

CONSULTATION DOCUMENT

**Modification Proposals to the Gas Transmission
Transportation Charging Methodology**

**NTS GCM 02 :
DN Pensions Deficit Charge**

24 November 2006

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Executive Summary

This document sets out for consultation National Grid NTS's proposals for revising the Gas Transmission Transportation Charging Methodology (the "Charging Methodology") in regard to the introduction of a DN Pensions Deficit Charge to be levied on all Distribution Networks Operators (DNOs). The proposal seeks to introduce the proposed charge from April 2007 for the duration of the next Transmission Price Control Period (April 2007 – March 2012).

National Grid NTS is bringing forward this proposal following the Authority's publication of the Transmission Price Control Review (TPCR) document (September 2006) (the "Updated Proposals") in which Ofgem has proposed that an allowance of £188.1m of the Pension Scheme Deficit is to be recovered from consumers. Ofgem further proposes that this will be recovered over 10 years with the first 5 years being in respect of the 2007 – 2012 price control period. This allowance relates to the pensions liabilities deficit associated with non-active members (i.e. former employees of the DNs who retired prior to DN sales) originally employed by the DNs. Ofgem have stated that this agreed pension deficit cost will be recoverable under the NTS price control as a charge to DNOs.

In bringing forward these proposals at this stage, National Grid NTS is mindful that this is in advance of Ofgem's publication of its final proposals for the TPCR, expected in early December 2006. However, we believe that initiating a consultation exercise at this stage would be the preferred approach as it allows discussion on the principles of the proposed charge in a timely manner, and provides the required notice to DNOs of the potential new charges, subject to a non-veto decision by the Authority.

A UNC Modification Proposal will also be raised to seek to ensure that the UNC is changed to provide for the definition of the proposed charging arrangements, including the invoicing and settlement elements. .

The Charging Methodology proposal sets out the actual allowances that have been put forward in Ofgem's Updated Proposals that National Grid NTS will be allowed to recover over the next Price Control Period. It should be noted that these allowances and the assumptions that underpin them will therefore be subject to change as part of the ongoing TPCR consultations. Finalised figures will not be known until completion and agreement of the TPCR process, and will be subject to National Grid's acceptance of Ofgem's Final Proposals and subsequent implementation of the modifications to NTS' GT Licence.

Respondents are invited to provide comments specifically on the proposed change to National Grid NTS' Charging Methodology, rather than the principles and levels of Ofgem's proposed DN Pensions Deficit Allowances, which has been the subject of Ofgem's TPCR Consultation Documents.

National Grid NTS proposes the following change to its Charging Methodology :

- a DN Pensions Deficit Charge is introduced from April 2007 that will be levied on DNOs.
- the Charge will be levied on a monthly basis, and set at a level to allow recovery of the annual fixed allowances during any formula year (thus avoiding any "carry over" of revenue amounts).
- The level of the annual charge for each DNO will be in accordance with the DN allowances set out in National Grid's NTS GT Licence, divided into 12 monthly amounts, and hence will remain fixed for the term of the next price control.

- In the event that the timing of the TPCR outcome does not allow charges to become effective from 1 April 2007, for the first year the monthly charges will be determined from the annual allowances divided by the remaining number of months in the formula year.

This consultation has been placed on National Grid's Industry Information website :

<http://www.nationalgrid.com/uk/Gas/Charges/> .

The closing date for submission of your responses is **22 December 2006**.

Your response should be e-mailed to dominic.j.harrison@uk.ngrid.com or alternatively by post to Dominic Harrison, Regulatory Frameworks, National Grid, National Grid House, Gallows Hill, Warwick, CV34 6DA. If you wish to discuss any matter relating to this charge methodology consultation then please call 01926 656316.

Responses to this consultation will be incorporated within National Grid NTS' conclusion report. If you wish your response to be treated as confidential then please mark it clearly to that effect.

