

**Review of the Income Adjusting Event  
provisions in NGC's transmission licence  
and Transco's Gas Transporter licences**

**Consultation under section 11(2) of the  
Electricity Act 1989 and section 23(3) of the  
Gas Act 1986**

November 2004

## Summary

This document sets out the proposed revisions to National Grid Company plc's (NGC) transmission licence and Transco's Gas Transporter (GT) licences<sup>1</sup> designed to accommodate proposed changes to the Income Adjusting Event (IAE) provisions of their respective System Operator (SO) incentive arrangements. The licence modifications that form the subject of this statutory licence consultation document are intended to improve transparency of the IAE process and the overall effectiveness of the IAE provisions. Customers<sup>2</sup> and market participants have expressed some concern about these aspects of the current arrangements. The proposed modifications are in response to these concerns.

### ***Background***

NGC and Transco have in place commercial incentive schemes to carry out the day-to-day operation of their respective transmission systems in an economic, efficient and co-ordinated manner. These schemes have been effective in reducing the costs of system operation over time. This benefits customers as they ultimately pay these costs.

Both SOs are allowed to recover the costs of operating their systems, adjusted by an incentive receipt or payment determined by their performance relative to pre-defined cost targets. If the companies out-perform the targets, they receive payments, if they under-perform, they make payments. NGC and Transco can ask for their SO revenues to be adjusted through the IAE provisions in the transmission licence and the GT licences respectively. These provisions are in place to provide protection for the SOs and customers when an unexpected event occurs for which no allowance was made at the time the relevant incentive schemes were set.

<sup>1</sup> As part of the proposed disposal of Transco's Distribution Networks (DNs), Ofgem granted Transco five additional gas transporter (GT) licences for the purpose of accommodating four independent gas DNs and Transco's retained DNs, in the event that the Authority were to consent to any such disposal of DN assets occurring. The GT licences are identical to Transco's current GT licence, and it is intended that the changes proposed in this document will apply to all six of Transco's existing GT licences. For more information on DN sales, please visit the DN sales section of Ofgem's website at:

<http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/gasdistributionnetworksale>

<sup>2</sup> This includes both industrial and commercial and domestic customers, who ultimately pay for the costs of system operation.

## ***Income adjusting events***

To date, only NGC has utilised its IAE provisions, and has done so on two separate occasions<sup>3</sup>. During the consultation process for the first IAE, raised by NGC in March 2003, market participants said that the information made available by NGC was insufficient to assess whether the proposed IAE should be approved. In its June 2003 decision document<sup>4</sup> on this IAE, Ofgem stated that it considered that there was scope for enhancing the IAE provisions in terms of transparency and the information provided by the person giving notice of a proposed IAE.

In April 2004, NGC gave notice to Ofgem that it considered a second IAE had occurred. Ofgem took initial steps to address the issues that were raised by respondents to the previous IAE, by publishing this notice on Ofgem's website<sup>5</sup>, following consultation with the licensee. In its May 2004 initial consultation document on the second IAE, Ofgem considered that the experience gained by Ofgem, NGC and market participants during the progression of the first proposed IAE offered valuable insight into how the IAE process could be improved. Ofgem highlighted a number of areas where it considered the IAE process could be improved. In addition to Ofgem's informal commitment to place notices of proposed IAEs on its website, Ofgem outlined its intention to modify the IAE provisions in both NGC's transmission licence and Transco's GT licence<sup>6</sup>, and provided an indication of the types of modifications that Ofgem considered may enhance the IAE provisions.

## ***Enhancements to the Income Adjusting Event provisions***

Following careful consideration of the views of the industry in response to the IAE consultation documents, Ofgem has developed proposed changes to the IAE process in relation to a number of areas. In particular Ofgem has proposed changes that would:

- ◆ provide a more detailed explanation of the reasons why an IAE has been raised;

<sup>3</sup> For more details, see "Proposed income adjusting events" in the introduction to this document.

