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Date: 30 October 2012

Dear colleague

RIIO-T1 (Gas): Further views sought on implementation arrangements relating to the treatment of incremental capacity and constraint management incentives

This letter considers two areas of gas transmission policy following our review of responses to questions within our Initial Proposals.[1] The areas are:

(1) Arrangements for providing incremental (extra) capacity in RIIO-T1, in particular, detail on the use of permits (tools to defer the provision of set capacity beyond required lead times) and implementation arrangements for the calculation of new revenue drivers (the basis on which extra revenue becomes available to NGGT in relation to providing extra capacity if required).

(2) The basis of the incentive arrangements for constraint management for RIIO-T1 (tools to incentivise efficient use of activities used in a range of circumstances including where insufficient capacity is available for NGGT to meet its obligations). In particular, this consults on two further modified versions of the options consulted on in Initial Proposals.

We welcome views on either or both issues. We will consider these views in taking our decision in these areas in our Final Proposals for National Grid Gas plc (NGGT) for RIIO-T1. Please submit any written comments to RIIO.T1@ofgem.gov.uk, by **Tuesday 27 November 2012**. Unless clearly marked as confidential, responses will be published on our website (www.ofgem.gov.uk).

Please contact iain.morgan@ofgem.gov.uk if you would like to discuss any of the issues set out in this letter.

Annex A sets out illustrative and draft licence drafting for special conditions GTC 131 (Permit arrangements to manage the time of delivery of incremental capacity) and GTC 120 (Entry and exit capacity constraint management). These two conditions are referred to in the other draft licence conditions being consulted on through the second informal consultation.[2]

[1] Ofgem: RIIO-T1 Initial Proposals for National Grid Electricity Transmission and National Grid Gas, Overview Document, July 2012. This and its supporting documents are available on our website at http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/RIIO%20T1%20Initial%20Proposals%20for%20NGGT%20and%20NGET%20Overview%202707212.pdf.

[2] RIIO-T1 and GD1: Draft licence conditions –Second informal licence drafting consultation, 30 October 2012 (http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/RIIOT1andGD1_2nd_licence_draft_consultation.pdf).

Background

In October 2010 we introduced RIIO (Revenue = Incentives + Innovation + Outputs), our new approach to regulating Britain's gas and electricity network companies. RIIO is designed to drive real benefits for consumers; providing network companies with strong incentives to step up and meet the challenges of delivering a low carbon, sustainable energy sector at a lower cost than would have been the case under our previous approach.

In March 2011, we set out our strategy for RIIO-T1.[3] This set out decisions on the key aspects of the regulatory framework. It also set out what we expected to see in a well-justified business plan and the criteria against which we would assess the companies' business plans.

National Grid Electricity Transmission plc (NGET) and NGGT submitted their original business plans to us at the end of July 2011, and published them on their websites.[4] Following our decision that the plans of those companies were not suitable for 'fast-tracking', and in line with the RIIO-T1 process, both companies were required to submit updated business plans by 5 March 2012. Both NGET and NGGT submitted their updated business plans on 2 March 2012.

In July 2012 we published our consultation on our Initial Proposals for NGET and NGGT. We received 36 responses to the consultation. The 33 responses that were not marked as confidential are published on our website.[5]

Arrangements for the provision of incremental capacity

Issue

NGGT's RIIO-T1 updated business plan submitted in March 2012 proposed new arrangements for the release of incremental capacity. The proposal was a response to its view of the implications of the Planning Act 2008 in England and Wales and the level of investment expected over the RIIO-T1 period. Its proposals included a lengthening of the overall process (lead times) for delivering capacity but with greater certainty over the final 24 months of delivery.

NGGT's proposals consisted of a number of elements which included new bilateral contracts and a new timetable and process for calculating revenue drivers. It became apparent on receipt of the plan that the proposals would be likely to involve changes to industry code arrangements and needed significant discussion with industry stakeholders. It also became apparent that these changes were unlikely to be implemented in time for 1 April 2013. On 1 May 2012, major industry stakeholders were being introduced to the proposals and discussing implications, including possible code changes. We know that industry stakeholders expect to have full discussions over any code changes and these discussions need to be taken forward.

