

**Explanation of the NTS SO and TO Commodity charges for the formula year 2019/20**

This document should be used in conjunction with the embedded Excel spreadsheet as the Tables that are referred to within this document, are contained in the spreadsheet.

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### Introduction

This document seeks to provide greater transparency to the processes and data used by National Grid Gas NTS (“National Grid”) to set the NTS System Operation (SO) and Transportation Owner (TO) Commodity charges.

National Grid sets its charges to recover the price controlled allowances set by Ofgem. The current price control RIIO-T1 applies from 1 April 2013 and runs until 31 March 2021.

Charges are generally set before actual costs and allowed revenues have been finalised and can be subject to significant variances and volatility throughout the year, which are amplified by the fact that Indicative and Final notices and their related costs are forecast 150[[1]](#footnote-1) days and 2 months before actual charges are implemented and costs incurred.

National Grid has an obligation to use its best endeavours in setting its charges to ensure that, in respect of any formula year, the revenue which it derives (from SORt & TORt) shall not exceed the maximum NTS allowed revenue (SOMRt & MRt).

Therefore, as costs fluctuate throughout the year, the charging obligations on National Grid ensure that charges may fluctuate as well.

By providing greater transparency of the individual cost components and how these contribute to charges, NTS users could potentially forecast any future fluctuations and price changes.

If you would like further information on how the costs and allowed revenues are derived, please refer to System Operator incentive consultations, TO Price Control documents and charging notices for further detail regarding these matters.

#### Other related information sources

This document is one of a suite of documents that describe the NTS charges levied by National Grid and the methodologies behind them. The other documents that are available are:

* Statement of the Gas Transportation Charging Methodology
* UNC Section Y - Gas Transportation Charging Methodology
* Statement of Gas Transmission Transportation charges
* Entry Capacity Release Methodology Statement
* Connection Charging Statement

#### Please see the Charging section on National Grid’s website.

#### Structure of this document

This document is divided into four sections:

* Part A relates to the SO Commodity charge;
* Part B relates to the TO Entry Commodity charge;
* Part C relates to the TO Exit Capacity and TO Exit Commodity charges;
* Part D provides details of the annual charge setting timetable and sources of further information.

#### Comments & Feedback

As part of our commitment to customers, National Grid welcomes comments and feedback on the information contained in this notice. In particular, to ensure that information is provided and presented in a way that is of most use to customers, we would welcome specific feedback on:

* the level of numeric detail provided to explain charge changes;
* the quality of the explanation given to describe and explain charge changes;
* information that is not useful and could be omitted; and
* information that is missing that could be added.
* These should be sent to:

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## Part A: SO Commodity charge

The SO Commodity charge recovers the difference between the SO allowed revenue and revenues received from other SO charges.

To derive the SO Commodity charge a number of high-level steps are required:

**Step 1:** Determine the SO allowed revenue

**Step 2:** Determine the actual revenue to be recovered from the SO Commodity charge

**Step 3:** Determine the volumes that attract the SO Commodity charge

**Step 4:** Calculate the SO Commodity charge rate

### Step 1: Determining the SO allowed revenue

The maximum NTS SO allowed revenue in respect of formula year t (SOMRt) is defined in National Grid’s Gas Transporter Licence for the NTS (“the Licence”). It is calculated using the following formula:

SOMRt = SOBRtt + CMtt + SOOIRCt + TSSt + DELINCt - SOKt

**Table 1** details the individual terms contained in the equation above, which have been used to determine the final prices that applied during the relevant year. Note that all the figures quoted within this note relate to the entire formula year.

For further details of the SO allowed revenue, refer to Special Condition 3A “NTS System Operation activity revenue restriction”.

#### Typical variations in SOMRt

The values in Table 1 are subject to uncertainty, particularly those that are linked to externalities such as gas costs. It is anticipated that separate reporting of the SO external incentive performance will allow shippers to better predict future price movements. However, shippers may wish to note that the new Licence makes allowances for many of the cost terms and so it is the variation from the allowance that is added on to the base revenue that makes up the maximum allowed revenue (SOMRt).

### Step 2: Determining the target revenue for the SO Commodity charge

The maximum NTS SO allowed revenue is collected though a number of charges in addition to the standard SO Commodity charge. The revenue from these other charges must first be forecasted so that the residual target revenue to be collected through the SO Commodity charge can be calculated. The SO Commodity charge is set such that the target actual SO Revenue equals the maximum NTS allowed revenue. The actual NTS SO revenue (SORt) is calculated using the following formula:

SORt = SOREntCt + SOROCt + SORExCt + RCOMt

#### Other SO charges: Associated SO charges

**Table 2** shows forecasted revenue resulting from associated SO charges levied by National Grid which is deducted from the maximum NTS SO allowed revenue total.

