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Station Approach
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Andrew Ryan
Head of Regulatory Finance Policy
Ofgem

By email to andrew.ryan@ofgem.gov.uk

18 May 2022

Dear Andrew,

Open letter about recovery of Last Resort Supply Payment claims from customers connected to GDN and IGT networks

SGN welcomes the opportunity to respond to the above consultation¹. We have responded to the proposed interim and enduring solutions provided relevant to SGN as a Gas Transporter.

Should you require any further information with regards to our response then please do not hesitate to contact me at David.Handley@SGN.co.uk

Yours sincerely,

David Handley
Head of Regulation
SGN

¹ https://www.ofgem.gov.uk/publications/recovery-gas-transporters-last-resort-supply-payments?utm_medium=email&utm_source=dotMailer&utm_campaign=Daily-Alert_20-04-2022&utm_content=Recovery+by+gas+transporters+of+Last+Resort+Supply+Payments&dm_i=1QCB,7TV5S,SAH8VA,VYAIM,1



Original text: “Interim option 1 – intra-year revision to network charges

Our currently preferred interim option, subject to consultation responses and further thinking, is an intra-year revision to tariffs by GDNs. The LRSPs would continue to be paid directly by GDNs, as we do not consider it proportionate to revise existing approved SoLR claims such that they are paid by both GDNs and IGTs. To avoid GDNs over-recovering, GDNs would revise their 2022/23 tariffs by end of July, effective from 1 October 2022. As set out in Ofgem’s recent consent, IGTs would pay the GDNs for the LRSP costs relating to the customers connected via an IGT network, £35 per year per domestic customer.

GDNs would be required to seek Ofgem’s permission to revise tariffs within-year, effective from 1 October 2022. Our current thinking is that we would be strongly minded to approve such a request. We do not believe this option would require a change in the GDNs’ or the IGTs’ licenses, but should we proceed with this option we would propose to revise and consult on the Regulatory Instructions and Guidance (RIGs) to make it clear that the money received by GDNs from IGTs should be treated as revenue for regulatory reporting purposes.

We do not believe that option 1 has any tax or accountancy implications. It is not Ofgem’s intent to expose networks to any additional tax or to have financial reporting issues as a result of this approach and we welcome feedback and discussion on the tax implications of this, our currently preferred, option.”

SGN recognise that as an interim solution that of the three, Option 1 is the most practicable and least disruptive. To keep this disruption to a minimum, it is very important that GDNs are permitted by Ofgem to revise their tariffs within-year with the new tariffs to come into force on the 1st October 2022. This will minimise any unnecessary over recovery by networks, and reduce the timing implications of splitting the process over two tax periods (with different tax rates).

However, whilst Ofgem do not consider it is “proportionate to revise existing approved SoLR claims” it should be noted that there is currently no contractual or licence mechanism in place between GDNs and IGTs to allow the undefined cash transfers that this option creates. Therefore, by not revising existing claims, the accounting for such transfers and legal nature of the payments would need to be determined or a direction provided.

Our view is that to get to the required level of comfort, a contractual arrangement and/or licence change would need to be in place for us to support this option. Both would need to preserve the existing accounting treatment for the SoLR levy payments as any changes will be subject to scrutiny/challenge from auditors. We are happy to work with other networks, Ofgem and the IGTs to put in place an appropriate contractual arrangement.

It should be noted that even with an agreed contract between the IGTs and GDNs for the recovery of SOLR from the IGTs we are not confident that there is a clear route for any adjustments through ‘k’ for any under of over recovery of SOLR claims from the IGTs. As such it may be that a change to the licence may be required to enable this.

It remains our view that the requirements needed to make all parties comfortable with this option seems unnecessary when IGTs already have a mechanism in place (Licence SpC A48), which enables them to recover costs from Shippers and make the subsequent payments directly to SoLR Suppliers (see Interim option 2). Secondly, this approach could increase GDN’s expose to bad debt. As it stands IGTs will only pass on to GDNs the amounts which they have recovered after reasonable endeavours. In practice this could introduce a significant time lag between when an under payment is recognised and when GDNs are able to recover that in their following round of billing.



In conclusion, whilst SGN recognise that this may be necessary on an interim basis we are not supportive of this approach as an enduring solution.

Original text: *Interim option 2 - Both GDNs and IGTs to pay money to the SoLR*

Under this option GDNs would pay the SoLR for the share of LRSP claims relating to customers connected directly to the GDN networks. IGTs would pay the SoLR for the share of LRSP claims relating to customers connected via an IGT network.

Reasons for considering and consulting on option 2

This option would remove any concerns GDNs may have relating to the accounting and tax concerns relating to the receipt of money from IGTs.

The GDNs' proposal is for LRSP claims to be revised, and around 10% of the claim to be allocated to IGTs and paid directly by them. Both GDNs and IGTs would pay the LRSP claims to the SoLRs, and there would be no payment between GDNs and IGTs.