<sup>4</sup> See 'Income adjusting event under NGC's 2002/03 system operator incentive scheme: A decision document', Ofgem, June 2003. This document can be found at the following address: [http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/3775\\_Drax\\_IAE\\_DecisionvFINAL1.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/3775_Drax_IAE_DecisionvFINAL1.pdf)

<sup>5</sup> See: [www.ofgem.gov.uk](http://www.ofgem.gov.uk)

<sup>6</sup> This consultation process pre-dates the DN sales project.

- ◆ provide a more detailed explanation of the method of calculating the proposed value of the IAE;
- ◆ create a requirement to provide supporting information that is sufficient to enable both Ofgem and market participants to fully assess the IAE;
- ◆ ensure that the notice of a proposed IAE is made publicly available;
- ◆ target any consultation on a proposed IAE to market participants who are directly affected by the proposed event;
- ◆ prevent an automatic allowed income adjustment equal to the proposed value of the IAE if an Authority decision has not been issued within three months, where the Authority considers that supporting evidence provided is insufficient to enable the Authority and market participants to fully assess the IAE to which the information relates;
- ◆ amend the ability to revoke an IAE with the consent of the licensee should information subsequently come to light that could affect the Authority's decision; and
- ◆ disapply the threshold amount from applying to network gas supply emergencies in the GT licences.

In addition to these changes, Ofgem has made some minor housekeeping changes.

As mentioned in the May 2004 consultation, Ofgem considers that, due to the similarity of the drafting relating to the IAE provisions in NGC's transmission licence and Transco's GT licences, it would be appropriate to extend the proposed revisions to both NGC's and Transco's licences<sup>7</sup>.

<sup>7</sup> Disapplying the threshold from network gas supply emergencies is analogous to disapplying the threshold from security periods, which is already the case in the existing transmission licence.

## ***Way forward***

This document constitutes statutory notice of Ofgem's intention to modify NGC's transmission licence under section 11 of the Electricity Act 1989 and Transco's GT licences under section 23 of the Gas Act 1986.

The statutory notice provisions contained in section 11 of the Electricity Act 1989 and section 23 of the Gas Act 1986 specify a period of 28 days during which interested parties can make representations or objections to the proposed licence modification, following which, revisions to the proposed licence modification will be made if they are considered appropriate. Responses should be submitted in writing by 23 December 2004.

If NGC and Transco consent, Ofgem intends, subject to any representations made during the consultation, to direct the modification of NGC's transmission licence and Transco's GT licences in line with the proposed licence modifications. If NGC and/or Transco do not consent to the proposed licence modifications, Ofgem has the ability to refer the proposed licence modifications to the Competition Commission for final adjudication.

This document is published in conjunction with a statutory licence consultation issued under section 23 of the Gas Act pursuant to Ofgem's Distribution Network (DN) sales project, in which a number of licence modifications to Transco's original GT licence and five replica GT licences issued to Transco on 5 November 2004 to accommodate a potential sale, are being consulted upon. These changes are intended to facilitate the licence regime required to support a divested industry structure post any DN sales, should the Authority provide its consent to such a transaction occurring.

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# 1. Introduction

## *Purpose of this document*

- 1.1. This document outlines the Income Adjusting Event (IAE) provisions in National Grid Company plc's (NGC) transmission licence and Transco's Gas Transporter (GT) licences, the circumstances that have led to Ofgem considering that a review of these provisions is desirable and Ofgem's proposed enhancements to the provisions contained within NGC's transmission licence and Transco's GT licences.

## *Background*

- 1.2. NGC's system operator (SO) incentive scheme is designed to provide it with financial incentives to operate the England and Wales<sup>8</sup> electricity transmission system in an economic, efficient and co-ordinated manner. This is in the interest of consumers who ultimately pay for the costs of system operation.
- 1.3. Under the external SO incentive schemes<sup>9</sup> that have been in place since 27 March 2001, NGC is allowed to recover the actual costs of electricity balancing and system balancing<sup>10</sup>, adjusted by incentive payments or receipts relating to these costs. The value of any incentive payment or receipt depends upon the level of NGC's Incentivised Balancing Costs (IBC) at the end of the incentive period in relation to a cost target for the balancing services activity (MT) that is set in advance by Ofgem following consultation with market participants. The components of NGC's IBC are outlined in Appendix 5.

