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23 September 2021

Dear Max,

Notice of Statutory Consultation on a proposal to modify Special Condition 5.5 of the Gas Transporter Licence held by National Grid Gas Plc (NGG) dated 25 August 2021 ("Notice").

This response to the above Notice is provided on behalf of National Grid Gas plc (NGG).

In February 2021, due to the impacts of the implementation of UNC Modification 678A (UNC678A) "Amendments to Gas Transmission Charging Regime (Postage Stamp)" on the Capacity Constraint Management (CCM) scheme, Ofgem published an open letter signalling an intent to review the CCM scheme for both RIIO-2 and regulatory year 2020/21, which we welcomed and supported. UNC678A removed the zero priced reserve price (replaced by the postage stamp) for certain capacity products that fed into the CCM incentive as revenue components in both RIIO-1 and RIIO-2. This meant that the CCM incentive revenue resulting from the sale of these products would potentially increase when compared to the CCM incentive revenue for those same products for the period pre-October 2020.

Since the implementation of UNC678A we have been monitoring and analysing the impacts on the CCM incentive scheme performance, supplying data and proactively engaging with Ofgem to ensure there are no undue benefits or consequences as a direct result of its implementation. This has helped to inform an amendment to the CCM incentive scheme for the final year of RIIO-1 (2020/21) and has helped to inform Ofgem's statutory consultation to modify special condition 5.5 of the Gas Transmission Licence for the RIIO-2 period.

The purpose of Special Condition 5.5 is to calculate the Constraint Management allowed revenue (CMT), which comprises incentive revenue from the CCM incentive scheme. Ofgem's proposed modification would amend the revenues that feed into the CCM incentive by changing the calculation of the Constraint Management operational performance measure (CMOpPMt) in Special Condition 5.5. Ofgem propose to do this by removing revenue associated with the sale of on-the-day obligated and interruptible/off-peak capacities from the CCM incentive, and by introducing a 14% scaling factor for the non-obligated capacity revenue components of the scheme. Ofgem also propose to remove Parts D and E of Special Condition 5.5, as they would no longer be applicable under the proposed removal of the interruptible/off-peak revenue streams.

We agree with Ofgem's conclusion that increased revenues have occurred since October 2020 as a direct result of the implementation of UNC678A and that it is likely increased revenue contributions to the CCM performance measure will also occur in the RIIO-2 period. We therefore agree that the RIIO-2 CCM scheme should be amended to take this into account.

Ofgem's proposed adjustment to the RIIO-2 CCM incentive scheme

As part of our engagement with Ofgem we proposed a set of principles that any CCM scheme adjustment should ideally adhere to, namely;

- that any adjustments should aim to neutralise the effect of the October 2020 charging changes on the incentive scheme;
- that any adjustments should not fundamentally change the purpose of the CCM scheme;
- and

- that any adjustments should be transparent and understandable.

We are therefore pleased that this set of principles is central to Ofgem's proposed CCM scheme adjustment.

In determining the CCM scheme adjustment, Ofgem has used historic data supplied by ourselves to project forward CCM revenues for the RIIO-2 period. Whilst we believe it's not possible to accurately predict future CCM revenues with a high degree of confidence, we do believe the methods Ofgem describe and detail within their RIIO-2 Incentive review letter are pragmatic, well considered and therefore are a sound basis to build projections from. On the basis of that forward projection, Ofgem are proposing to remove revenue from on-the-day sales of obligated capacity (RODEC and RODExC) from the scheme and remove revenue arising from interruptible entry capacity and off-peak exit capacity sales (and as a consequence, the removal of the interruptible/off-peak scale back revenue component that was introduced for the RIIO-2 period). We fully support Ofgem's proposed removal of these revenue components from the scheme and the rationale provided by Ofgem that underpins their removal.

Ofgem further propose that revenue from the sale of capacity associated with the release of non-obligated capacity (RNOEC and RNOExC) is retained but scaled by a 14% factor. Non-obligated capacity, by its nature, is released at our discretion and at our risk, we therefore agree with Ofgem that non-obligated revenue should be retained in the scheme to encourage balanced non-obligated capacity release decisions. We also agree with Ofgem that there is an increased likelihood that, if left unadjusted, the revenue resulting from non-obligated capacity sales could lead to excessive capacity auction revenues feeding into the CCM scheme calculation. We support Ofgem's proposed 14% scaling of non-obligated revenues as a reasonable and pragmatic adjustment, however given the uncertainties with regards to future market behaviour, we don't agree that it's possible to conclude that the proposed adjustment, in the absence of constraint costs, is likely to result in the upper quartile of possible incentive performance.

Proposed Licence Modifications

We have no substantive comments on the proposed modifications to Special Condition 5.5 of the NGG licence save to note that:

- the heading to Part C in Appendix 1 to the Notice is incorrect and should refer to "The Constraint Management operational performance measure (CMOpPM_i); and
- the paragraph being modified in Part C is 5.5.5 and not 5.5.4 as referred to in Appendix 1 to the Notice.

These changes should be reflected in the modification direction.

In conclusion we welcome and fully support the proposed changes to the RIIO-2 CCM scheme. We also agree with Ofgem's position that the clause within the licence to review the CCM incentive if the cap of the incentive is hit in two consecutive years, or the collar hit in one year (or where the Authority expects either to occur) should be retained.

I confirm that this response can be published on Ofgem's website.

Yours sincerely,

[By email]

Tony Nixon
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National Grid