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Date: 9 May 2022

Dear Chris,

**Decision on the Entry Capacity Release Methodology Statement ('ECR') (Special Condition 9.18 of National Grid Gas plc ('NGG') Gas Transporter Licence<sup>1</sup> (the 'licence'))**

Thank you for submitting the proposed modifications to the ECR to us<sup>2</sup> for approval on 3 May 2022.<sup>3</sup> The proposed revisions were submitted in your consultation report.<sup>4</sup>

We have decided to approve the proposed revisions to the ECR and we have outlined our reasons for doing so in this letter.

**Revision of the ECR in accordance with Special Condition 9.18.10 of the licence**

Special Condition 9.18.10 of your licence provides that you must, if so directed by the Authority, and in any event not less than once in every period of two regulatory years, review the ECR. As part of this review, you have proposed changes to reflect the introduction of weekly entry capacity auctions, and the ability to withhold capacity where,

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<sup>1</sup> The link to the National Grid Gas Plc ('NGG') Gas Transporter Licence is here: <https://epr.ofgem.gov.uk/Content/Documents/National%20Grid%20Gas%20Plc%20-%20Special%20Conditions%20Consolidated%20-%20Current%20Version.pdf>.

<sup>2</sup> The terms "the Authority", "Ofgem", "we", "us" and "our" are used interchangeably in this letter.

<sup>3</sup> This includes NGG's consultation report.

<sup>4</sup> The consultation with relevant stakeholders ran between 20th April and 26th April 2022, and eleven responses were received. The responses and the revisions proposed (pursuant to Special Condition 9.18.11(c)) are available at the following link: <https://www.nationalgrid.com/uk/gas-transmission/capacity/capacity-methodology-statements>.

in respect of any given gas flow day, circumstances arise in which NGG foresees a capacity constraint occurring at the Milford Haven Aggregated System Entry Point ('ASEP').

You identified the need to revise the ECR in the light of unprecedented and rapidly changing market conditions and wrote to us on 11 April 2022, requesting a derogation in respect of:

- i. Special Condition 9.18.11(b), which requires that before revising an ECR statement, the licensee (NGG) must consult for a period of not less than 28 days with the relevant parties referred to in paragraph 9.18.10(a), in this case Relevant Shippers<sup>5</sup> and any other interested parties; and
- ii. Special Condition 9.18.11(d), which requires that before revising an ECR statement, the licensee (NGG) must submit to Ofgem, alongside its report, a statement from an Independent Examiner:
  - a. confirming that the Independent Examiner has carried out an examination, the scope and objectives of which were approved by Ofgem; and
  - b. giving an opinion on whether the capacity release methodology statement as revised would be consistent with the licensee's duties under the Gas Act 1986 and with the licensee's obligations under the Licence.

We reviewed your derogation request letter submitted to us on 11 April 2022 and, in accordance with Special Condition 9.18.16, we decided to grant the requested derogation to NGG to consult for less than 28 days on its proposed revisions to the ECR – but no less than 7 days as specified in our direction annexed to the letter – and submit its report to us without an accompanying statement from an Independent Examiner. We made this decision on 19 April 2022.<sup>6</sup>

### **NGG Consultation on revisions to the ECR**

You submitted your consultation report to us on 3 May 2022. You received eleven responses to your consultation, some of which were marked as confidential. The non-confidential responses are available on NGG's website.<sup>7</sup> Eight respondents opposed the proposed revisions, two expressed support and one was critical of the process but did not express a view on the proposed changes to the ECR. You have published NGG's joint

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<sup>5</sup> 'Relevant Shipper' has the meaning given to the term in the Gas Transporter Licence: Standard Special Condition A3 (Definitions and Interpretation), link here:

<https://epr.ofgem.gov.uk//Content/Documents/Standard%20Special%20Condition%20-%20PART%20A%20Consolidated%20-%20Current%20Version.pdf>.

<sup>6</sup> The derogation decision letter and direction can be found on our website:

<https://www.ofgem.gov.uk/publications/decision-and-direction-further-national-grid-gas-plcs-request-derogation-under-special-condition-918-its-gas-transporter-licence>.

<sup>7</sup> <https://www.nationalgrid.com/gas-transmission/capacity/capacity-methodology-statements>.

response document addressing the comments received via the responses to your consultation. This is also available on NGG's website.

