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Direct Dial: 020 7901 7105  
Email: paul.branston@ofgem.gov.uk

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## **Modification of Special Licence Conditions 1A, 2D, 5F and 5G of National Grid Gas (NTS)'s gas transporter Licence**

We<sup>1</sup> are making changes to the special conditions of National Grid Gas (NTS) (NGGT)'s gas transporter licence to terminate the Permit Arrangements and adjust the revenue earned from them for the period 1 April 2013 – 31 March 2015.

We published a statutory consultation and covering letter about our proposed modifications to NGGT's licence on 4 March 2015.<sup>2</sup> These documents explained our reasons for proposing changes to NGGT's licence and sought views from stakeholders. The deadline for representations on the proposed modifications was 1 April 2015. Our letter announcing this consultation also provided responses to a previous consultation, published on 10 November 2014,<sup>3</sup> and our views on points raised.

### **Summary of statutory responses and our views**

We received one non-confidential response to the statutory consultation from NGGT. This has been published on our website.

NGGT said that the points it made in its response to our 10 November consultation still applied and repeated these in a summarised version.

NGGT agreed with our proposal that some adjustment should be made to reduce the revenue earned for the period 1 April 2013 – 31 March 2015, but did not support our proposed option to achieve this.

NGGT said that it did not consider that our proposed option adheres to the principle we expressed in our consultation "*...that it would [not] be right to retrospectively adjust allowances for risk, after the period in which that risk was borne and managed by NGGT.*"

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<sup>1</sup> The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably. The Authority is the Gas and Electricity Markets Authority. Ofgem is the Office of the Gas and Electricity Markets Authority.

<sup>2</sup> <https://www.ofgem.gov.uk/publications-and-updates/proposed-modifications-national-grid-gas-plc-s-licence-terminate-permit-arrangements-and-adjust-revenue-earned-period-1-april-2013-31-march-2015>

<sup>3</sup> <https://www.ofgem.gov.uk/publications-and-updates/proposal-terminate-use-permits-arrangements-national-grid-gas-transmission%E2%80%99s-licence-and-adjust-revenue-earned-permit-arrangements-period-1-april-2013-%E2%80%93-31-march-2015>

We do not agree with NGGT that our proposal does not adhere to this principle. The adjustment we are making is not retrospective for a period in which NGGT bore the relevant risk as NGGT did not bear or manage the risk to which the revenue was linked – future signals for incremental capacity during the March 2015 Quarterly System Entry Capacity (QSEC).

NGGT expressed the view that our proposed option is *"based upon historic performance and with the full benefit of hindsight."*

We consider that we should not ignore relevant historic facts and in this case in particular, NGGT's decisions in relation to its July 2014 exit capacity risk. We consider that this represents a more valid basis to estimate NGGT's prospective risk (from the March 2015 QSEC) than the other options considered.

NGGT said that it expects *"greater regulatory transparency and certainty of our incentives and regulatory allowance than provided in this case."*

We would not normally reduce revenue associated with an incentive as this can cause regulatory uncertainty. However, in this case the risk to which the incentive was linked no longer applies. NGGT's permits revenue is not related to any output, and the revenue adjustment will not affect NGGT's obligations or its funding of them. We consider this case to be exceptional and perhaps unique, and our proposal is specific to these unusual circumstances. The Permit Arrangements were extended as a contingency for the delays in developing Planning and Advanced Reservation of Capacity Agreements (PARCAs) in time for RIIO-T1. We were clear in the RIIO-T1 Final Proposals<sup>4</sup> that the Permit Arrangements were an interim measure. We also indicated our proposal to terminate the Permit Arrangements in our consultation of 17 March 2014<sup>5</sup> when we said: *"If and when new commercial arrangements are introduced we will consider what an appropriate and fair treatment of NGG's permit allowance is"*. We confirmed this in our decision of 28 April 2014<sup>6</sup> to extend permits to 31 March 2015.

NGGT also reiterated its preference for the option based on our subjective assessment of the number of permits that would be required.

We believe that our proposed option represents a better proxy of NGGT's risk from the March 2015 QSEC and that it is the option best calculated to protect the interests of existing and future gas consumers.

Having carefully considered the responses to the statutory consultation, we think that it is in consumers' interests to adjust NGGT's revenue by an amount based on the option which best estimates the reduction in its risk.

We consider that the time-related options and those where the adjustments relate to whether permits were allocated for entry or exit are poor indicators of this reduction in risk.

We believe that a reduction of £8.35m based on permits committed for use by NGGT at the July exit window, is less subjective on our part, is not excessive, and is the option which best estimates the reduction in NGGT's risk.

NGGT agrees that our proposed modification to its Special Licence Conditions reflect our final proposals but has expressed a preference that paragraphs 2D.10 and 2D.11 are not deleted.

Paragraphs 2D.10 and 2D.11 of Special Licence Condition 2D provide the following:

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<sup>4</sup> <https://www.ofgem.gov.uk/ofgem-publications/53599/1riiot1fpoverviewdec12.pdf>

<sup>5</sup> <https://www.ofgem.gov.uk/ofgem-publications/86584/140317riioy2permitscoverletter.pdf>

<sup>6</sup> <https://www.ofgem.gov.uk/ofgem-publications/87455/140415permitscoverformoddirfinal.pdf>

*"Part D sets out the revenue earned by the Licensee for the Permit Arrangements commencing on 1 April 2013 and 1 April 2014.*

*Part E sets out arrangements to allow the Licensee to obtain additional revenue for any permits under the Legacy Permit Arrangements remaining on 31 May 2013."*

Parts D and E still form part of Special Licence Condition 2D so paragraphs retaining 2D.10 and 2D.11 in the NGGT licence arguably make this more clear.

We have carefully considered these proposed changes to the draft licence text published in the statutory consultation. We think these additional changes (reinsertion of text which we had proposed to delete) are minor changes which correct drafting. They do not affect our policy intent or the effect of the licence modifications but may make the licence text clearer to readers.

We have therefore incorporated these changes into the licence text included in the statutory direction. They have been highlighted in yellow.

### **Our decision**

We have decided to proceed with the modifications to Special Licence Conditions 1A, 2D, 5F and 5G of NGGT's licence. The effective date of these modifications is on and from 29 June 2015.

The modification decision is published on our website alongside this letter.

If you have any questions regarding the content of this letter, please contact David Reilly by email at [david.reilly@ofgem.gov.uk](mailto:david.reilly@ofgem.gov.uk) or on 0203 263 9648.

Yours faithfully

**Paul Branston**

Associate Partner, Gas Networks