What we set out in Initial Proposals

Given the clear relationship between the proposed regulatory changes and any future commercial changes, we did not consider it appropriate to make any changes to the regulatory arrangements in this area where these could prejudge industry discussion on commercial changes. We therefore set out in Initial Proposals our decision to:

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[3] Decision on strategy for the next transmission price control: RIIO-T1 – Ofgem, 31 March 2011 #46/11 http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/T1decision.pdf
[4] Links to the TOs' plans were provided in our August 2011 consultation letter which sought view on those plans http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/RIIOT1busplans.pdf
[5] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=214&refer=Networks/Trans/PriceControls/RIIO-T1/ConRes

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(1) retain the existing regulatory arrangements in this area for the start of RIIO-T1 including the time period for the release of incremental capacity

(2) provide an enhanced allowance of permits of £19m for the year from 1 April 2013 to 31 March 2014 that would enable NGGT to take longer to provide more capacity in some cases (where permits are applied to specific signals received in that year). We specifically asked for views on what level of permits (if any) should be available in the remaining years of the RIIO-T1 period.

We also set out that we expected NGGT to be proactive in taking forward further discussion with the industry on any potential commercial changes in this area.

Views of respondents to our Initial Proposals

Provision of incremental capacity

All five third party respondents who commented on this area of our Initial Proposals supported our proposal to retain the existing arrangements until appropriate changes could be brought forward through industry processes. Two respondents emphasised the importance of Ofgem actively participating in the relevant industry working groups for taking this forward.

NGGT expressed disappointment that Ofgem had not commented further on its proposed changes. It argued that the majority of its proposals could be implemented from April 2013 utilising existing commercial processes. In discussions since Initial Proposals, NGGT has responded on the proposed approach to calculate revenue drivers in the absence of its wider proposals. It set out the following order of preference for the calculation of revenue drivers:

(1) via an approved Generic Revenue Driver Methodology
(2) if option 1 is not achieved then via a table that would include revenue drivers for any entry and exit points which it has established through discussion with the industry would be likely to be required in the early years of RIIO-T1
(3) updating the existing TPCR4 revenue drivers for up to date unit cost information and adjustment to the right form for RIIO-T1.

Permits allowance

In relation to the associated permits allowance one respondent questioned whether the increased allowance of £19m was justified. Another respondent compared the proposed allowance with likely projects of different types. The same respondent noted that it would be sensible to consider any allowance that might be needed from April 2014 onwards, closer to the time when more information about possible signals for extra capacity is available.

NGGT considered that Ofgem had provided an insufficient level of permits for the first year of RIIO-T1 and that combined with the absence of caps and collars for the constraint management scheme (discussed below), this would potentially expose NGGT to open-ended risks over which it has very little control. It considered this should be reflected in its cost of capital. It also:

- argued that it should be able to overdraw on permits to protect against unlimited constraint management costs
- disagreed with splitting the permits allowance in the first year of the period between entry and exit rather than allowing NGGT the flexibility to apply the permits to whatever projects it felt appropriate (following further discussions around the proposed licence changes).

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Areas for further views to inform our Final Proposals

For the most part, we will address the policy issues raised by respondents in this area in our Final Proposals eg further consideration of any financial implications of the proposals. However, we are seeking further views through this letter on a number of specific areas where we consider points have been raised that would merit further input from stakeholders before we reach Final Proposals. These areas are as set out below.

<u>Provision of incremental capacity</u>

Our Initial Proposals required a new revenue driver to be calculated at points where NGGT thinks there is a reasonable likelihood of it being needed.

We retain the view that it is important that revenue drivers are calculated in a timely manner. Further, it is equally important that information associated with the calculation of revenue drivers is presented in a transparent way and is available for use if the need is not anticipated by NGGT.

We recognise that there are potential advantages to the introduction of a Generic Revenue Driver Methodology to the extent that it provides greater certainty on the process that will be followed in calculating revenue drivers. We are aware and welcome NGGT's engagement with industry on this topic. However, we do not at this stage have sufficient details on the specific form and content of that methodology. Further, it is critical that industry is signed up to such an approach before it takes effect. We will also consider any relevant issues from NGGT's consultation on the Generic Revenue Driver Methodology.

If a new Generic Revenue Driver Methodology can be agreed with industry and approved by the Authority in time for the start of RIIO-T1, this can be used as the basis to calculate new drivers. This is in line with option 1 highlighted by NGGT and summarised above.

However, it is possible that the Generic Revenue Driver Methodology will not be available for 1 April 2013 and in that case it remains important that revenue drivers are ready for use. At any point where NGGT thinks there is a reasonable likelihood of a signal for extra capacity being needed, it should calculate new revenue drivers. To retain workable revenue drivers in other cases (which are needed but are not anticipated by NGGT) we are also planning to retain the existing table in its licence. However, to be workable the existing annual increments will need to be adjusted to revenue drivers reflecting a total project expenditure figure. Also up to date unit cost information could also be used to inform this adjustment.

