To: National Grid Gas Plc

Gas Act 1986
Section 23(1)(a)

Modification of the Special Conditions of the Gas Transporter Licence held by National Grid Gas Plc and the GT2 Price Control Financial Handbook

1. The licensee to whom this document is addressed is the holder of a Gas Transporter Licence ('the Licence') granted or treated as granted under section 7 of the Gas Act 1986 ('the Act').

2. Under section 23(2) of the Act, the Gas and Electricity Markets Authority (the 'Authority')[1] gave notice[2] on 2 December 2022 (the 'Notice') that it proposed to modify the Special Conditions of the Licence held by National Grid Gas Plc ('the Licensee') and the GT2 Price Control Financial Handbook. We stated that any representations on the modification proposals must be made on, or before 9 January 2023.

3. A copy of the Notice was sent to the Secretary of State in accordance with section 23(4)(b) of the Act, and we have not received a direction that the changes should not be made.

4. We received one response to the Notice, which we have carefully considered. The response will be published on our website.[3]

5. In the initial Notice, we proposed making amendments to:

   - Part A of Special Condition 2.1 (Transportation owner revenue restriction)
   - Part A of Special Condition 2.3 (System operator revenue restriction)
   - Part B of Special Condition 8.2 (Annual Iteration Process for the GT2 Price Control Financial Model)
   - the GT2 Price Control Financial Handbook ('the Handbook').

6. The modifications to the Licence would allow the Licensee to over-recover revenues, provided it occurs as a result of the applicable charging methodology and with the explicit consent of the Authority. We also proposed a modification to enable a later re-publication of the GT2 Price Control Financial Model than is currently allowed. In addition, we proposed to amend the GT Price Control Financial Handbook to bring it in line with these changes and to remove paragraph 2.66 which is inconsistent with the licence. Our rationale for these modifications is set out in our accompanying cover letter.

7. 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

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[1] The terms "the Authority", "we" and "us" are used interchangeably in this document.
[2] Consultation on modifications to National Grid Gas's Transporter Licence | Ofgem
[3] https://www.ofgem.gov.uk/publications/consultation-modifications-national-grid-gass-transporter-licence

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charges, from Part B of Special Condition 8.2 of the Licence to Parts A of Special Conditions 2.1 and 2.3. Subsequent paragraphs will also be renumbered to accommodate the proposed additions.

8. Having carefully considered the response received to the Notice, we have decided to proceed with the modifications to the GT2 Special Licence Conditions set out in Appendix 1. An updated version of the Handbook with modifications shown as tracked changes will also be published alongside this document.

9. Since publishing the Notice, we have identified a number of cross references to paragraphs in conditions 2.1 and 2.3 as well as a footnote in the Handbook that require updating as a result of our proposed modifications. These alterations are shown in yellow highlight in the modification text that can be found in Appendix 1.

10. Where an application for permission to appeal our decision is made to the Competition and Markets Authority (CMA) under section 23B of the Act, Rule 5.7 of the Energy Licence Modification Appeals: Competition and Markets Authority Rules[4] requires that the appellant must send to any relevant licence holders who are not parties to the appeal a non-sensitive notice setting out the matters required in Rule 5.2. Section 23(10) of the Act sets out the meaning of 'relevant licence holder'.

11. Under the powers set out in section 23(1)(a) of the Act, we hereby modify the GT2 Price Control Financial Handbook and the Special Licence Conditions of the Gas Transporter Licence of the Licensee in the manner specified in Appendix 1 and in the attached document. This decision will take effect from 10 April 2023.

12. This document is notice of the reasons for the decision to modify the Gas Transporter Licence held by National Grid Gas plc as required by section 38A of the Act.

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Alsarif Satti
Senior Manager – Energy Systems Management & Security
Duly authorised on behalf of the Gas and Electricity Markets Authority

10 February 2023

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[4] CMA70 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/655601/energy-licence modification-appeals-rules.pdf

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Appendix 1

We have included the sections of the special conditions we are proposing to amend below. Deletions are shown in ~~strike through~~, new text is <u>double underlined</u>, and changes made after the consultation are in <mark>yellow highlight</mark>.