NGG proposed introducing the following changes to the ECR:

- insertion of paragraphs describing the new weekly capacity auction and the quantity of capacity available under the auction. This reflects the changes introduced via Uniform Network Code (UNC) modification 0752S - Introduction of Weekly Entry Capacity Auction.<sup>8</sup>
- paragraph 74 referring to NGG'S right to withhold capacity in a scenario where it foresees a constraint would be amended to include the ability to withhold capacity from the Weekly System Entry Capacity ('WSEC') auction and the Rolling Monthly Trade and Transfer System Entry Capacity ('RMTnTSEC') auction.

### **Introduction of WSEC auctions**

The text included in the ECR reflects the changes made via the introduction of UNC 0752S and this aligns the ECR and UNC. These changes are descriptive and we agree that the ECR should be updated to reflect the introduction of weekly auctions.

### **Changes to WSEC and RMTnTSEC to allow capacity to be withheld**

Currently NGG may withhold sale of daily capacity (which includes day ahead release) in a scenario where it foresees a constraint could arise. NGG outlined in its consultation letter the need for a temporary provision to allow NGG to extend the ability to restrict the release of capacity to the weekly WSEC and rolling monthly RMTnTSEC auctions, in a situation where a specific longer-term constraint is forecast should the full baseline be made available. This change is specific to the Milford Haven entry point for the period between 30 May and 31 October 2022. If the specific system conditions allow, NGG would make available any withheld capacity (in full or in part) in the weekly or daily auctions (day ahead and within day) to maximise the availability of capacity within its system capability for its customers.

### **Background to the reasons for the proposed changes to the ECR**

NGG has identified the current geopolitical situation developing in Europe as more than likely to have a significant impact on the energy sector across the continent, including the UK. In NGG's view, the unprecedented high gas prices and the desire of European countries to reduce dependency on Russian gas are leading to changes in strategies in relation to future sources of energy; the UK has a part to play in supporting Europe in its transitional

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<sup>8</sup> <https://www.gasgovernance.co.uk/0752>.

arrangements to the extent that this is possible. This might mean that larger than anticipated quantities of Liquefied Natural Gas ("LNG") could be delivered to the UK shores this summer, with an intention of being transported to Europe via the interconnectors to Belgium and the Netherlands. Additionally, EU storage levels are close to historic lows and therefore the summer refill period has the potential to further increase demand on the interconnectors to help refill EU storage.

NGG believes the introduction of weekly entry capacity auctions in May 2022 may create a new market dynamic and this may increase the risks arising from releasing weekly capacity, in light of these geopolitical changes and that this will also be true for monthly auctions. NGG believes it needs to mitigate the potential consequences that the release of monthly and weekly firm capacity may cause in the current circumstances.

We agree that the current market situation presents particular challenges to the release of capacity, especially at Milford Haven, and NGG has highlighted its concerns about the ability of the National Transmission System (NTS) to accommodate flows at close to historic highs or higher levels for prolonged periods during the summer period at the Milford Haven entry point.

The introduction of weekly auctions to the UNC was progressed against a market background which did not reflect the situation that has developed in the past few weeks and we believe that NGG has to consider whether this presents it with additional risks and if appropriate, mitigate those risks.

We believe that there is a need to consider any mitigations rapidly and we understand that NGG is extending existing measures around capacity release to mitigate risk, enabling it to maximise the amount of capacity it can release to accommodate the demand for higher LNG deliveries at Milford Haven that it has identified as being likely over the summer in 2022.

Given the limited nature of the amendments being considered and required urgency to manage the evolving issues, we think that the requirement for an Independent Examiner to carry out an examination and give an opinion on the revisions to the ECR statement will not provide more assurance about the changes proposed, and we agreed this requirement may be omitted.

## **Responses to NGG's consultation**

Several respondents expressed a concern that NGG was potentially proposing to withhold an unknown quantity of capacity. In its Joint Response document<sup>9</sup> NGG has confirmed that, based on its capability assessment, the quantity of entry capacity at Milford Haven which it is committing to make available is clearly defined and it is in excess of any summer capacity flows seen historically.<sup>10</sup> The current sold long term capacity level is around 32mcm/d for the June to September period and around 77mcm/d for October indicating that for most months there is still a significant quantity of unsold capacity available.

The feedback NGG received regarding the capability assessment indicated that the results would potentially be more accurate if it had considered five years of the demand data (as opposed to three). This is because two out of three years of data could have been skewed by the Covid pandemic period. NGG has re-calculated the analysis based on a 5-year period and rather than taking the median of the whole dataset, NGG has proposed that for each month, it will release capacity equivalent to the maximum median capability observed in the 5-year period, except for October where the capacity released and sold is already at/above this median value. The results are shown in the table below.