Draft licence conditions related to this are set out in our second informal consultation on licence conditions and in particular special conditions GTC3 (Determination of incremental obligated entry capacity volumes and the appropriate revenue drivers to apply) and GTC4 (Determination of incremental obligated exit capacity volumes and the appropriate revenue drivers to apply). These conditions provide drafting both for situations where the Generic Revenue Driver Methodology is available following approval by the Authority (Part E) and where this is not the case (Part D).

We seek views on the approach described above. In particular:

- Do stakeholders support the use of a Generic Revenue Driver Methodology if available?
- In the absence of this do stakeholders support the proposed approach to retain existing revenue drivers in the licence for all entry and exit points (updated as appropriate) along with new drivers being calculated by NGGT where it perceives a likelihood of the need for the drivers.

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Permits allowance

In relation to the permits allowance, there are a number of detailed implementation issues on which we sought stakeholder views through Initial Proposals and where further views might be helpful to inform our Final Proposals. These are as follows:

- Whether NGGT should be able to use the first year permits allowance of £19m flexibly against any signals for capacity, or whether there should be some limit either on how many permits can be used against entry or against exit capacity projects or a limit on how many can be used in relation to a single project?
- How we should determine the level of permits (if any) that should be available to NGGT from 1 April 2014 onwards?
- How we should identify the point at which NGGT can cash-out any unused permits?

The permits for both entry and exit are set to extend the delivery time over the required lead times for a set amount of capacity by a month for each £5,000 permit. We are concerned that allowing the £19m permits allowance for 2013-14 to be applied by NGGT freely against different types of projects might lead to a serious detrimental impact either to a single project or to a particular category of projects eg exit projects because of undue lengthening of the projects. We are interested in stakeholder views on whether the context of the Planning Act 2008 and/or other reasons mean that NGGT needs total flexibility to manage this risk. We are also interested in stakeholder views on the following options:

- limiting the level of permits that can be applied to entry and to exit projects either through:
  - allocating the £19m of permits between entry and exit based on the evidence provided by NGGT on the evidence on the likely project signals (ie the evidence that informed the £19m); or
  - a more general limitation such as only 75%[6] of permits can be used on either entry or on exit; or
- limiting the number that can be applied against any single project.

The purpose of the permits allowance in the first year is to support NGGT managing risk associated with the retention of lead times given its view of the implications of the new planning arrangements. A limit in relation to any single project would provide the greatest protection against significant lengthening of the project but would be the least flexible option. If even some of the implications of the planning changes suggested by NGGT hold, the outcome might make this approach too rigid. An alternative approach is therefore to limit the use of permits by entry and exit projects. However, we recognise that NGGT's probabilistic analysis of future projects was set against significant uncertainty. This might be a reason for considering a limit on the maximum number of permits on entry and exit that is broader based than a specific reflection of NGGT's analysis. For example, where no more than 75% of the total permits allowance for the year can be applied either to entry or to exit projects. We welcome views on this to inform our Final Proposals in this area.

The illustrative licence drafting in Annex A provides stakeholders with an illustration of how a limitation between entry and exit could be implemented based on NGGT's analysis. This is without prejudice to our Final Proposals but clearly a fully flexible condition would allow the drafting to rationalise and consolidate the entry and exit arrangements, a per project limit or the use of a 75% limit on either would need specific extra drafting.

In relation to the permits beyond 1 April 2014, one respondent stated that 'it would seem sensible to consider any allowance that might be necessary from April 2014, taking into account any signals that might have been given in the rollover year and for exit capacity in

[6] This is an example of the level that this limit might take. We would need to consider the precise level in light of consideration of NGGT's analysis of likely signals.

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the first year of the new price control period'. The level of permits we proposed in our Initial Proposals for the year 2013-14 was determined in the light of NGGT's assessment of likely projects leading to signals in that year. There is merit in incorporating similar information as it comes available about likely signals before determining the level of permits needed for the year 2014-15 (or beyond). We also recognise that setting the level ahead of this may prove unnecessary as the wider incremental capacity arrangements might be subject to change by April 2014.

We are interested in stakeholders views on whether information can be made available now that could help inform an evidence based level of permits for at least the second year of the control and potentially for the control as a whole (recognising that the uncertainty would increase with time). We are also interested in all stakeholder views on the merits of reviewing the appropriate level of permits from 1 April 2014 during the second half of 2013.

While we envisage the permit arrangements playing an important role as a risk management tool we recognise it could still also operate as an incentive and it is important for NGGT to understand when it is able to cash-out remaining permits (receiving the remaining value as a reward). This has traditionally been at the end of the control period. However, differences to consider compared to the last control are the eight year length of control period and the possible material change to incremental capacity arrangements at some point during the period. We are interested in views as to whether these reasons suggest deviating from the current approach to the cash out taking place at the end of the control.