<u>Modifications to the Gas Transporter Licence held by National Grid Gas Plc</u>

Chapter 2: Revenue Restriction

Special Condition 2.1 Transportation owner revenue restriction (AR$_t$)

Part A: Licensee's obligation when setting NTS Transportation Owner Charges

2.1.3 The licensee must, when setting NTS Transportation Owner Charges, use its best endeavours to ensure that TO Recovered Revenue does not exceed Allowed Revenue~~.~~<u>, unless paragraph 2.1.4 applies.</u>

<u>2.1.4 This paragraph applies where:</u>
<u>   (a) the licensee deliberately over-recovers TO Recovered Revenue as a result of the applicable charging methodology in the Uniform Network Code; and</u>
<u>   (b) the Authority has provided its consent to such over-recovery.</u>

<u>2.1.5 The published or republished values for the terms ADJR$_t$ and AR$_t$ must be used by the licensee when setting Network Charges.</u>

Part B: Formula for calculating the TO Recovered Revenue term (RRt)

<mark>2.1.4</mark>~~6~~ The value of RR$_t$ is derived in accordance with the following formula, net of Bad Debt as derived in accordance with Part I:

$$RR_t = TOREntC_t + TORExC_t + TORCOM_t$$

where:

TOREntC$_t$ means the amount of revenue in respect of NTS Transportation Owner Activity that results from the sale of the following types of Entry Capacity:

(a) Interruptible Entry Capacity;

(b) Non-Incremental Obligated Entry Capacity; and

(c) Funded Incremental Obligated Entry Capacity;

TORExCt   means the amount of revenue in respect of NTS Transportation Owner Activity that results from the sale of the following types of Exit Capacity:

(a) Off-Peak Exit Capacity;

(b) Non-Incremental Obligated Exit Capacity; and

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(c) Funded Incremental Obligated Exit Capacity; and

TORCOMt   means the amount of revenue in respect of NTS Transportation Owner Activity that results from:

(a) charges levied by the licensee on Gas Shippers and DN Operators pursuant to Standard Special Condition A4 (Charging – General); and

(b) payments made by the licensee to Gas Shippers and DN Operators other than revenue earned by the licensee through TOREntCt and TORExCt.

Part C: Formula for calculating the Allowed Revenue term (ARt)

2.1.5<mark>7</mark> The value of AR$_t$ is derived in accordance with the following formula:

$$AR_t = ADJR_t^* + K_t + LAR_t$$

where:

$ADJR_t^*$ means ADJR$_t$ most recently published by the Authority pursuant to Part B of Special Condition 8.2 (Annual Iteration Process for the GT2 Price Control Financial Model) prior to the start of Regulatory Year t;

K_t means the K correction term and is derived in accordance with Part H; and

LAR_t is derived in accordance with Special Condition 7.1 (Transportation owner legacy adjustments).

Part D: Formula for calculating Adjusted Revenue (ADJRt)

2.1.6<mark>8</mark> The value of ADJR$_t$ is derived in accordance with the following formula:

$$ADJR_t = R_t \frac{PI_t}{PI_{2018/19}} + ADJ_t$$

where:

R_t means the Calculated Revenue term (R$_t$) calculated in accordance with Paragraph 2.1.<mark>7</mark><mark>9</mark> of this condition;

PI_t means the price index term derived in accordance with Part F; and

ADJ_t means the transportation owner AIP adjustment term and is derived in accordance with Part G.