**Figure 1: Historic Maximum Median Capability Year at Milford Haven and NGG proposed minimum release level**

Month	May	June	July	August	September	October
NGG proposed minimum release level (mcm/d)	68	63	63	62	66	77 (sold)
Year observed	2017	2021	2018	2017	2017	2022

We note that these are the minimum levels of capacity that we expect NGG to release and NGG has committed to actively forecasting capability so as to maximise capacity release on a weekly basis. You have confirmed that you are committed to optimising the capability at Milford Haven and releasing the maximum amount of capacity without presenting a significant constraint risk. You recognise the importance of transparency and have proposed a process to ensure you are accurately reporting anticipated levels of capacity release to the industry and providing confidence that appropriate levels of capacity are released at all times. This includes the following actions:

<sup>9</sup> NGG's Joint Response can be found at the link here: <https://www.nationalgrid.com/gas-transmission/capacity/capacity-methodology-statements>.

<sup>10</sup> The highest flow in the last 3 years between June to October was seen in June 2020 – 38mcm/d.

- Prior to monthly auctions: Release capacity up to the capability levels defined within the Joint Response document and Figure 1 above.
- Prior to weekly auctions: Complete bespoke demand forecasts of offtake points that impact on the capability of Milford Haven. Update the capability assessment and release to the industry via NGG's website, if there is a change in the capability/amount of capacity being made available, indicating the amount of capacity to be released in the weekly auctions and the capability, the capability is likely to be available circa 3 or 4 days in advance of the weekly auction date, the capacity being made available can only be published once the RMTnTSEC auction has been allocated which could be 17:00 the day before the first weekly auction following the RMTnTSEC allocation, for all other weeks in the month the information can be published circa 1-3 working days in advance of the weekly auctions. Where a weekly auction crosses a month boundary, capacity to be released equivalent will be to the highest capacity release for the week in the respective monthly auctions.
- Day Ahead: Create a dashboard for use in the control centre that will aggregate all D-1 flow notifications and provide a forecast capability of the entry point. Capacity to be released up to the level defined within the capability assessment.

We will monitor the levels of capacity release over the summer and expect NGG to be transparent about this, providing adequate information to industry.

NGG received feedback on its proposals, which included: support from two parties, one neutral, and eight that raised concerns. NGG has responded to these in its Joint Response document. We note the views to the consultation responses which NGG has provided. The range of concerns falls into several broad areas and these are:

- Concerns about the impact on Security of Supply
- Concerns about the impact on wholesale gas prices
- Concerns the proposed changes could result in higher costs for consumers
- Concerns about the way GB will be viewed as a destination for LNG
- Concerns that this could set a precedent in terms of how constraints are managed in future
- Concerns that targeting actions around one entry point may be discriminatory
- Concerns that this creates uncertainty and is an inefficient process for LNG suppliers into Milford Haven
- Concerns about the short process and notice of change and the analysis supporting the proposed changes

We comment further on each of these areas below.

### **Concerns about the impact on Security of Supply**

Respondents to NGG's consultation thought that the changes could result in insufficient entry capacity being available, which would discourage/reduce deliveries at South Hook over both the short and the long term. It was contended that the risk of reduced LNG deliveries is greater than the constraint risk and could undermine confidence in the regulatory regime amongst LNG shippers.

#### **Our views**

NGG has made the capability of the network over the summer months known via its published maintenance plan. The changes to the ECR, which are time limited, do not change the capability of the NTS in any way. The levels of capacity to be released are in line with or above the previously published capability levels. As such the ability of NGG to accommodate flows up to the network capability level will not be affected by the proposed changes to the ECR. We therefore believe that certainty about the levels of capacity release is a positive measure in terms of security of supply. It makes constraints less likely than might otherwise be the case, and helps ensure that available network capability may be fully utilised in accordance with prevailing market conditions and should not discourage LNG deliveries.

### **Concerns about the impact on wholesale gas prices**

There was a view among those opposed to the proposal that the change would increase wholesale gas prices. The reasons given for this include that the methodology change will create uncertainty for shippers around securing capacity, leading LNG cargoes to go elsewhere and impacting price signals. One respondent stated that shippers buying back their hedges at the NBP as a result will increase wholesale costs. A number of respondents noted that NGG has not modelled or accounted for the cost of this, and some believe that this could have a greater impact than the constraint management costs being protected against.