1 Introduction

- 1.1 As part of Gas Distribution Network Sales, all pension liabilities associated with non-active members (i.e. former employees of the DNs who retired prior to DN sales) originally employed by the DNs were required to remain with the National Grid UK (NGUK) Pension Scheme. In order to avoid a significant differential in the pension liabilities between NG-owned DNs and independently-owned DNs that this would have imposed, Ofgem decided that pension deficit costs in respect of non-active members would be channelled through the gas transmission price control rather than the gas distribution price controls.
- 1.2 As part of Ofgem's Updated Proposals, it has therefore been proposed that an allowance of £188.1m of the Pension Scheme Deficit is to be recovered from consumers through Transmission's Price Control. In common with other final salary pension schemes, changes in Pensions regulations and wider market movements have resulted in a deficit in the NGUK Pension Scheme (formally Lattice Group Pension Scheme). Ofgem have proposed an appropriate allowance after taking into account the treatment of unfunded ERDCs (Early Retirement Deficiency Contributions) and the Centrica pension liabilities for non-active scheme members, the details of which are explained in Ofgem's Updated Proposals (Section 8.10 – 8.23). Ofgem further state that this agreed pension deficit cost will be recoverable under the NTS price control, with 86% to be recovered as a charge to DNOs and the balance of 14% to be recovered through general NTS transportation charges.
- 1.3 It is envisaged that the pensions allowance recoverable from DNOs will be included in National Grid's NTS GT Licence as a fixed annual allowance in respect of each DN for the duration of the 5 year price control period. The same allowance figures would also be set out in each of the respective DNs' GT Licences as cost-pass through items. It is expected that this approach will be consistent with Ofgem's GT Licence Modification consultation documents once released.
- 1.4 It is anticipated that the TO (Transportation Owner) Maximum Allowable Revenue and the TO Revenue (both determined in accordance with Special Condition C8B of National Grid NTS' GT Licence) will both include the agreed annual pension deficit allowance, further details of which are explained in Section 2.

2 Background

- 2.1 National Grid NTS proposes to introduce a DN Pensions Deficit Charge that will be levied on DNOs from the commencement of the next Price Control Period. As part of TPCR discussions, Ofgem have proposed that gas pension costs associated with non-active members of the National Grid UK Pension Scheme will continue to lie with National Grid Gas and be recoverable under the NTS price control.
- 2.2 In Ofgem's Updated Proposals document, a deficit pensions allowance to be recovered through the TO price control of £188.1m has been included. On the agreement that this would be recovered over a ten year period, with a discount factor of 4.84% ¹, this provides an annual deficit allowance of £27.5m.
- 2.3 Based on Ofgem's view that 86% of this allowance relates to former DN employees (the remaining 14% relating to former NTS employees), this would imply that £23.3m would be the fixed annual allowance to be recovered from the DNOs. It is proposed that this amount would be recovered by the introduction of a new DN Pensions Deficit transportation charge to be levied on DNOs. (It is anticipated that National Grid NTS would roll the remaining 14% of costs into its TO ongoing cost base to be recovered via the NTS TO transportation charges.)
- 2.4 The fixed annual allowances for each DN (equating to £23.3m in total) are then expected to be set out in National Grid NTS' GT Licence, the details of which will be subject to the precise licence drafting. The same allowance figures in respect of each DN would also be set out in each of their respective GT Licences. It is envisaged that these annual allowances will be reviewed at the end of the 5 year price control period as part of a re-evaluation of the pensions deficit.
- 2.5 It is anticipated that the final agreed annual deficit allowance (of £27.5m, comprising the aggregate of all DN allowances, and the NTS deficit allowance) will be included in National Grid NTS' TO (Transportation Owner) Maximum Allowable Revenue (determined in accordance with Special Condition C8B of the NTS' GT Licence, and given the licence term "TOMR"). Further detail of this is given in *Appendix A*.
- 2.6 In respect of National Grid NTS' actual revenue (also determined in accordance with Special Condition C8B of its GT Licence and given the licence term "TOR"), it is proposed that the licence term "TORCOM_t" will be used to capture the actual payments made to the NTS by the DN Operators. Again, this is detailed in *Appendix A*

¹ based on Real Vanilla weighted average Cost of Capital

3 Proposed Methodology.

- 3.1 It is proposed that National Grid NTS' Statement of Transportation Transmission Charges will set out the monthly pension deficit charges for each DN, in accordance with the fixed annual allowances that will be illustrated in the amended National Grid NTS GT Licence. In the event that the timing of the TPCR outcome does not allow charges to become effective from 1 April 2007, for the first year the monthly charges would be determined from the annual allowances divided by the remaining number of months in the formula year. This approach will avoid any "carry over" of allowable revenue from one formula year to the next.

e.g Assume annual allowance for 'x' DNO is £2.4 m

1. Where charge implemented 1/4/07, monthly charge for 'x' DNO = **£0.2 m**
(2.4 divided by 12 months)
2. Where charge implemented 1/8/07, monthly charge for 'x' DNO = **£0.3 m**
(2.4 divided by 8 months)

