

Kelvin Bradbury
Head of Regulatory Finance
National Gas Transmission plc

Email: Gas.TransmissionResponse@ofgem.gov.uk

Date: 30 November 2023

Dear Kelvin,

Direction for the value of the Penal Rate Proportion (PRP_t) for the National Gas Transmission plc Gas Transporter Licence in respect of Regulatory Year 2022/23.

On 29 September 2023, National Gas Transmission plc (NGT) submitted a request to the Authority¹ under Part H of Special Condition 2.1 of their Gas Transporter Licence (the Licence) that the Authority direct a value of zero for the PRP_t in respect of the Regulatory Year starting 1 April 2022.

Following an assessment of the request and the supporting information provided, we have decided to direct a PRP_t value of zero for the Regulatory Year starting 1 April 2022.

Background

The PRP_t is the “penal rate proportion” and its value determines what proportion of the 1.15% penal rate should be applied to the difference between NGT’s Allowed Revenue and Recovered Revenue for a Regulatory Year. A PRP_t value of one means that the 1.15% adjustment is applied to the full under- or over-recovery of revenue, and a PRP_t value of zero means that no adjustment is applied to any under- or over-recovery of Allowed Revenue.

Paragraph 2.1.16 of Special Condition 2.1 of the Licence says that the Authority may direct a value for the PRP_t which is not less than zero and not more than one if we are “satisfied

¹ References to the “Authority”, “Ofgem”, “we” and “our” are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

that the difference between TO Recovered Revenue and Allowed Revenue is for reasons outside the reasonable control of the licensee [NGT].”

For the Regulatory Year starting 1 April 2022, NGT’s TO Recovered Revenue was £278m higher than their Allowed Revenue of £894m. On 29 September 2023, NGT requested that we direct a value of zero for the PRP_t in respect of the Regulatory Year starting 1 April 2022 because in their view “the over-collection of revenue in Regulatory Year 2022/23 was driven by elements outside of [NGT’s] control.”

NGT say there are several reasons which caused the over-recovery, these can be split into two areas; Transmission Exit and Transmission Entry.

Transmission Exit:

- the impact of auction premia at Bacton (Exit) Interconnection Point (IP) was significant, and resulted in **£188.2m** over-recovery;
- there were additional flows and capacity variances at Bacton (Exit) IP above the forecast across the winter months, resulting in **£10.9m** over-recovery;
- to support Power Generation there were additional flows, partly needed to support Europe due to issues with the French Nuclear Fleet. Across the year, Exit capacity for Power Generation resulted in **£21.6m** over-recovery.
- The impact of the implemented UNC796² methodology created a variance driven from updated revenue target calculation that resulted in a **£13.9m** over-recovery.

Transmission Entry:

- There were additional flows to support Bacton (Exit) IP and Power Generation demands, beyond those forecast when setting charges. These additional flows resulted in extra capacity being booked to meet these levels increasing revenues compared to the forecast. At Beach terminals, capacity bookings were 5.5% above forecast, resulting in **£40.3m** over-recovery.
- As with Transmission Exit, the implemented UNC796 methodology created a variance driven from updated target revenue calculation that resulted in a **£0.3m** over-recovery.

Our view

We consider that **£275.2m** of the difference between NGT’s Allowed Revenue and Recovered Revenue for Regulatory Year 2022/23 was for reasons outside the reasonable control of NGT. From the information provided to us by NGT, we were not able to infer whether the remaining over-recovery was for reasons outside the reasonable control of

² <https://www.gasgovernance.co.uk/0796>

NGT. We also note that we were not able to reconcile some figures provided to us by NGT with Price Controls Financial Model (PCFM) values. For this reason, we have decided to attribute this part of the over-recovery to reasons within the reasonable control of NGT. This means that the over-recovery which was within the reasonable control of NGT was approximately 0.45% of Allowed Revenue. The licence determines that a penalty is zero where the difference between TO Recovered Revenue and Allowed Revenue is below a 6% threshold. Since the over-recovery within the reasonable control of NGT was below 6% of Allowed Revenue, we consider that the penal rate adjustment would have been zero if it were not for reasons outside the reasonable control of NGT. Therefore, we direct that the PRP_t should be zero for the Regulatory Year starting 1 April 2022.

Auction premia at Bacton (Exit) IP

We agree with NGT that the £188.2m of over-recovery that was attributable to auction premia at Bacton (Exit) IP was outside the reasonable control of NGT.

Within the Regulatory Year, NGT recovered significant revenues due to auction premia at Bacton (Exit) IP. The over-recovery attributed to auction premia is unprecedented, as previous years have seen very minimal auction premia or none at all. NGT have explained that they do not forecast auction premia as part of charge-setting.

Therefore, we consider the impacts of auction premia at Bacton (Exit) IP within Regulatory Year 2022/23 on over-recovery to be outside the reasonable control of NGT.