To summarise this section we particularly welcome respondents' views on the following:

- Should we place a limit on the application of permits between entry and exit, and if so which of the above approaches would be appropriate? Should there be a limit of permits per individual project? Alternatively should there be full flexibility on how NGGT use the permits?
- Should we focus on gathering information to support permit arrangements for the whole control period? and what information is available? If not, should we consider the appropriate permits for 2014 onwards in the second half of 2013?
- Should the cash-out be at the end of RIIO-T1?

Constraint management arrangements

Issue

NGGT uses constraint management tools in various circumstances, for example when insufficient capacity is available to meet its obligations and (for incremental capacity) where no alternative capacity is available through substitution or where investments are delivered late. We incentivise the company to minimise its constraint management costs through a range of mechanisms that currently differentiate between different forms of capacity.

In its RIIO-T1 business plan NGGT proposed a unified incentive bringing together tools related to both operational and incremental buyback and related to both entry and exit capacity. Full implementation of this approach could deliver two types of benefit. Firstly, NGGT's decisions could consider the whole range of tools and make the most efficient decision informed by the incentive signals. Secondly, some types of information would no longer need to be classified differently, providing resource savings.

NGGT submitted its proposals in this area with its System Operator (SO) external incentive business plan (submitted on 31 May 2012). In its stakeholder engagement prior to submission of the proposals and since, NGGT faced many questions from industry stakeholders about the rationale for change.

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NGGT also proposed that there should be a linkage between the constraint management targets and changes through other uncertainty mechanisms.

What we set out in Initial Proposals

In Initial Proposals we consulted on two options:

(1) NGGT's proposed option of unifying the multiple existing incentive schemes into a single incentive scheme but having no caps and collars so as to fully expose NGGT to the consequences of its actions

(2) retaining the existing schemes with their own targets and cap and collar arrangements ie status quo.

Views of respondents to our Initial Proposals

Four respondents expressed concern over NGGT's proposal for a single incentive mechanism for capacity constraint management. All, at least implicitly, supported retaining the existing separate incentive schemes until a case could be made for amending the existing arrangements. Three of those respondents supported the requirement for further analysis on constraint management incentives which might give rise to alternative capacity constraint arrangements.

Two respondents noted that the 'capacity' products are all sold independently and should be managed as such. They also questioned the loss of transparency associated with the impact of bringing the arrangements together. One respondent noted that combining the incentives into one could encourage better decision making if the limitations of the current schemes could be removed but acknowledged that the impact on shippers/customers was diverse. There was some suggestion that NGGT should expand on the detail of the benefits in terms of its decision making ability if the change is made.

One respondent commented on the proposed removal of caps and collars. It noted that removing caps may incentivise NGGT to manage constraints more efficiently at all times. It noted that the suggested maximum upsides and downsides seemed reasonable but that the targets should be recalculated to establish a neutral outcome as the starting point.

NGGT continues to argue in favour of its proposal but made a number of arguments about the proposal to remove caps and collar arrangements in particular on the financeability of the proposal.

Areas for further views to inform our Final Proposals

In light of these responses we are seeking views on two modified versions of the options consulted on in Initial Proposals. These are:

(1) A more limited version of NGGT's proposal, still involving the unified incentive and removal of caps and collars (subject to possible smoothing of annual rewards/penalties) but retaining the information reporting requirements of the existing schemes for at least the first half of the RIIO-T1 period. This would retain the transparency that stakeholders seek but enable NGGT to derive benefits from more efficient decision making. It would also not rule out benefits from savings on information reporting at the middle of the RIIO-T1 period if the Authority is satisfied at that time that either the need for the existing information has lessened or that the benefits of resource savings outweigh the cost in lost information.

(2) Retaining the existing schemes but with removal of the cap and collar arrangements (subject to possible smoothing of annual rewards/penalties) to allow greater exposure to NGGT. The cap and collar arrangements on the existing schemes limit NGGT's risk significantly (including through the overarching cap across all schemes).

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Its degree of exposure is particularly important in the initial part of RIIO-T1 when NGGT argues that it will need to consider constraint management tools to a greater degree against the background of the new planning arrangements in England and Wales and the proposed retention of current lead times.