#### Adjustments for the sale of incremental capacity

Revenue from the sale of **legacy** incremental entry and exit capacity is deducted as this is recovered through the relevant capacity charges. For entry the amount equates to revenue resulting from any incremental capacity allocated through the Entry Capacity auctions held ahead of the gas day and this capacity may either be obligated or non-obligated. The revenue is effectively used to net off the incremental SO allowed costs included in SOMRt. For exit the adjustment is equal to the forecasted revenue collected in the formula year in relation to Exit charges for firm exit capacity above the baseline.

**Table 3** shows the adjustments for the sale of incremental capacity.

#### Adjustments for other charges

A proportion of the SO costs are recovered through the St Fergus Compression charge, NTS Optional Commodity charge (shorthaul) and Capacity Neutrality Buyback revenue. The St Fergus Compression charge recovers the compression costs associated with the North Sea Midstream Partners (NSMP) sub-terminal at St. Fergus directly from those shippers at that terminal due to local pressure tier arrangements. The Optional Commodity charge is offered as a replacement to the TO and SO Commodity charges. In all cases, the forecast revenue recovered from these charges is deducted from SOMRt.

**Table 4** shows the adjustments for other charges.

**Table 5** shows the target revenue to be recovered through the SO Commodity charge.

The figure changes as National Grid’s view of the above costs and revenue change.

**Table 6** details how the target revenue to be collected through the SO Commodity charge has varied during the formula year.

### Step 3: Determining the volumes that attract the SO Commodity charge

The volumes that attract the SO Commodity charge are those forecast entry and exit flows excluding storage flows, net of shorthaul volumes i.e. the volumes that shippers have nominated to attract the Optional Commodity charge. Shippers can nominate to go onto shorthaul at any time throughout the year.

**Table 7** shows the volumes used for the prices set for the formula year.

The flow data is updated as part of the demand forecasts published in mid-May. Therefore, shippers may observe different flow assumptions for the final notice of the October price change.

### Step 4: Calculation of the SO Commodity charge rate

The SO Commodity charge is collected from non-storage entry and exit flows excluding shorthaul flows, therefore to calculate the charge rate to apply from April the following formula is used:



#### Mid-year updates to the SO Commodity charge

The commercial framework allows the SO Commodity charge to be revised in October. Further updates are permitted in exceptional circumstances.

When making a mid-year price update, the actual revenue collected during the year to date is deducted from the revised forecast annual revenue, and the remaining flows for the year considered.

For example, to update prices in October the following formula is applied:



#### Forecast revenue recovery through SO Commodity charge

**Table 8** shows the forecast monthly flows that will attract the SO Commodity charge and the expected revenue from this charge. Data shown in red is based on actuals, other data is forecast.

Charges are always set to recover the exact amount of allowed revenue for the formula year, however, as costs and volumes are not fixed and are subject to variability, any forecast/actual difference between allowed revenue and actual revenue feeds through into the formula year in two years’ time (with the appropriate interest adjustments made). This is through the NTS SO revenue adjustment term SOKt which applies in that formula year.

## Part B: TO ENTRY Commodity charge

To derive the TO Entry Commodity charge a number of high-level steps are required:

**Step 1:** Determine the TO allowed revenue

**Step 2:** Determine the target revenue to be collected via the TO Entry Commodity charge

**Step 3:** Determine the volumes that attract the TO Entry Commodity charge

**Step 4:** Calculating the TO Entry Commodity charge rate

### Step 1 Determining the TO allowed revenue

The maximum NTS TO allowed revenue in respect of formula year t (MRt) is defined the Licence. It is calculated using the following formula:

MRt = BRt + PTt + OIRt +NIAt + NICFt- Kt

**Table 9** details the terms used to determine the final prices to apply during the formula year.

For further details of the TO allowed revenue, refer to Special Condition 2A “NTS transportation owner activity revenue restriction”.

#### Typical variations in MRt

Assuming no change to the Transportation Licence, shippers may wish to note that the new Licence makes allowances for many of the cost terms and so it is the variation from the allowance that is added on to the base revenue that makes up the maximum allowed revenue (MRt).

### Step 2: Determining the target revenue for the TO Entry Commodity charge

The TO Entry Commodity charge collects the difference between auction revenue applicable to the formula year and TO entry allowed revenue.

#### TO entry allowed revenue

The TO entry allowed revenue is equal to the TO maximum allowed revenue (net of K (Kt)). The revenue collected from the Pension Deficit charge (levied on Distribution Networks) and Metering charges is then deducted. This is then divided by 2. Finally the TO Entry Allowed Revenue is then adjusted by the Entry K amount. Please compare Table 9 and Table 11 to see how this works in detail.