#### **Our views**

These proposals do not affect the physical ability of the NTS to accept LNG cargoes and there is no clear evidence to indicate that fewer cargoes can be accommodated than would otherwise be the case. We believe that this action will continue to support the aim of attracting LNG deliveries to the UK and reduce the uncertainty that might otherwise arise. Wholesale gas prices are subject to global market pressures, and we would not expect a

decision about local network capability at Milford Haven to have a significant impact on the wholesale price of gas.

### **Concerns the proposed changes could result in higher costs for consumers**

Some respondents considered that withholding capacity at Milford Haven could cause increased costs for consumers. In their view it could cause uncertainty that would negatively impact the LNG supply to the UK, and that this could have greater impact on costs to consumers than constraint management costs. One respondent said that in moving away from a market-based mechanism to an interventionist approach avoids addressing structural improvements which are required and would result in costs to the end consumer. Shippers' inability to deliver volumes due to short-term capacity reduction could have large financial impacts, risk and operational uncertainty or constraints could lead to diversions. A reduction in supply could result in upward pressure on wholesale prices.

However, a minority of responses supported the change in the ECR methodology on the basis that it will avoid constraint management costs that would be passed onto consumers.

#### **Our views**

The proposed changes to the ECR are targeted, specific and time-limited. They are not a permanent change to the regulatory regime and are not intended to be. The issues we are dealing with are urgent and need action now to protect the interests of consumers in the event that sustained higher levels of LNG delivery over a prolonged period are experienced over the summer. We believe that approving the temporary changes to the ECR will ultimately protect consumers from the avoidable costs that they could otherwise face as a result of the increased likelihood of constraints.

### **Concerns that this could set a precedent in terms of how constraints are managed in future**

Respondents expressed concerns that this could set a precedent in terms of how constraints are managed in future. Some also suggested that NGG should invest to increase capability in the network.

#### **Our views**

The current geopolitical situation that we find ourselves in is very challenging. We are taking these decisions to deal with very specific risks which may arise in the short-term. This decision is seen as a one-off and is necessary to ensure that we protect consumers' interests in the face of unprecedented externally driven market conditions. Not doing so would risk exposing consumers to the potential of very high costs. The proposed solution is targeted, specific and time limited.



Any decisions about increasing network capability would need to be assessed against the future needs of the network and the justification for the investment needed in doing so. These are longer term views which would not help address the current and immediate concerns that have been identified as likely to be present during Summer 2022.

### **Concerns about the way GB will be viewed as a destination for LNG**

Concerns were raised that withholding capacity creates uncertainty and may result in LNG cargoes being diverted elsewhere and make GB less attractive as a destination for LNG. There was also a question as to whether this change was consistent with the government's British Energy Security Strategy ('BESS').<sup>11</sup>

### **Our views**

We recognise that this is a change from previous years and we have outlined the reasons why we are making them. The ability to withhold capacity at an entry point in circumstances where NGG believes that a constraint may arise is not a new provision. We believe that this change removes uncertainty about capacity release at Milford Haven over the summer months but it does not change the capability of the network, and still allows shippers to access capacity up to the capability level. We believe that this action will continue to support the aim of attracting LNG deliveries to the UK and reduce the uncertainty that might otherwise arise.

Levels of sold capacity across summer months remain around 32mcm/d (compared to a baseline level of 87mcm/d capacity). The levels of available unsold capacity, even at the proposed release levels indicated by the revisions to the ECR, remain high. We expect the available unsold capacity to be utilised to support higher than usual levels of LNG imports and exports to Europe.

We are aiming to maximise gas exports from the UK to Europe over summer, consistent with government aims. The risk of NTS entry constraints occurring at Milford Haven increases if high LNG import and interconnector export volumes persist over a prolonged period and this makes it necessary for Ofgem to take action to protect consumers. We consider that the capacity available to shippers under this proposal will enable the anticipated increase in LNG cargoes landing at Milford Haven over the summer months, and to facilitate gas exports to Europe.

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<sup>11</sup> This was published on 7 April 2022 and can be found here:  
<https://www.gov.uk/government/publications/british-energy-security-strategy>.

