.

### **Background**

Each year, the Gas Distribution Networks (GDNs) are required<sup>1</sup> to estimate the volume of Shrinkage for the coming Formula Year; this is known as the Shrinkage Proposal process and reflects the GDNs' estimates of leakage, 'transporter responsible theft' and 'Own Use Gas'. This estimate is used as the level of Shrinkage for the RbD process and, accordingly, GDNs procure the amount of gas commensurate with this estimate throughout the year.

At the end of the Formula Year, the GDNs are required<sup>2</sup> to assess the actual level of Shrinkage and a financial adjustment<sup>3</sup> is made to the RbD process via a Neutrality Invoice for any difference between the original estimate and the end of year assessment; this is known as the Assessment and Adjustment process.

In July 2013, the GDNs consulted on a proposed modification to the Shrinkage and Leakage Model (SLM); the SLM is used to provide the estimate of leakage for both the Shrinkage Proposal and Assessment and Adjustment processes. The current version of the SLM is known as v1.3 and the modified version is v1.4. The 'approved' version of the SLM will be used for the end of year assessment.

Version 1.4 of the SLM was submitted to Ofgem for approval in September 2013; however, Ofgem identified two issues that require addressing before the model can be approved; independent verification of the NGN & WWU models and clarification of the variance in impact between the LDZs.

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<sup>1</sup> UNC Section N3.1

<sup>2</sup> UNC Section N3.3

<sup>3</sup> UNC Section N3.4; the financial adjustments are evaluated at System Average Price (SAP)

NGN and WWU are arranging independent verification of their models and National Grid has demonstrated the reason for the variance between the LDZs<sup>4</sup>.

The difference in Shrinkage associated with the application of each version of the leakage model has been estimated to be 116GWh, which is roughly equivalent to £2.6m but is dependent on the outturn price of gas. This represents the amount of adjustment that would occur should the within-year Shrinkage procured by the GDNs be based on SLM v1.3 and v1.4 be subsequently approved and used for the Assessment and Adjustment<sup>5</sup>.

Any adjustment to transportation charges in relation to Shrinkage is done with a lag of two years based on the final Shrinkage values for the year. Therefore the choice of model to use for the original assessment of Shrinkage has no impact on transportation charges.

The GDNs are neutral to the actual Shrinkage Quantities procured, as the GDN Allowances are adjusted to account for the outturn values<sup>6</sup>. Therefore, the only consideration in respect of the decision on which model to use for the Shrinkage Proposal process is the potential cash-flow issue for RbD Shippers associated with the Assessment and Adjustment process being based on a different version of the SLM than the Shrinkage Proposals.

#### **UNC Shrinkage Timeline:**

- 1 January – GDNs publish Initial Shrinkage Proposals
- 1 January to 1 February – Consultation period/User representation
- 1 February to 15 February – GDN/User engagement
- 1 March – GDNs publish Final Shrinkage Proposals
- 1 March to 15 March – UNC Users may seek disallowance of proposals from Ofgem
- 31 July – GDNs publish Assessment and Adjustment for the previous Formula Year

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<sup>4</sup> A variance analysis paper and supporting spreadsheet will be made available via the Joint Office

<sup>5</sup> This would be a debit to the RbD Shippers; however, if v1.4 is used for the proposals but doesn't get approved there would be an equivalent end of year credit to RbD Shippers. The Neutrality Invoice adjustments would be split across the RbD Shippers in proportion to their respective portfolios.

<sup>6</sup> GDNs have an incentive to procure the Shrinkage Quantities efficiently and have a separate incentive to reduce Shrinkage.