#### Auction revenue

The obligated entry capacity revenue collected in the relevant year must be determined by considering all applicable capacity auctions (ahead of the day). A combination of forecast and actual data is used depending on the auction type and when it is held.

For instance, revenue from the Quarterly System Entry Capacity (QSEC) auctions is based on actual data. The QSEC auction sells entry capacity for capacity year+1 to capacity year+16 inclusive. The QSEC to be held in March 2017 sells capacity from 1 October 18 to 30 September 34. Therefore all QSEC auctions held previous to QSEC 2017 will have sold entry capacity for the 2017/18 formula year, hence it is actual data. The Annual Monthly System Entry Capacity (AMSEC) auction sells capacity for capacity year+1 to capacity year+2. AMSEC 2016 and AMSEC 2017 will have therefore sold capacity for the 2017/18 formula year. To set the TO Entry Commodity charge to apply from April, revenue from one AMSEC auction will be based on actual auction results and the other based on forecast data (as charges set in April will be set before the actual AMSEC auction is held). Actuals for both the AMSEC auctions are available for the October price changes.

Where forecast auction revenues are required, this will typically be based on the actual revenues generated from the same auction held the previous year unless National Grid receives better information from shippers. Shippers should note this is not always reliable particularly at times of regime change when shippers may adopt different bidding strategies.

For the Rolling Monthly Trades & Transfer System Entry Capacity (RMTNTSEC) and Day Ahead Daily System Entry Capacity (DADSEC) auction revenues, the final total is forecasted for April price changes (historically negligible change is seen between forecast and actual), as at the point when charges are finalised further auction revenue will be collected.

**Table 10** shows the auction revenue assumptions used to set the final TO Entry Commodity charge during the relevant year.

The target TO Entry Commodity charge revenue is calculated as shown by **Tables 11-13.**

The purpose of **Table 11** is to remove Kt which forms part of the overall MRt. This allows the individual Entry and Exit K's to be applied, and subsequently the amount of revenue to be collected from Entry and Exit charges for the year to be calculated accurately as shown in **Table 12.**

Now that the Individual Entry K has been applied, revenue collected from TO Capacity Auctions is deducted to leave the remaining TO Entry Allowed revenue, which is collected through the TO Entry Commodity charge as shown in **Table 13.**

**Table 14** details how the target revenue to be collected through the TO Entry Commodity charge varies during the formula year.

### Step 3: Determining the volumes that attract the TO Entry Commodity charge

The volumes that attract the TO Entry Commodity charge are those forecast non-storage entry flows net of shorthaul volumes i.e. the volumes that shippers have nominated to attract the Optional Commodity charge (Shorthaul).

**Table 15** shows the volumes used for the prices set for the year.

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The flow data is updated as part of the demand forecasts published in mid-May. Shippers will therefore observe different flow assumptions for indicative and final notices of the October price change to those made for the April prices.

### Step 4: Calculating the TO Entry Commodity charge rate

The TO Entry Commodity charge is collected from non-storage entry flows excluding shorthaul flows, therefore to calculate the charge rate to apply from April the following formula was used.



#### Mid-year updates to the TO Entry Commodity charge

The commercial framework allows the TO Entry Commodity charge to be revised in October. Further updates are permitted in exceptional circumstances.

When making a mid-year price update, the actual revenue collected during the year to date is deducted from the revised annual revenue, and the remaining flows for the year considered.

For example, to update prices in October the following formula is applied:



#### Forecast revenue recovery through TO Entry Commodity charge

**Table 16** shows the forecast monthly flows that will attract the TO Entry Commodity charge and the expected revenue from this charge. Data shown in red is based on actuals, other data is forecast.

If actual revenue recovered is greater than the TO entry allowance revenue then the over recovery will be dealt with first by the application of the buy-back offset mechanism, with any residual revenue credited back to entry shippers through the TO Entry Commodity charge rebate mechanism.

Any TO Entry over recovery not dealt with via the above mechanisms will flow through into the formula year in two years’ time (with the appropriate interest adjustments made) through the NTS TO revenue adjustment term Kt which applies in that formula year.

## PART C: TO EXIT Commodity and Target Exit Revenue for the Transportation Model

To derive the TO Target Exit Revenue a number of high-level steps are required:

**Step 1:** Determine the TO Allowed Revenue

**Step 2:** Determine the target exit revenue to be collected in formula year

**Step 3:** Determine the target exit revenue to be entered into the Transportation Model

**Step 4:** Determine the target revenue for the TO Exit Commodity charge

**Step 5:** Determine the volumes that attract the TO Exit Commodity charge

**Step 6:** Calculate the TO Exit Commodity charge rate

### Step 1 Determining the TO allowed revenue

This step is exactly the same as Step 1 used to calculate the TO Entry Commodity charge as shown on page 6 of this document.