4 Justification – Assessment against Licence Relevant Objectives

- 4.1 The National Grid plc GT Licence in respect of the NTS requires that proposed changes to the Charging Methodology shall achieve the relevant methodology objectives.
- (1) Reflect the costs incurred by the licensee in its transportation business;;
- The proposed new charge will be based on the pension deficit cost allowances that are expected to be agreed for the next Transmission Price Control, and therefore will fully reflect the additional costs incurred by the NTS in respect of the adjustment to the TO allowable revenue.
- (2) So far as is consistent with (1) properly take account of developments in the transportation business;
- The agreed approach that the DN Pensions Deficit costs will be met through National Grid NTS's price control has prompted the need for a new charge to be levied on DNOs, thus in National Grid 's view properly takes account of developments in the transportation business
- 4.2 National Grid NTS is obliged to keep the NTS Charging Methodology under review at all times for the purposes of ensuring that it achieves the relevant objectives.

5 Implementation of the Charge

- 5.1 It is anticipated that the proposed DN Pensions Deficit Charge will be levied on all DNOs on a monthly basis for the period April 2007 – March 2012. The proposed charge will be recovered via an offline invoice (either Ad-Hoc or TMBS² Invoice).
- 5.2 The level of the annual charge for each DNO will be in accordance with the DN allowances set out in National Grid's NTS GT Licence, divided into 12 monthly amounts, and hence would remain fixed for the term of the next price control. However, in the event that the timing of the TPCR outcome does not allow charges to become effective from 1 April 2007, for the first year the monthly charges would be determined from the annual allowances divided by the remaining number of months in the formula year. This approach will avoid any "carry over" of allowable revenue from one formula year to the next.

² Transportation Miscellaneous Billing System

6 Questions for Consultation

6.1 National Grid NTS invites views on whether the proposed changes to our Charging Methodology meet National Grid NTS's relevant GT Licence objectives, specifically that:

- a new DN Pensions Deficit Charge is to be levied on DNOs from April 2007 for the duration of the next Price Control;
- the Charge will be levied on a monthly basis, and set at a level to allow recovery of the annual fixed allowances during any formula year (thus avoiding any "carry over" of revenue amounts);
- the level of the annual charge for each DNO will be in accordance with the DN allowances set out in National Grid's NTS GT Licence, divided into 12 monthly amounts, and hence will remain fixed for the term of the next price control;
- in the event that the timing of the TPCR outcome does not allow charges to become effective from 1 April 2007, for the first year the monthly charges will be determined from the annual allowances divided by the remaining number of months in the formula year.

The closing date for submission of your responses is **22 December 2006**.

Your response should be e-mailed to dominic.j.harrison@uk.ngrid.com or alternatively by post to Dominic Harrison, Regulatory Frameworks, National Grid, National Grid House, Gallows Hill, Warwick, CV34 6DA. If you wish to discuss any matter relating to this charge methodology consultation then please call ☎ 01926 656316.

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Appendix A – Indicative Pension Allowances and Amendments to NTS TO Revenues

1. Indicative Pension Annual Allowances (£m, 2005-06 prices)

	GDN	NTS Charge for non-active deficit
NGG	East England	4.3
	London	2.5
	North West	3.0
	West Midlands	2.1
NGN	North England	2.8
SGN	Scotland	1.9
	South England	4.4
WWU	Wales & West	2.6
	Total	23.7

2. Adjustment of Maximum NTS transportation owner revenue ($TOMR_t$)

The principal formula that derives the TOMR in respect of formula year t is :

$$TOMR_t = TOZ_t + TOF_t - TOK_t$$

where , :

TOZ_t means the core transportation revenue

TOF_t means the NTS Prescribed Rates & the NTS licence fees

TOK_t means the NTS TO revenue adjustment for any NTS TO over or under recovery in respect of formula year t-1

National Grid's preferred approach would be to bundle the agreed annual deficit allowance within the term TOF_t as it is considered this would ensure transparency, and would seem appropriate for such a fixed allowance sum.

3. Adjustment of Transportation Owner Revenue (TOR_t)

The principal formula that derives the TOR in respect of formula year t is :

$$TOR_t = TOREVBEC_t + TOExR_t + TORCOM_t$$

where :

$TOREVBEC_t$ means the NTS TO revenue derived from the sale of NTS SO baseline entry capacity.

$TOExR_t$ means the NTS TO revenue derived from the sale of NTS Exit Capacity.

$TORCOM_t$ means the NTS TO revenue derived from transportation charges levied on gas shippers and DN operators, other than revenue earned through $TOREVBEC_t$ and $TOExR_t$.

It is proposed that payments made to the NTS by the DN Operators would be streamed to " $TORCOM_t$ ".