While we propose greater exposure for NGGT through changes to the cap and collar arrangements, the precise details of the cap and collar arrangements accompanying this will need to be determined as part of our Final Proposals. In doing so we are considering the financing of the whole package and the arguments that NGGT made in relation to this. One aspect of detail we are considering and would welcome any views to help inform our work is whether we should consider some smoothing of annual rewards and penalties while retaining unlimited exposure over the whole control. This could work by allowing additional costs or revenues above/below a specified annual level to be carried forward for some or all of the remaining years of the control period. Views are sought on the merits of this.

We are interested in further views on whether the constraint management targets ie the efficient level of net cost from constraint management activities, should be altered where any of the uncertainty mechanisms included as part of the RIIO-T1 proposals is triggered. An example is where incremental capacity is released. The rationale for such an adjustment is that the circumstances have changed from the modelled basis for the initial constraint management incentives. We welcome views on whether the targets should be reviewed as part of a change such as the release of incremental capacity and how this review might be carried out. In particular, should there be an automatic metric and if so what could this be? Otherwise should each case be reviewed at the time? Issues to consider include balancing a better reflection of the changes of circumstances with resource costs and possible spurious levels of accuracy.

We welcome respondents’ views in the following areas:

- What are your views on the two modified constraint management options?
- Should single year exposure be limited where the exposure to constraint management rewards or penalties are unlimited over the period?
- Should the constraint management targets be reviewed in the light of release of incremental capacity or other uncertainty mechanisms in the RIIO-T1 proposals?

Next steps

We welcome views on any aspect of the issues outlined in this open letter.

We intend to publish Final Proposals for NGET and NGGT on 17 December 2012. We will publish final licence conditions for NGGT along with the three electricity transmission owners on 21 December 2012.

We will take into consideration any responses to this letter in developing our Final Proposals.

Yours sincerely

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Annex A: Illustrative drafting for special conditions GTC 131 (Permit arrangements to manage the time of delivery of incremental capacity) (previously known as delivery incentive) and GTC 120 (Entry and exit capacity constraint management)

[GTC 131]. Special Condition [x]. Permit arrangements to manage the time of delivery of incremental capacity (previously Delivery incentive)

Introduction

131.1. The purpose of this condition is to provide arrangements for the potential use of permits by licensee in relation to the provision of incremental capacity (entry and exit). This includes the maximum level of permits available for the year 1 April 2013 – 31 March 2014 of £19m (2009-10 prices).

131.2. Part A sets out what the permits are and how they can be used.

131.3. Part B sets out the arrangements for the level of permits applicable in the first year of RIIO-T1.

131.4. [There is a separate as yet unpopulated Part C that could be adapted for later years in RIIO-T1 i.e. applicable from 1 April 2014 to 31 March 2021. This Part could contain details of dependent on consultation responses in this area and our final proposals].

Part A: Permit arrangements

131.5. This scheme shall apply, unless otherwise directed by the Authority in writing, in respect of the period [from 1 April 2013 – 31 March 2014] [from 1 April 2014 onwards – dependent on consultation responses and policy decisions].

131.6. The licensee may, with the consent of the Authority, vary the lead time for the contractual delivery of incremental obligated entry capacity at an individual NTS entry point from the default of 42 months from the first day of the month following the end of the Annual Invitation Period (as defined in the network code). Consent shall be deemed to have been granted if:

(a) the licensee is proposing to reduce the lead time for the contractual delivery to a period of less than 42 months; or

(b) the volume of firm entry capacity being deferred (in units of GWh per day for each one month period) is, at day n, less than the licensee's "entry lead time [permit entitlement]" $LTDVEn_n$ defined in paragraph 131.10 of this condition.

131.7. The licensee shall notify the Authority in writing and in a timely manner of each instance where it varies the lead time for the contractual delivery of incremental obligated entry capacity from the NTS entry capacity release default lead time, specifying:

(a) The NTS entry point affected;

(a) The volume of capacity (in units of GWh per day) for which the contractual delivery date is being brought forward; or

(b) The volume of capacity (in units of GWh per day) for which the contractual delivery date is being put back.

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131.8. The licensee may, with the consent of the Authority, vary the lead time for the contractual delivery of NTS obligated incremental exit flat capacity at an individual exit point from the NTS exit flat release default lead time. Consent shall be deemed to have been granted if:

(a) the licensee is proposing to reduce the lead time for the contractual delivery to a period of less than the NTS exit flat release default lead time; or

(b) if the volume of NTS exit capacity being deferred (in units of GWh per day) is at day n, less than the licensee's "exit lead time deferment volume entitlement" $LTDVEx_{n)}$ defined in paragraph [131.11]

131.9. The licensee shall notify the Authority in writing and in a timely manner of each instance where it varies the lead time for the contractual delivery of NTS incremental exit flat capacity from the NTS exit flat release default lead time specifying:

(a) The NTS exit point affected;

(b) The volume of capacity (in units of GWh per day) for which the contractual delivery date is being brought forward; or

(c) The volume of capacity (in units of GWh per day) for which the contractual delivery date is being put back.