Additional flows and capacity bookings across Entry and Exit

We agree with NGT that £72.8m of their over-recovery was a result of higher than forecast capacity bookings, the accuracy of which was outside the reasonable control of NGT. This amount is broken down as follows: £10.9m over-recovery at Bacton (Exit) IP, £21.6m at Exit Points to GB Power Generation, and £40.3m at Entry Points at Beach terminals.

NGT claim that the additional flows and capacity bookings at Bacton IP and Exit Points to GB Power Generation were predominantly needed to support Europe due to issues relating to the French nuclear fleet. Though we acknowledge that there was reduced availability of the French nuclear fleet and this likely increased exports of both gas and electricity to Europe, it is very difficult to quantify the precise impact this had on gas exports and gas-fired electricity generation in GB. Regarding export flows at Bacton IP, our data shows that during the Regulatory Year under consideration, these were at unprecedented high levels compared to historical flows. The market circumstances and behaviours surrounding these high export flows were unforeseen and therefore this part of the over-recovery (£10.9m) was outside the reasonable control of NGT. Regarding the over-recovery linked to Exit Points to GB Power Generation (£21.6m), we note that gas demand at power stations was

moderately higher than NGT expected but we consider that NGT's forecasts could not have been regarded as unreasonable. However, the variance between forecast and actual capacity bookings at power stations was significant and cannot be explained exclusively by the moderately higher gas demand at these Exit Points. On balance, we consider that the variance between forecast and actual capacity bookings at power stations was linked to changes in booking behaviour which could not have been foreseen and therefore the resulting over-recovery was for reasons outside the reasonable control of NGT.

Finally, at Entry Beach terminals there was a disproportionate variance between the percentage difference in forecast capacity booking (5.5%) and the actually observed over-recovery amount (£40.3m). NGT have explained that this is due to the impact of Existing Contracts.³

Existing contracts are fixed-price capacity bookings and contracts registered prior to 6 April 2017 in accordance with Article 35 of the Tariff Network Code ("TAR NC"). Their presence in GB charging arrangements allows Users who hold Existing Contracts to access capacity at a fixed price, which is on average significantly lower than "new" Entry capacity (i.e. capacity booked after 6 April 2017). During the course of the Regulatory Year, additional "new" Entry capacity was purchased at Beach terminals beyond the levels forecast by NGT. As "new" Entry capacity has a much higher prevailing price than Existing Contracts, this exacerbated the over-recovery that NGT experienced at these terminals despite there only being a relatively modest variance when compared to forecasts.

Therefore, we consider that the over-recovery resulting from these additional flows and capacity bookings across Entry and Exit Points to be for reasons outside the reasonable control of NGT.

UNC796 methodology

NGT have explained that the impact of the implemented UNC796 methodology created an over-recovery variance driven from the updated target revenue calculation. This resulted in a total over-recovery of £14.2m, with £13.9m over-recovery attributable at Transmission Exit and £0.3m at Transmission Entry.

On 25 May 2022, we decided to approve UNC796: '*Revision to the Determination of National Grid NTS Target Revenue for Transportation Charging*'. The aim of the modification was to reduce the level of year-on-year volatility in Reserve Prices for NTS Capacity by

³ "Existing contracts" are certain fixed-price capacity bookings and contracts registered prior to 6 April 2017 in accordance with Article 35 of Commission Regulation (EU) 2017/460 of 16 March 2017 establishing a network code on harmonised transmission tariff structures for gas (TAR NC). TAR NC is 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.

revising the determination of the Allowed Transmission Services Revenue for each Gas Year by taking into account part of the allowed revenue for each Formula Year that coincides with the Gas Year. The subsequent impact of the revised methodology is that NGT may over- or under-recover their Allowed Transmission Services Revenue at the end of a Regulatory Year to reduce the volatility of Reserve Prices set across Gas Years.

As the over-recovery mentioned above is attributable to the revised methodology implemented under UNC796, we consider the amount as being outside the reasonable control of NGT as it was the result of the charging methodology which is now embedded in the UNC. Subsequently, we agree with NGT that its assessment of £13.9m over-recovery at Transmission Exit and £0.3m at Transmission Entry was for reasons outside of their reasonable control.

Next steps

We expect NGT to continue to maintain a robust charging methodology, including a Forecasted Contracted Capacity ("FCC") methodology, to ensure that revenue recovery is efficient and any under- or over-recoveries are minimised. NGT should review the areas wherein the variance between forecast and actual capacity bookings and flows were significant to determine whether changes are required to its FCC methodology.

We will continue to monitor NGT's revenue recovery, and we will act to ensure that NGT continues to maintain a robust charging methodology as mentioned above, including directing a PRPt value above 0 in future regulatory years, if under- or over-recoveries are for reasons within the reasonable control of NGT.

Authority direction

Following an assessment of the request and the supporting information provided, in accordance with paragraph 2.1.16 of Special Condition 2.1, we have decided to direct a PRPt value of zero for the Regulatory Year starting 1 April 2022.

If you have any questions on the above, please contact:
Gas.TransmissionResponse@ofgem.gov.uk.

Yours Sincerely,

Charlotte Friel

Deputy Director - Market Operations and Signals

Signed on behalf of the Authority and authorised for that purpose