<sup>8</sup> The Energy Bill received Royal Assent on 22 July 2004, thereby formally establishing the legal framework for the British Electricity Transmission and Trading Arrangements (BETTA) that are intended to go-live on 1 April 2005. At the same time as the legal framework for BETTA was being put in place, on 23 August 2004, Stephen Timms, then the Energy Minister, confirmed the appointment of NGC as GB system operator. The changes to the IAE provisions outlined in this document will be extended to apply GB wide.

<sup>9</sup> NGC's external SO incentive scheme focuses on NGC's costs of operating the existing transmission system and balancing overall supply and demand (i.e. the costs to NGC of purchasing balancing services from generators, suppliers and large customers).

<sup>10</sup> In its role as SO, NGC is responsible for the residual purchasing and selling of electricity to keep the transmission system in balance in real time ("electricity balancing"). The SO is also responsible for ensuring that the system remains within safe operating limits and that the pattern of generation and demand is consistent with any system transmission related constraints ("system balancing").

- 1.4. Adjustments can be made to NGC's IBC, via the IAE provisions in order to take account of any costs incurred or savings made as a result of an event for which no allowance was made when setting the SO incentive scheme parameters. The IAE provisions provide protection for both NGC and customers in the event that an incident results in costs or savings which were not envisaged at the time that the SO incentive parameters were defined.
- 1.5. Similarly, Transco's National Transmission System (NTS) SO incentive scheme provides a number of incentives for Transco to carry out the day-to-day role of operating the NTS economically and efficiently. Transco is allowed to recover the costs of operating the system adjusted by incentive payments or receipts relating to these costs. The value of these payments or receipts depend upon the value of the NTS system operation revenue (SOR) at the end of the incentive period in relation to a cost target for the maximum NTS system operation revenue (SOMR) that is set in advance by Ofgem following consultation with market participants.
- 1.6. As in the case with NGC's IBC, Transco's SOMR can be adjusted in order to take account of any costs incurred or savings made arising from events or circumstances that were not envisaged at the time the NTS SO incentive scheme was set. The IAE provisions provide protection for both Transco and customers in the event that an incident results in costs or savings which were not envisaged at the time that the NTS SO incentive parameters were defined. To date however, the IAE provisions in Transco's GT licences have not been utilised. Therefore, this document will focus mainly on the practical experience gained through the use of the IAE provisions contained within NGC's transmission licence.
- 1.7. The mechanism by which Transco's operating costs are altered by an IAE is slightly different to the mechanism contained within NGC's transmission licence. Under the terms of Transco's GT licences, if the value of the NTS system operation costs (SOIC) is affected by an IAE, then the adjustment is applied to SOMR – the equivalent of NGC's target for the balancing services activity – rather than the actual value of costs incurred, as would be the case under NGC's transmission licence. However, this subtle difference in the mechanism does not alter the overall impact of the IAE provisions.

## ***Proposed income adjusting events***

- 1.8. In June 2003, Ofgem<sup>11</sup> issued its decision in respect of the first IAE to be proposed within NGC's SO incentive scheme. In its decision document<sup>12</sup>, Ofgem stated that the experience gained by Ofgem, NGC and market participants during the progression of the first proposed IAE offered valuable insight into how the IAE process could be enhanced and improved. Ofgem outlined its intention to review the IAE provisions within NGC's transmission licence in order to identify and evaluate possible enhancements to the IAE process.
- 1.9. On 7 April 2004, NGC gave notice to Ofgem that it considered that an IAE had occurred under the 2003/04 SO incentive scheme. In May 2004, Ofgem published its initial consultation document<sup>13</sup> relating to this IAE. In this document, Ofgem stated that it had reviewed the existing IAE provisions within NGC's transmission licence and had developed proposed revisions which it considered would improve the operation of these provisions. In addition to consulting upon the treatment of the proposed IAE to which the May 2004 consultation relates, Ofgem sought views from interested parties in relation to the proposed revisions. Ofgem also expressed its intention to develop equivalent revisions to the existing drafting of Transco's GT licences, which largely mirrors the provisions in NGC's transmission licence.
- 1.10. This document outlines proposed revisions to the IAE provisions within NGC's transmission licence and Transco's GT licences that Ofgem considers are appropriate following its review of the respective IAE provisions and describes Ofgem's reasons for proposing these revisions. This document also constitutes

<sup>11</sup> Ofgem is the office of the Authority. The terms "Ofgem" and "Authority" are used interchangeably in this document.