Part B: Level of permits arrangements (1 April 2013 – 31 March 2014)

131.10. The licensee's entry lead time [permit entitlement] on day n ($LTDVEn_n$) (in units of GWh per day for each one month period) shall be calculated in accordance with the following formula:

$$LTDVEn_n = [pae^7] + \sum_{v,n-1} DLTDVEn_v$$

where:

DLTDVEn	means the change in the lead time for contractual delivery (in units of GWh per day for each one month period) that arises from the variation event v as notified to the Authority pursuant to paragraph [131.9] of this condition. For the avoidance of doubt, where v=0 DLTDVEn0 shall take the value zero; and
v	means the relevant variation event, where v=1 shall mean the first variation event notified to the Authority pursuant to paragraph [x] of this condition.

131.11. The licensee's exit lead time deferment volume entitlement on day n ($LTDVEx_{n)}$ in units of GWh per day) shall be calculated in accordance with the following formula:

$$LTDVEx_n = [pax] + \sum_{v,n-1} DLTDVEx_v$$

where:

[7] This and other numbers in square brackets would be derived from a fixed allocation of permits between entry and exit based on the same analysis as used to derive the £19m.

DLTDVExv	means the change in the lead time for contractual delivery that arises from the variation event v and notified to the Authority under paragraph [131.11] of this condition);
V	means the indexation of each variation pursuant to paragraph [131.12] of this condition; and
DLTDVExv	shall, where there have been no variations to the lead time for contractual delivery (v=0), take the value zero (0).

131.12. In the Formula Year commencing 1 April 2013 it shall be calculated in accordance with the following formula:

DELINCt [a term in GTC20] =R LTDVEn + RLTDVEx

where:

RLTDVEn = MIN[(ROLTDVEnend x £5000),([£ pae[8]]* RPIFt)];

where:

ROLTDVEnend	means the value of ROLTDVEnn (in GWh per day for each one month period) where day n is [31 March 2021]

RLTDVEx = MIN[(ROLTDVExend x £5000),([£pav[9]]* RPIFt)];

where:

ROLTDVExend	means the value of ROLTDVExn (in GWh per day) where day n is [31 March 2021].

Part C: Level of permits arrangements (from 1 April 2014)

[To be considered in light of responses to this letter]

[GTC120] Special Condition [x]. Entry and exit capacity constraint management

Introduction

120.1 The purpose of this condition is to calculate the value of the entry and exit capacity Constraint Management allowed revenue (CMt). This is the sum of the costs relating to constraint management and the incentive revenue from the application of the incentive scheme.

[8] This would be the value derived from the allocation of permits to entry based again on NGGT's analysis of likely project signals.
[9] This would be the value derived from the allocation of permits to exit based again on NGGT's analysis of likely project signals.

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120.2 Part A sets out the impact of these arrangements on allowed revenue.

120.3 Part B provides the basis for the calculation of constraint management related costs

120.4 Part C provides the basis for the calculation of constraint management incentive revenues

120.5 Part D brings the above costs and revenues together in the performance mechanism

120.6 Part E and Part F derive and allow for changes to the annual constraint management targets

120.7 The effect of the application of the CMt term derived in accordance with this condition is to adjust the SO Output Incentive Revenue (SOOIRt) in order to reflect the performance of the licensee in relation to its management of constraints on the NTS.

Part A: Formula for the Constraint Management allowed revenue (CMt)

120.8 For the purposes of [Part E] of Special Condition [GTC 7] (Restriction of NTS System Operation Revenue) the CMt term shall be derived in accordance with the following formula:

$$CMt = (CMC_{t-2} + CMIR_{t-2}) \times PVF_{t-2} \times PVF_{t-1} \times RPIF_t$$

where:

CMCt	means the costs, as defined in Part B of this condition, incurred by the licensee in respect of Formula Year t in respect of entry and exit capacity constraint management; and
CMIRt	means the incentive revenue, as defined in Part C of this condition, incurred by the licensee in respect of Formula Year t in respect of entry and exit capacity constraint management.
PVF_t	is the present value adjustment term as defined in Part D of [GTC 20] Special Condition [x] (Restriction of NTS Transportation Owner Revenue).
$RPIF_t$	has the value given to it by Part D of [GTC20].