Part E: Formula for calculating the Calculated Revenue term (Rt)

2.1.<mark>7</mark><mark>9</mark> The value of Rt is derived in accordance with the following formula:

$$R_t = FM_t + PT_t + DPN_t + RTN_t + RTNA_t + EIC_t + DRS_t + BPI_t + ODI_t + ORA_t + TAX_t + TAXA_t$$

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where:

FM_t means fast money and has the value set out in the "Revenue" sheet of the GT2 Price Control Financial Model;

PT_t is derived in accordance with Special Condition 6.1 (Transportation owner pass-through items);

DPN_t means depreciation and has the value set out in the "Revenue" sheet of the GT2 Price Control Financial Model;

RTN_t means return and has the value set out in the "Revenue" sheet of the GT2 Price Control Financial Model;

$RTNA_t$ means return adjustment and is derived in accordance with Special Condition 2.5 (Return Adjustment);

EIC_t means equity issuance costs and has the value set out in the "Revenue" sheet of the GT2 Price Control Financial Model;

DRS_t means Directly Remunerated Services and has the value set out in the "Revenue" sheet of the GT2 Price Control Financial Model;

ODI_t is derived in accordance with Special Condition 4.1 (Total output delivery incentive performance);

BPI_t means the business plan incentive term and has the value set out in the "Revenue" sheet of the GT2 Price Control Financial Model;

ORA_t is derived in accordance with Special Condition 5.1 (Transportation owner other revenue allowance);

TAX_t has the value set out in the "Revenue" sheet of the GT2 Price Control Financial Model; and

$TAXA_t$ means the tax allowance adjustment term and has the value zero, unless the Authority directs otherwise under Special Condition 2.2 (Transportation owner tax allowance adjustment).

Part F: Formula for calculating the price index term (PIt)

2.1.810 The value of PIt is the arithmetic average value of each of the twelve monthly values of PIm from 1 April to 31 March within Regulatory Year t, derived in accordance with the following formula:

$$
PI_m = \begin{cases} RPI_m, & \text{if } m < April\ 2021 \\ PI_{m-1}\left(0.5\,\dfrac{CPIH_m}{CPIH_{m-1}} + 0.5\,\dfrac{RPI_m}{RPI_{m-1}}\right), & \text{if } m = April\ 2021 \\ PI_{m-1}\cdot\dfrac{CPIH_m}{CPIH_{m-1}}, & \text{if } m > April\ 2021 \end{cases}
$$

where:

m refers to a year and month;

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RPI_m means the Retail Prices Index for the year and month m; and

$CPIH_m$ means the Consumer Prices Index Including Owner Occupiers' Housing Costs for the year and month m.

Part G: Transportation owner AIP adjustment term (ADJt)

2.1.9~~11~~ For the Regulatory Year commencing on 1 April 2021, the value of ADJ is zero.

2.1.~~10~~12 For subsequent Regulatory Years, the value of ADJ_t is derived in accordance with the following formula:

$$ADJ_t = (ADJR_{t-1} - ADJR^*_{t-1})(1 + TVM_{t-1})$$

where:

$ADJR_t$ is derived in accordance with Part D;

$ADJR^*_t$ means $ADJR_t$ most recently published by the Authority pursuant to Part B of Special Condition 8.2 (Annual Iteration Process for the GT2 Price Control Financial Model) prior to the start of Regulatory Year t; and

TVM_t means the time value of money term derived in accordance with paragraph 2.1.~~11~~13.

2.1.~~11~~13 The value of TVM_t is derived in accordance with the following formula:

$$TVM_t = (1 + WACC_t)\frac{PI_{t+1}}{PI_t} - 1$$

where:

$WACC_t$ means the vanilla weighted average cost of capital for the licensee as derived by the Authority in accordance with the GT2 Price Control Financial Handbook; and

PI_t means the price index term derived in accordance with Part F.