<sup>12</sup> See 'Income adjusting event under NGC's 2002/03 system operator incentive scheme: A decision document', Ofgem, June 2003. This document can be found at the following address:  
[http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/3775\\_Drax\\_IAE\\_DecisionvFINAL1.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/3775_Drax_IAE_DecisionvFINAL1.pdf)

<sup>13</sup> See 'Income adjusting event under National Grid Company's 2003/04 system operator incentive scheme: a consultation document', May 2004. This document can be found at the following address:  
[http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/7218\\_10804.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/7218_10804.pdf)

statutory notice of proposed modifications to NGC's transmission licence<sup>14</sup> and Transco's GT licences<sup>15</sup>. These proposals are intended to enhance and improve the IAE process.

1.11. Ofgem's proposed revisions are intended to:

- ◆ provide a more detailed explanation of the reasons why an IAE has been raised;
- ◆ provide a more detailed explanation of the method of calculating the proposed value of the IAE;
- ◆ create a requirement to provide supporting information that is sufficient to enable both Ofgem and market participants to fully assess the IAE;
- ◆ ensure that the notice of a proposed IAE is made publicly available;
- ◆ target any consultation on a proposed IAE to market participants who are directly affected by the proposed event;
- ◆ prevent an automatic allowed income adjustment equal to the proposed value of the IAE if an Authority decision has not been issued within three months, where the Authority considers that supporting evidence provided is insufficient to enable the Authority and market participants to fully assess the IAE to which the information relates;
- ◆ amend the ability to revoke an IAE with the consent of the licensee should information subsequently come to light that could affect the Authority's decision;
- ◆ disapply the threshold amount from applying to network gas supply emergencies in the GT licences; and
- ◆ make minor housekeeping changes.

<sup>14</sup> Appendix 1 contains a statutory notice in respect of the modifications to NGC's transmission licence.

<sup>15</sup> Appendix 2 contains a statutory notice in respect of the modifications to Transco's GT licences.

## ***The way forward***

- 1.12. Revising the IAE provisions requires modification of NGC's transmission licence and Transco's GT licences. In order to amend NGC's transmission licence and Transco's GT licences, statutory notices of the proposed licence modifications are required under section 11 of the Electricity Act 1989 and section 23 of the Gas Act 1986.
- 1.13. Both the statutory notices under section 11 of the Electricity Act 1989 and section 23 of the Gas Act 1986 specify a period of 28 days during which interested parties can make representations or objections to the proposed licence modification, following which, revisions to the proposed licence modification will be made if it is considered appropriate.
- 1.14. Following Ofgem's consideration of responses to this consultation and if NGC and Transco provide their written consent to the proposed modifications, Ofgem expects to direct the modification of NGC's transmission licence and Transco's GT licences in line with the proposed licence modifications (amended following consideration of respondents' views if appropriate).
- 1.15. This document is published in conjunction with a statutory licence consultation issued under section 23 of the Gas Act pursuant to Ofgem's Distribution Network (DN) sales project, in which a number of licence modifications to Transco's original GT licence and five replica GT licences issued to Transco on 5 November 2004 to accommodate a potential sale, are being consulted upon. These changes are intended to facilitate the licence regime required to support a divested industry structure post any DN sales, should the Authority provide its consent to such a transaction occurring.
- 1.16. If you wish to discuss any aspect of this document, please contact any of the following people who will be pleased to help:
- ◆ David Hunt – telephone number: 020 7901 7429, fax number: 020 7901 7189, email: [david.hunt@ofgem.gov.uk](mailto:david.hunt@ofgem.gov.uk)
  - ◆ Simon Bradbury – telephone number 020 7901 7249, fax number 020 7901 7189, email: [simon.bradbury@ofgem.gov.uk](mailto:simon.bradbury@ofgem.gov.uk)

