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Date: 2 December 2022

Dear colleagues,

Statutory consultation on proposed licence changes to amend Part A of Special Condition 2.1, Part A of Special Condition 2.3, and Part B of Special Condition 8.2 of the Gas Transporter licence and the GT2 Price Control Financial Handbook

Please find enclosed a proposal to make amendments in the following areas:

- Part A of Special Condition 2.1 (Transportation owner revenue restriction) of National Grid Gas plc's Gas Transporter licence ("the licence")
- Part A of Special Condition 2.3 (System operator revenue restriction) of the licence
- Part B of Special Condition 8.2 (Annual Iteration Process for the GT2 Price Control Financial Model) of the licence
- The GT2 Price Control Financial Handbook

Part A of Special Conditions 2.1 and 2.3 of the licence details the licensee's obligations when setting NTS Transportation Owner (TO) and System Operator (SO) Charges, respectively. Currently, the licensee is required under paragraph 2.1.3 to ensure, to the best of its abilities, that TO Recovered Revenue does not exceed TO Allowed Revenue. Paragraph 2.3.3 makes the same requirement in relation to SO Recovered Revenue and SO Allowed Revenue.

National Grid Gas plc is required by legislation¹ to set transportation charges on a Gas Year basis (1 October to 30 September), while allowed revenues are set for Regulatory Years (1 April to 31 March). These arrangements are unique to gas transmission, as in all other networks the charging year and Regulatory Year coincide. The result of this disconnect is that two Regulatory Years fall within each Gas Year, which can lead to year-on-year volatility in prices. This can be mitigated by the licensee taking the allowed revenue for both Regulatory Years into account when setting charges.² However, this may result in the licensee deliberately over-recovering allowed revenue for a given Regulatory Year, which is currently prohibited by the licence.³ The changes proposed would relax the requirements

¹ Commission Regulation (EU) 2017/460 of 16 March 2017 establishing a network code on harmonised transmission tariff structures for gas ('TAR NC'), now incorporated in UK law by the European Union (Withdrawal) Act 2018 and the European Union (Withdrawal Agreement) Act 2020, as amended by Schedule 5 of the Gas (Security of Supply and Network Codes) (Amendment) (EU Exit) Regulations SI 2019/531.

² This approach is now permitted for the setting of TO charges, following the implementation of UNC796: Revision to the Determination of National Grid NTS Target Revenue for Transportation Charging.

³ Special Conditions 2.1 and 2.3 require the licensee to use its best endeavours to ensure that TO and SO Recovered Revenue do not exceed Allowed Revenue.

under Special Conditions 2.1 and 2.3, allowing the licensee to over-recover as a result of the charge setting process and only with the explicit consent of the Authority. This will mean that any action taken by the licensee to set charges so as to mitigate year-on-year fluctuation in accordance with its charging methodologies will not result in a breach of the licence.

Part B of Special Condition 8.2 sets out the process of publishing the values of the terms $ADJR_t$, AR_t , $SOADJR_t$ and $SOAR_t$ ("Allowed Revenue values"). At present, these values are initially published no later than 30 November prior to each Regulatory Year, with an opportunity to republish by the end of January prior to the Regulatory Year if the values have changed materially during this time. These values are then used by the licensee to inform the setting of Network Charges for the Gas Year beginning in the following October. This means that there is a large time gap between the publishing of relevant terms and the setting of prices during which allowed revenue forecasts can change significantly, particularly in the event of unexpected developments. The result of this can be significant over- or under-recovery of revenues by the licensee, which then needs to be corrected in subsequent years.

The proposal under consideration would move the deadline for republication of the Allowed Revenue from the end of January prior to the Regulatory Year to the end of May during the Regulatory Year. This additional time will allow for the values to more accurately reflect market conditions and take into account unexpected fluctuations, which will in turn mitigate the risk of significant over- or under-recovery of revenues. As a result, the proposed changes would be expected to provide greater price stability for the market.⁴

The Authority is also proposing to make changes to the GT2 Price Control Financial Handbook (PCFH). In the GT2 PCFH, we are proposing to update the deadlines for notification and republication of the PCFM. This would bring the PCFH into line with the proposed changes to the Licence. We are also proposing the removal of paragraph 2.66 of the, GT2 PCFH. This paragraph is inconsistent with the licence requirement for charges to be set based on published Allowed Revenue figures. The proposed change would ensure that the documentation clearly instructs licensees to use Ofgem-published allowed revenue values to set is tariffs.

Please send any views on the issues raised in this letter and the accompanying statutory consultation by 9 January 2023 to: Gas.TransmissionResponse@ofgem.gov.uk.

If you have any questions regarding either this letter or the statutory consultation, please contacts us using the email address provided above.

Yours sincerely,

Charlotte Friel

Deputy Director – Market Operations and Signals

For and on behalf of the Gas and Electricity Markets Authority

⁴ Any backstop should strike an appropriate balance between two competing objectives: (1) on the one hand, ensuring that allowed revenues are based on up-to-date information; versus (2) providing certainty to the market that target revenues will not change materially at short notice.