Part B: Formula for the Constraint Management costs (CMCt)

120.9 CMC_{t-2} means the costs incurred by the licensee in respect of Formula Year $_{t-2}$ in respect of entry and exit capacity constraint management derived in accordance with the following formula:

$$CMC_{t-2} = \sum_{d|y(d)=t} BBCd_{,t-2} + \sum_{d|y(d)=t} ECCCd_{,t-2} + \sum_{d|y(d)=t} ExROd_{,t-2} + \sum_{d|y(d)=t} ExCCd_{,t-2} / RPIA_{t-2}$$

where:

CMC_{t-2}	means the licensee's allowance in Formula Year t-2 for constraint management cost as set out in Appendix 1.

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$BBCd_{,t-2}$	means the costs incurred by the licensee in respect of any constraint management taken in relation to entry capacity in respect of day d of Formula Year $_{t-2}$(including those related to capacity management relating to the surrender of firm entry capacity).
$ECCCd_{,t-2}$	means the costs incurred by the licensee in respect of any payments made by the licensee to gas shippers in exchange for agreeing to offtake gas from the NTS at the licensee's request on day d in respect of Formula Year t-2 and in respect of any costs incurred by the licensee undertaking any other commercial or physical action to manage entry capacity excluding those covered by BBCd,t including any locational buy actions.
$ExROd_{,t-2}$	means the costs incurred by the licensee in respect of accepted NTS offtake reduction offers in respect of day d of Formula Year t.
$ExCCd_{,t-2}$	means the costs incurred by the licensee in respect of any NTS exit capacity constraint management taken in respect of day d of Formula Year t-2 (including those related to Exit Constraint Management Actions and NTS Exit Capacity (Flat) surrender charges) and in respect of any costs incurred by the licensee undertaking any other commercial or physical action to manage exit capacity excluding those covered by ExROd,t.
$RPIA_{t-2}$	has the value given to it by Part D of [GTC20].

Part C: Formula for the Constraint Management incentive revenue (CMIRt)

120.10 CMIRt means the incentive revenue earned by the licensee in Formula Year t-2 in respect of entry and exit capacity constraint management derived in accordance with the following:

$$CMIR_t = CMSF \times \left(CMTC_{t-2} - \frac{CMIP_{t-2}}{RPIA_{t-2}} \right)$$

Where :

CMIRt = CMSF x ((CMTCt x RPIFt) – CMIPt)

where:

$CMIP_{t-2}$	means the constraint management performance measure in respect of Formula Year t-2 and shall be defined in accordance with Part D of this

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condition

$CMTC_{t-2}$	means the constraint management target cost in respect of Formula Year t-2 and shall be defined in accordance with Part E of this condition;
$RPIF_{t-2}$	has the value given to it by Part D of [GTC20].
CMSF	means the constraint management sharing factor and shall take the value of [40% or 50% - to be aligned with TIM efficiency rate]

Part D: Formula for the Constraint Management performance measure ($CMIP_{t-2}$)

120.11 For the purposes of Part C of this condition, the constraint management performance measure in respect of Formula Year t (CMIPt) shall be derived in accordance with the following formula:

$$CMIP_{t-2} = CMC_{t-2} – RODEC_{t-2} – RIEC_{t-2} – RNOEC_{t-2} – RCOR_{t-2} – RLOC_{t-2} – ROPExC_{t-2} – RNOExC_{t-2} – RExUNC_{t-2} - RADD_{t-2}$$

120.12 where:

CMC_{t-2}	shall have the meaning given to that term in Part B of this condition
$RODEC_{t-2}$	means revenue derived by the licensee in respect of Formula Year t-2 from on the day sales of Obligated Entry Capacity [to be defined in GTC19]
$RIEC_{t-2}$	means revenue derived by the licensee in respect of Formula Year t-2 from the sale of interruptible entry capacity [to be defined in GTC19];
$RNOEC_{t-2}$	means the revenue derived by the licensee in respect of Formula Year t-2 from sales of non obligated entry capacity as defined in paragraph [to be defined in GTC19];
$RCOR_{t-2}$	means the revenue derived by the licensee in respect of Formula Year t-2 from system entry overrun charges and NTS Exit (Flat) Overrun charges (both having the meaning given in the network code);
$RLOC_{t-2}$	means the revenue derived by the licensee in respect of Formula Year t-2 from locational sell actions and physical renomination incentive charges (having the meaning given to that term in the network code);
$ROPExC_{t-2}$	means the revenue derived by the licensee in respect of Formula Year t-2 from the sale of NTS off peak exit capacity [to be defined in GTC19] ;
$RNOExC_{t-2}$	means the revenue derived by the licensee in respect of Formula Year t-2 from the sale of NTS

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	non-obligated exit capacity [to be defined in GTC19];
$RExUNC_{t-2}$	means the revenue that users are liable to reimburse to the licensee in relation to an NTS Exit Point in accordance with the network code; and
$RADD_{t-2}$	means any further revenues derived by the licensee in respect of Formula Year t-2 that the Authority has directed to include in the formula for the constraint management performance measure ($CMIP_{t-2}$).