Part H: Transportation owner correction term (Kt)

2.1.~~12~~14 The value of K_t is derived in accordance with the following formula:

$$K_t = (AR_{t-1} - RR_{t-1})(1 + I_{t-1} + 1.15\% + PRP_{t-1} \times PRA_{t-1})$$

where:

AR_t for Regulatory Years starting on or after 1 April 2021 is derived in accordance with Part C. For the Regulatory Year starting on 1 April 2020 AR_t has the value of MR_t derived in accordance with Part C of Special Condition 2A (Restriction of NTS Transportation Owner Revenue) of this licence as in force on 31 March 2021;

RR_t means TO Recovered Revenue derived in accordance with Part B;

I_t means the average value of SONIA;

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PRP_t means the penal rate proportion and has the value of 1, unless the Authority has directed a value between 0 and 1 in accordance with paragraph 2.1.~~15~~16; and

PRA_t means the penal rate adjustment, derived in accordance with paragraph 2.1.~~14~~15.

2.1.~~13~~15 The value of PRAt is derived in accordance with the following formula:

$$PRA_t = \begin{cases} 1.15\% & if\ RR_t/AR_t \geq 1.06 \\ -1.15\% & if\ RR_t/AR_t \leq 0.94 \\ 0, & otherwise \end{cases}$$

where:

RR_t is derived in accordance with Part B; and

AR_t is derived in accordance with Part C.

2.1.~~14~~16 The Authority may direct a value for PRPt which is not less than zero and not more than 1 if it is satisfied that the difference between TO Recovered Revenue and Allowed Revenue is for reasons outside the reasonable control of the licensee.

Part I: Formula for calculating the Bad Debt term (BDt)

2.1.~~15~~17 The value of BDt is derived in accordance with the following formula:

$$BD_t = BDA_t - RBD_t$$

where:

BDA_t means the aggregate value of Bad Debt the licensee has incurred or expects to incur, inclusive of RIIO-GT1 Bad Debt and COVID-19 Transportation Owner Bad Debt, with respect to NTS Transportation Owner Charges owed to the licensee by one or more Defaulting Gas Shippers, less the interest income accrued at the default rate set out in the Uniform Network Code net of WACC with respect to the COVID-19 Scheme; and

RBD_t means the aggregate value of Bad Debt previously recovered, inclusive of RIIO-GT1 Bad Debt and COVID-19 Transportation Owner Bad Debt, by the licensee via the BDAt term, where the licensee has received cash through either the Defaulting Gas Shipper or been credited by the administrator or liquidator of a Defaulting Gas Shipper.

Special Condition 2.3 System operator revenue restriction (SOAR$_t$)

Part A: Licensee's obligation

2.3.3 The licensee must, when setting NTS Transportation Owner Charges, use its best endeavours to ensure that SO Recovered Revenue does not exceed Allowed Revenue~~.,~~ unless paragraph 2.3.4 applies.

2.3.4 This paragraph applies where:

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2.3.5 The published or republished values for the terms $SOADJR_t$ and $SOAR_t$ must be used by the licensee when setting Network Charges.

Part B: Formula for calculating the SO Recovered Revenue term (SORRt)

2.3.4<mark>6</mark> The value of $SORR_t$ is derived in accordance with the following formula, net of SO Bad Debt as derived in accordance with Part H:

$$SORR_t = SOREntC_t + SORExC_t + RCOM_t + SOROC_t$$

where:

$SOREntC_t$ means the amount of revenue in respect of NTS System Operation Activity that results from the sale of Non-Obligated Entry Capacity;

$SORExC_t$ means the amount of revenue in respect of NTS System Operation Activity that results from the sale of Non-Obligated Exit Capacity;

$RCOM_t$ means the amount of revenue in respect of NTS System Operation Activity that results from charges levied by the licensee on Gas Shippers and DN Operators pursuant to Standard Special Condition A4 (Charging – General) in respect of NTS System Operation Activity. This will include revenue from charges to recover costs incurred by the licensee and net payments made to or by the licensee in respect of reducing the costs arising from NTS System Operation Activity other than revenue earned by the licensee through:

(a) $SOREntC_t$;

(b) $SORExC_t$;

(c) $SOROC_t$; and

(d) revenues received by the licensee from the sale of gas purchased by the licensee in respect of its use of Constrained Storage Facilities in order to avoid Transportation Constraints; and