### Step 2: Determining the initial target Exit Revenue

**TO exit allowed revenue**

 The initial target Exit Revenue is shown in **Table 17 (from Table 12)**

This gives the TO Exit Revenue to recover within the formula year from TO Exit Capacity charges

### Step 3: Determining the Transportation Model target Exit Revenue

When setting the Exit Capacity charges in October, the revenue figure which is entered into the Transportation model differs from the target Exit Revenue to be collected for the formula year. This is because Exit charges are set and fixed for the capacity year Octobert to Septembert+1 whereas the formula year runs from Aprilt to Marcht+1.

When setting Exit Capacity charges for Octobert the revenue recovered over the period Aprilt to Octobert (set by the previous years’ Exit Capacity charges) needs to be taken into account.

Therefore the target exit revenue to input into the model is derived from the following formula.

Transportation model target Exit Revenue =

(Initial target Exit Revenue – Forecast Exit Revenue Apr to Oct) x 2

The formula is multiplied by two as Exit charges are fixed for an entire Gas year. To recover £100m for the final 6 months, £200m needs to be entered into the Transport model as the Transportation Model calculates a daily exit charge per day for a full year Octobert to Septembert+1.

**Table 18** gives the details for the target revenue to be input into the Transportation model.

For the April 2019 commodity charges the latest view of the revenue needed to set the October 2019 Exit Capacity charges has been included in the analysis.

The Transportation Model sets both Baseline and Incremental Exit Capacity charges. Revenue from Baseline Capacity is classed as TO, whereas revenue from Incremental is classed as SO.

### Step 4: Determining the target revenue for the TO Exit Commodity charge

The TO Exit Commodity charge, which was introduced in October 2012, is a residual charge to enable National Grid to collect the correct TO Exit income from exit shippers when capacity has not been booked up to the baseline.

Once the TO Exit allowed revenue has been determined, take forecast income from baseline exit capacity from this to give the revenue to be collected though the TO Exit Commodity charge. Details are shown in **Tables 19 and 20**.

**Table 21** shows the volumes used for the prices set for the year.

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### Step 5: Determining the volumes that attract the TO Exit Commodity charge

The volumes that attract the TO Exit Commodity charge are those forecast non-storage exit flows net of shorthaul volumes i.e. the volumes that shippers have nominated to attract the Shorthaul Commodity charge.

The flow data is updated as part of the demand forecasts published in mid-May. Shippers will therefore observe different flow assumptions for indicative and final notices of the October price change to those made for the April prices.

### Step 6: Calculating the TO Exit Commodity charge rate

The TO Exit Commodity charge is collected from non-storage entry flows excluding shorthaul flows, therefore to calculate the charge rate to apply from April the following formula was used.



#### Mid-year updates to the TO Exit Commodity charge

The commercial framework allows the TO Exit Commodity charge to be revised in October. Further updates are permitted in exceptional circumstances.

When making a mid-year price update, the actual revenue collected during the year to date is deducted from the revised annual revenue, and the remaining flows for the year considered.

For example, to update prices in October the following formula is applied:



#### Forecast revenue recovery through TO Exit Commodity charge

**Table 22** shows the forecast monthly flows that will attract the TO Exit Commodity charge and the expected revenue from this charge. Data shown in red is based on actuals, other data is forecast.

If actual revenue recovered is greater than the TO entry allowance revenue then the over recovery will be dealt with first by the application of the buy-back offset mechanism, with any residual revenue credited back to entry shippers through the TO Entry Commodity charge rebate mechanism.

Any TO Exit under or over recovery will flow through into the formula year in two years’ time (with the appropriate interest adjustments made) through the NTS TO revenue adjustment term Kt which applies in that formula year.

## Part D: Charging timetable & further information

### Charging timetable

Charge changes are published by the following dates throughout the year:

|  |  |
| --- | --- |
| **Date (by)** | **Notification of…** |
| 2 November | Indicative charges to apply from following 1 April |
| 31 January | Final charges to apply from following 1 April |
| 1 May | Indicative and final Exit Capacity charges to apply from following 1 October  |
| 31 July | Final charges to apply from following 1 October |

Notices of the updates will be posted on National Grid’s industry website and on the Joint Office’s website. The updates will also be notified via the Joint Office’s email notification service.

### Further information

If you require further details about any of the information contained within this document or have any comments on how this document might be improved please contact Karin Elmhirst (01926 655540) or Dave Bayliss (01926 656853) or email the charging team at box.transmissioncapacityandcharging@nationalgrid.com.

1. In exceptional circumstances notices may be made in a time period less than 150 days such as a third price change [↑](#footnote-ref-1)