Part E: Formula for the Constraint Management target (CMTCt)

120.13 For the purposes of Part C of this condition, $CMTC_{t-2}$ means the constraint management target cost in respect of Formula Year $_{t-2}$ and shall be derived in accordance with the following formula:

$$CMTC_{t-2} = CMBT_{t-2} + CMDT_{t-2}$$

120.14 where:

$CMBT_{t-2}$	means the constraint management base target in respect of Formula Year t-2 as specified in the table in Appendix 2; and
$CMDT_{t-2}$	means the variation to the constraint management target (which could be positive or negative) and shall be such value (or values) as shall be determined in accordance with Part F of this condition. Such value (or values) shall be deemed to be incorporated in the table set out in Appendix 2.

Part F: Determination of the variation to the Constraint Management target (CMDTt-2)

120.15 For the purposes of Part E of this condition, CMDTt-2 means the variation to the constraint management target in respect of Formula Year t-2 from time to time determined by the Authority following an application by the licensee under this Part F.

120.16 The licensee shall make an application in writing to the Authority setting out its proposal for CMDTt-2, which relates to a variation in the constraint management target arising from the application of the uncertainty mechanisms set out in any one of [the following conditions:

(d) Incremental Entry capacity (defined GTC 3)

(e) Incremental Exit capacity (defiend GTC 4)

(f) One-off Asset Health Costs (defined GTC 28)

(g) Industrial Emissions Costs (defined GTC 28)

120.17 Where the licensee makes an application pursuant to paragraph 120.11 of this condition it shall include, in sufficient detail to enable the Authority to decide whether the licensee

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should implement the proposal in accordance with paragraph 120.14 of this condition, the following:

(h) the uncertainty mechanism that has triggered the value for CMDTt-2;

(i) the evidence to support the licensee's proposal;

(j) the date from which the variation to the constraint management target would apply and, where relevant, the date to which it would apply; and

(k) the value that the CMDTt term should take in each relevant formula year.

120.18 The licensee shall keep a record of each application made pursuant to paragraph 120.9 of this condition.

120.19 The licensee shall provide the Authority with such additional information as the Authority reasonably requests for the purposes of considering the application made by the licensee.

120.20 The licensee shall implement the proposal as set out within the written application made pursuant to paragraph 120.9 of this condition or as modified in accordance with paragraph 120.14 of this condition, unless:

(l) the Authority has, within 7 days from the receipt by the Authority of the written application, notified the licensee in writing, on or before that date, to suspend implementation of the proposal because in its opinion the application made pursuant to paragraph 120.9 of this condition requires further consideration to evaluate whether the proposal, and the supporting information, is consistent with the licensee's duties under the Act and the standard, Standard Special and Special Conditions; and

(m) the Authority has, within 28 days from the receipt by the Authority of the written application, directed the licensee, on or before that date, not to implement that proposal.

120.21 Where the Authority has notified the licensee in writing to suspend implementation of the proposal in accordance with paragraph 120.14 of this condition:

(n) the Authority may direct the licensee, within 28 days from the receipt by the Authority of the written application, to implement the proposal in accordance with the application made pursuant to paragraph 120.9 of this condition; or

(o) the Authority may direct the licensee, within 28 days from the receipt by the Authority of the written application, to implement the proposal in a modified form, subject to the agreement of the licensee, where such modifications relate to:

  (i) the value of $CMDT_{t-2}$; and
  (ii) the date from which the value of $CMDT_{t-2}$applies.

120.22 The licensee may withdraw a proposal made pursuant to paragraph 120.9 of this condition within 7 days from receipt by the Authority of the application.

120.23 Where the Authority has notified the licensee under paragraph 120.13(i) of this condition to suspend implementation of the proposal made pursuant to paragraph 120.9 of this condition, the licensee may withdraw such a proposal within 28 days from receipt by the Authority of the application unless the Authority has otherwise directed the licensee to implement the proposal in accordance with paragraph 120.15 of this condition.

Appendix 1: Constraint management cost allowance (£m 2009/10 values)

2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
[x]	[x]	[x]	[x]	[x]	[x]	[x]	[x]

Appendix 2: Constraint Management Targets

2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
[x]	[x]	[x]	[x]	[x]	[x]	[x]	[x]

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