### **Concerns that targeting actions around one entry point may be discriminatory**

There were several respondents who said that the fact that the changes to capacity release are only happening at Milford Haven and not at other entry points is or could be discriminatory. One point that was made was that network capability constraints have happened at other ASEPs, so Milford Haven should not be the sole target of the proposed actions. Other respondents said that it could conflict with NGG's requirement under the licence to make decisions which are "economic and efficient and facilitate competition". Additionally, it was highlighted that the Isle of Grain is the only LNG terminal not affected and it is owned by NGG.

#### **Our views**

The measures are associated with a single entry point because of the particular local circumstances that have resulted in a risk being identified. The nature of constraints is that they are largely location specific and in this instance the risk that was identified is linked to the capability of the NTS at Milford Haven. We do not believe that targeted measures aimed at dealing with a potential locational issue are discriminatory. They are designed to deal with a particular issue and are proportionate in helping ensure that we protect the interests of consumers.

### **Concerns that this creates uncertainty and this may create an inefficient process for LNG suppliers into Milford Haven**

There were concerns expressed that withholding capacity because of the likelihood of constraints would create uncertainty and that this would lead to inefficiency in the way that LNG shippers could access capacity.

#### **Our views**

We recognise that this is a change from previous years, and we have outlined the reasons why we are approving them. We believe that this change removes uncertainty about capacity release at Milford Haven over the summer months but still allows shippers to access capacity up to the capability level. The question about efficiency is very subjective but we do not believe that these changes will alter the efficiency of the capacity auction processes.

### **Concerns about the short process and notice of change and the analysis supporting the proposed changes**

A majority of the respondents also raised concerns that the process that has been followed has been inadequate. A number felt that our decision to grant NGG a derogation<sup>12</sup> from their requirement to consult on revisions to the Entry Capacity Release methodology for less than 28 days and to submit its report without an accompanying statement from an Independent Examiner should not have been granted. Views we received on this included that as a result the consultation was too short for the significance of the change being made and the current state of the market. Also that the causal factors have been known about for around two months and therefore the short notice given to stakeholders was not justified.

Other respondents felt that some stakeholders may not have received adequate notice of the decision because the derogation was published over a holiday weekend, and some may not be aware of the proposal. Some parties questioned the analysis undertaken by NGG.

#### Our views

NGG has carried out analysis and assessed the capability of the NTS at Milford Haven (based on its network analysis). From its analysis and forward projections of market demand, NGG has calculated the likely impact of constraints which could arise and provided its view of these values. It has consulted with industry but because of the urgency of the situation this consultation was done over a shorter time frame. We are responding to new market pressures that were unforeseen and were not known until late February. They are fast-changing and we need to respond appropriately but also in a timely manner. We explained our reasons for agreeing to this shorter process in our derogation decision letter and direction.

#### **Approval of revisions to the ECR in accordance with Special Condition 9.18.12(a)**

As a result of the feedback it received, NGG has updated its capability analysis to indicate the level of minimum capacity release resulting in higher values than those in its ECR consultation. In its conclusions report, NGG indicated that it had considered all the responses received and, other than the update to the minimum release levels mentioned above, it did not propose any change to the ECR text outlined in its original proposal. We believe that the changes to the ECR proposed by NGG are necessary to address the real risk of constraint management costs which may arise as a result of the higher forecast flows through the Milford Haven entry point for sustained periods over the summer. We are

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<sup>12</sup> Special Condition 9.18.16 of NGG's Gas Transporter Licence:  
<https://epr.ofgem.gov.uk//Content/Documents/National%20Grid%20Gas%20Plc%20-%20Special%20Conditions%20Consolidated%20-%20Current%20Version.pdf>.

acting to protect the interests of consumers and mitigate against some of the uncertainty that might have arisen if constraints did occur.

We will monitor the levels of capacity release over the summer and expect NGG to be transparent about this, providing adequate and timely information to industry. We will reflect on any lessons from the summer and assess how the proposed arrangements have worked. Depending on the current market conditions and geopolitical situation, this may include considering the need for an enduring solution.

## **Our Decision**

Following consideration of the documentation you have provided pursuant to Special Condition 9.18 of the licence, we have decided to approve the proposed revisions to the ECR in accordance with Special Condition 9.18.12.

This letter has been made available on our website. You can contact Bogdan Kowalewicz at [Gas.TransmissionResponse@ofgem.gov.uk](mailto:Gas.TransmissionResponse@ofgem.gov.uk) if you have any further questions about this decision.

Yours sincerely,

**Dr. Adrian Richardson**  
**Head of Energy Security of Supply**