$SOROC_t$ means the amount of revenue derived by the licensee through associated NTS System Operation Charges and is derived in accordance with the following formula:

$$SOROC_t = RNC_t + RCOR_t + FTI_t + RLOC_t + RADD_t$$

where:

RNC_t means net revenue derived by the licensee from Balancing Neutrality Charges;

$RCOR_t$ means the revenue derived by the licensee from System Entry Overrun Charges;

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FTI_t means the revenue derived by the licensee from charges levied on Gas Shippers and DN Operators in respect of any Failure To Interrupt;

$RLOC_t$ means the revenue derived by the licensee from Locational Sell Actions and Physical Renomination Incentive Charges; and

$RADD_t$ has the meaning given in paragraph 5.5.5 of Special Condition 5.5 (Entry Capacity and Exit Capacity Constraint Management).

Part C: Part C: Formula for calculating the SO Allowed Revenue term (SOARt)

2.3.5~~7~~ The value of SOAR$_t$ is derived in accordance with the following formula:

$$SOAR_t = SOADJR_t^* + SOK_t + SOLAR_t$$

where:

$SOADJR_t^*$ means SOADJR$_t$ most recently published by the Authority pursuant to Part B of Special Condition 8.2 (Annual Iteration Process for the GT2 Price Control Financial Model) prior to the start of Regulatory Year t;

SOK_t means the SO K correction term and is derived in accordance with Part G; and

$SOLAR_t$ is derived in accordance with Special Condition 7.10 (System operator legacy adjustments).

Part D: Formula for calculating the SO Adjusted Revenue term (SOADJRt)

2.3.6~~8~~ The value of SOADJR$_t$ is derived in accordance with the following formula

$$SOADJR_t = SOR_t \frac{PI_t}{PI_{2018/19}} + SOADJ_t$$

where:

SOR_t means the SO Calculated Revenue term (SOR$_t$) calculated in accordance with paragraph 2.3.7~~9~~ of this condition;

PI_t means the price index term derived in accordance with Part F of Special Condition 2.1; and

$SOADJ_t$ means the SO AIP adjustment term and is derived in accordance with Part F.

Part E: Formula for calculating the SO Calculated Revenue term (SORt)

2.3.7~~9~~ The value of SOR$_t$ is derived in accordance with the following formula:

$$SOR_t = SOFM_t + SOPT_t + SODPN_t + SORTN_t + SOORA_t + SOTAX_t + SOTAXA_t$$

where:

$SOFM_t$ means fast money and has the value set out in the "System Operator" sheet of the GT2 Price Control Financial Model;

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$SOPT_t$ is derived in accordance with Special Condition 6.3 (System operator pass-through items);

$SODPN_t$ means depreciation and has the value set out in the "System Operator" sheet of the GT2 Price Control Financial Model;

$SORTN_t$ means return and has the value set out in the "System Operator" sheet of the GT2 Price Control Financial Model;

$SOORA_t$ is derived in accordance with Special Condition 5.4 (System operator other revenue allowance);

$SOTAX_t$ has the value set out in the "System Operator" sheet of the GT2 Price Control Financial Model; and

$SOTAXA_t$ means the SO tax allowance adjustment term and has the value zero unless the Authority directs otherwise under Special Condition 2.4 (System operator tax allowance adjustment).

Part F: SO AIP adjustment term (SOADJt)

2.3.810 For the Regulatory Year commencing on 1 April 2021, the value of SOADJ is zero.
2.3.911 For subsequent Regulatory Years, the value of $SOADJ_t$ is derived in accordance with the following formula:

$$SOADJ_t = (SOADJR_{t-1} - SOADJR^*_{t-1})(1 + TVM_{t-1})$$

where:

$SOADJR_t$ is derived in accordance with Part D;

$SOADJR^*_t$ means the value of SOADJR$_t$ most recently published by the Authority pursuant to Part B of Special Condition 8.2 (Annual Iteration Process for the GT2 Price Control Financial Model) prior to the start of Regulatory Year t; and

TVM_t is derived in accordance with paragraph 2.1.1113 of Special Condition 2.1 (Transportation owner revenue restriction).