As with Option 1, GDNs would be required to seek Ofgem's permission to revise tariffs within-year, effective from 1 October 2022. Our current thinking is that we would be strongly minded to approve such a request. GDNs would revise their 2022/23 tariffs by end of July.

Advantages and disadvantages of option 2

Our current understanding is that option 2 would have the advantage that it would avoid any possible tax concerns expressed by GDNs.

On the other hand, option 2 would involve licence modifications to Standard Licence Condition 48 for IGTs and possible A48 for GDNs, subject to the appropriate consultations. It would also involve revisions to already approved LRSP claims and a detailed set of re-profiled LRSP payments to ensure the correct flows of money. All of these changes would require extensive consultation with networks and suppliers.

SGN are in principle supportive of Interim option 2 as our preferred solution, however we recognise that the practicalities of putting it in place now would be challenging. Unlike Interim option 1, this approach does not require the creation of contractual arrangements between GDNs and IGTs or new licence mechanisms to allow for cash transfers expanding on a process that is already in place.

Additionally, the approach ensures the recovery of costs are targeted to the relevant parties [c.90% GDNs, c.10% IGTs). We are also supportive of the mid-year price change in 2022/23 for the reasons messaged in both in our response and also Ofgem's original open letter.

Whilst this option would require the activation of IGTs Licence SpC A48, we see this as a more straightforward approach than creating contractual/licence agreements between IGT/GDNs that Interim option 1 requires. Were this option to be approved, any licence changes required for the IGT A48 SpC would need to preserve the existing accounting treatment for the SoLR levy payments.

For this reason we would support option 2 as the basis for the enduring solution.

Original text: *Interim option 3 – GDNs to lower 2023/24 tariffs, instead of adjusting 2022/23 tariffs*

This option is similar to Option 1, but involves GDNs lowering 2023/24 tariffs instead of adjusting 2022/23 tariffs within-year. GDNs would continue to pay the LRSP claims to SoLRs, but IGTs would pay the GDNs for their share of LRSP costs. GDNs would over-recover for 2022/23 and their 2023/24 tariffs would reflect any money received from IGTs during 2022/23.

Whilst the GDNs would not be required to ask for consent to revise 2022/23 tariffs, the GDNs may ask for the penal rate of interest to be waived for any over-recovery associated with IGT payments.

Advantages and disadvantages of option 3

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An advantage of option 3 would be that GDNs would not need to revise their tariffs for 2022/23.

There are two disadvantages of option 3. Firstly, GDN customers would not benefit from the lower charges in 2022/23, having to wait until 2023/24. Secondly, there would be an inconsistency in charges between customers connected via an IGT network and those connected directly to a GDN network. Ofgem gave consent to IGTs to charge £35 pa per domestic customer for 2022/23 under the assumption that GDNs would revise their 2022/23 tariffs mid-year. If the GDNs delayed revising their tariffs until April 2023, existing GDN SoLR charges would remain unchanged at around £38 pa, whilst the charge levied by IGTs would be 10% lower at £35.

SGN do not support Interim option 3. This approach would result in an over-recovery of revenue in 2022/23, a year in which the industry and end users are already under considerable economic pressures. In addition to creating accountancy issues related to tax changes which would need to be reconciled beyond the revenue recovery period.

Original text: Enduring solution from 2023/24

Our preferred enduring solution for network charges from 2023/24 onwards is for a new Uniform Network Code (UNC) modification to be proposed which would allow an GDN to recover an LRSP charge from all customers, including those connected via an IGT, rather than just its own customers. As per the current arrangements, Ofgem would be responsible for apportioning the LRSP costs between domestic and non-domestic customers. The LRSP claims would continue to be paid only by GDNs, rather than expanding the scheme to oblige IGTs to pay a SoLR directly.

Whilst our current preference is for LRSP claims to be paid directly only by GDNs, we welcome views on the advantages and dis-advantages on reforming the LRSP process for future claims such that it involves payments by IGTs in addition to GDNs, or involves payments exclusively by National Grid Gas.

We are not supportive of this approach, SGN's preferred approach for the enduring solution would be consistent with our views provided in response to Interim option 2 above. Whilst we accept that for the practical reasons Option 1 is an appropriate short-term solution, we do not think that it should be bedded in as a longer term solution. We think that it is important for GDNs and IGTs to be treated on a comparable and consistent basis. There is currently an appropriate mechanism in the IGTs' own licence conditions that would enable and support this payment flow in a consistent manner to the GDNs payment flows. As such, there seems to be no basis on which to introduce a new process and to introduce a difference between IGTs and GDNs that may be problematic to resolve later.

Option 2 would create a more transparent enduring arrangement that will provide a true reflection of where costs are incurred. Once established this process will not require any more administration from Ofgem aside from the inclusion of IGTs data when finalising the % split for the SoLR claims.