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Date: 10 February 2023

Dear colleagues,

**Decision regarding licence changes to amend Part A of Special Condition 2.1, Part A of Special Condition 2.3, Part B of Special Condition 8.2 of the Gas Transporter licence and the GT2 Price Control Financial Handbook**

On 2 December 2022, we<sup>1</sup> published a consultation document<sup>2</sup> in which we proposed various changes to the Gas Transporter Licence held by National Grid Gas Plc (the "licence"). We proposed making changes to the following areas:

- Part A of Special Condition 2.1 (Transportation owner revenue restriction) of 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 use its best endeavours to ensure 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 legislation<sup>3</sup> 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. However, this may result in the licensee deliberately over-recovering allowed revenue for a given Regulatory Year, which could create a breach of the licence. The changes will relax the requirements under Special Conditions 2.1 and 2.3, allowing the licensee to over-recover, but only as a result of the charge setting process and only with the explicit consent of the Authority. This would mean that any action taken by the licensee to set charges so as to mitigate year-on-year

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<sup>1</sup> The terms we, Ofgem, the Authority are used interchangeably.

<sup>2</sup> <https://www.ofgem.gov.uk/publications/consultation-modifications-transporter-licence-held-national-grid-gas>

<sup>3</sup> 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.

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 required to be published no later than 30 November prior to each Regulatory Year, with an opportunity to republish by the February prior to the Regulatory Year if the values have changed materially. 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 we consulted on would move the deadline for republication of the Allowed Revenue from the February prior to the Regulatory Year to the end of May during the Regulatory Year. This additional time will allow for allowed revenues to more accurately reflect observed outcomes and later forecasts, which would in turn mitigate the risk of significant over- or under-recovery of revenues. As a result, these changes would be expected to provide greater price stability for the market.<sup>4</sup>

The Authority also proposed changes to the GT2 Price Control Financial Handbook (PCFH). We proposed updating the deadlines for notification and republication of the PCFM. This would bring the PCFH into line with the proposed changes to the Licence. We also proposed removing 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 the licensee to use Ofgem-published allowed revenue values to set tariffs.

Finally, we proposed moving a sentence requiring the licensee to use published or republished values for the terms  $ADJR_t$ ,  $AR_t$ ,  $SOADJR_t$ , and  $SOAR_t$  to set network charges, from Part B of Special Condition 8.2 of the Licence to Parts A of Special Conditions 2.1 and 2.3. This requirement relates specifically to charge setting and it is therefore more appropriate that this be moved under Chapter 2 (Revenue restriction). Subsequent paragraphs will also be renumbered to accommodate the proposed additions along with any references to renumbered paragraphs within the text.

We received one non-confidential response to the consultation, which was supportive of the proposed changes.<sup>5</sup> No other responses were received.

Having carefully considered the response to the consultation, we have decided to proceed with the modifications to the Licence and the PCFH set out in the consultation document. A Notice detailing the changes will be published alongside this letter. The decision will take effect from 10 April 2023.

If you have any questions regarding either this letter or the accompanying Notice, please contact us at: [Gas.TransmissionResponse@ofgem.gov.uk](mailto:Gas.TransmissionResponse@ofgem.gov.uk).

Yours sincerely,

Alsarif Satti

**Senior Policy Manager – Gas Charging and Access**

For and on behalf of the Gas and Electricity Markets Authority

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<sup>4</sup> 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.

<sup>5</sup> This is published alongside the original consultation: <https://www.ofgem.gov.uk/publications/consultation-modifications-transporter-licence-held-national-grid-gas>