Part G: SO K correction term (SOKt)

2.3.1012 The value of SOK$_t$ is derived in accordance with the following formula:

$$SOK_t = (SOAR_{t-1} - SORR_{t-1})(1 + I_{t-1} + 1.15\% + SOPRP_{t-1} \times SOPRA_{t-1})$$

where:

$SOAR_t$ for Regulatory Years commencing on or after 1 April 2021 SOAR$_t$ is derived in accordance with Part C. For the Regulatory Year commencing on 1 April 2020 SOAR$_t$ has the value of SOMR$_t$ derived in accordance with Part C of Special Condition 3A (Restriction of NTS System Operation Revenue) of this licence as in force on 31 March 2021;

$SORR_t$ means SO Recovered Revenue derived in accordance with Part B;

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I_t means the average value of SONIA in Regulatory Year t;

$SOPRP_t$ means the penal rate proportion and has the value of 1, unless the Authority directs otherwise in accordance with paragraph 2.3.~~13~~14; and

$SOPRA_t$ means the SO penal rate adjustment, derived in accordance with paragraph 2.3.~~12~~13.

2.3.~~12~~13 The value of $SOPRA_t$ is derived in accordance with the following formula:

$$SOPRA_t = \begin{cases} 1.15\% & if \ SORR_t/SOAR_t \geq 1.06 \\ -1.15\% & if \ SORR_t/SOAR_t \leq 0.94 \\ 0, & otherwise \end{cases}$$

where:

$SORR_t$ is derived in accordance with Part B; and

$SOAR_t$ is derived in accordance with Part C.

2.3.~~12~~14 The Authority will direct a value for $SOPRP_t$ which is not less than zero and not more than 1, if it is satisfied that differences between SO Recovered Revenue and SO Allowed Revenue were for reasons outside the reasonable control of the licensee.

Part H: Formula for calculating the System Operator Bad Debt term (SOBDt)

2.3.~~13~~15 The value of SOBDt is derived in accordance with the following formula:

$$SOBD_t = SOBDA_t - SORBD_t$$

where:

$SOBDA_t$ means the aggregate value of SO Bad Debt the licensee has incurred or expects to incur, inclusive of RIIO-GT1 SO Bad Debt and COVID-19 System Operator Bad Debt, with respect to NTS System Operation Charges owed to the licensee by one or more Defaulting Gas Shippers, less the interest income accrued at the default rate set out in the Uniform Network Code net of WACC with respect to the COVID-19 Scheme; and

$SORBD_t$ means the aggregate value of SO Bad Debt previously recovered, inclusive of RIIO-GT1 SO Bad Debt and COVID-19 System Operator Bad Debt, by the licensee via the SOBDAt term, where the licensee has been credited by the administrator or liquidator of a Defaulting Gas Shipper.

Chapter 8: Governance

Special Condition 8.2 Annual Iteration Process for the GT2 Price Control Financial Model

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Part B: Publication of the value of the terms $ADJR_t$, AR_t, $SOADJR_t$ and $SOAR_t$

8.2.9 The value of the terms $ADJR_t$, AR_t, $SOADJR_t$, and $SOAR_t$ will be published by the Authority no later than 30 November prior to each Regulatory Year. ~~The published or republished values for the terms ADJRt , ARt, SOADJRt and SOARt must be used by the licensee when setting Network Charges in accordance with Special Condition 2.1 (Transportation owner revenue restriction) and Special Condition 2.3 (System operator revenue restriction).~~

8.2.10 The Authority may re-publish the values of the terms ADJRt, ARt, SOADJRt, and SOARt by the ~~February prior to~~ <u>end of May during</u> the Regulatory Year t.