## ***Outline of this document***

- 1.17. In detail, this document is structured as follows. Chapter 2 provides the rationale of why the changes outlined in this document are considered desirable by Ofgem. Chapter 3 provides a detailed explanation of the proposed revisions to NGC's transmission licence and Transco's GT licence. Chapter 4 discusses the statutory notices of proposals for modification of NGC's transmission licence and Transco's GT licences.
- 1.18. The electricity transmission licence statutory notice and proposed licence drafting is contained within Appendix 1. Appendix 2 contains the Gas Transporter licences statutory notice and proposed licence drafting. Appendix 3 contains the current version of the IAE provisions in NGC's transmission licence. Appendix 4 contains the current version of the IAE provisions in Transco's GT licences. Appendix 5 contains a breakdown of NGC's Incentivised Balancing Cost (IBC) components. Appendix 6 contains a breakdown of Transco's NTS system operation revenue (SOR). Appendix 7 contains a breakdown of Transco's maximum NTS system operation revenue (SOMR). Appendix 8 contains a summary of those parts of the regulatory framework relevant to the proposed modifications.

## 2. Rationale

### ***Issue***

- 2.1. Ofgem considers that the experience gained by Ofgem, NGC and market participants during the progression of the two IAEs raised by NGC offered valuable insight into how the IAE process can be enhanced and improved. Ofgem considers that where it is appropriate to do so, any such enhancements and improvements to the IAE provisions should be made and applied to both NGC's transmission licence and Transco's GT licences.

### ***Objective***

- 2.2. Ofgem has reviewed the existing IAE provisions within NGC's transmission licence and Transco's GT licences and has developed proposals which it considers enhance these provisions. In this document, Ofgem is seeking views on the proposed revisions to the existing IAE provisions that it has developed. This document, including the formal notice under section 11(2) of the Electricity Act 1989 and the formal notice under section 23(3) of the Gas Act 1986, constitutes the consultation process to seek interested parties' views concerning modifications to the IAE provisions contained within paragraphs 10 to 12 inclusive of special condition AA5A of NGC's transmission licence and paragraph 14(11) of special condition 28B of Transco's GT licences.

### ***Policy***

- 2.3. Ofgem considers that the proposed revisions to the IAE provisions should, in particular, enhance the transparency surrounding any proposed IAEs in the future and clarify the process associated with the progression of proposed IAEs.
- 2.4. Ofgem will consider respondents' views in relation to the proposed revisions and will make any further amendments to the proposed revisions as considered appropriate following this assessment of views. Ofgem would then expect to direct the modification of NGC's transmission licence and Transco's GT licences

in line with the proposed revisions (amended following consideration of respondents' views if appropriate).

### 3. Suggested modifications to the income adjusting event licence drafting

#### *Introduction*

- 3.1. In response to the comments made by the industry to the May 2003 consultation on the first IAE raised by NGC, Ofgem outlined its intention to review the provisions relating to IAEs in NGC's transmission licence in Ofgem's June 2003 decision document<sup>16</sup>. This document represents the first step in the IAE review process.
- 3.2. In April 2004, NGC gave notice to Ofgem that it considered that an IAE had occurred. The notice related to the Supplemental Standing Reserve Tender (SSRT) that NGC undertook ahead of Winter 2003/04. In order to carry through Ofgem's intentions of enhancing the transparency of the IAE process, this notice was published on Ofgem's website, with the consent of the licensee. In May 2004, Ofgem published a consultation document (the May 2004 consultation)<sup>17</sup>, which not only sought views as to how the IAE should be treated, but also provided some suggested drafting amendments to NGC's transmission licence special condition AA5A.
- 3.3. The suggested revisions to the IAE provisions were designed to address concerns expressed by the industry following the progression of the first IAE. Respondents to the May 2003 consultation were particularly interested in ensuring that any information asymmetries between the SO and the rest of the industry were reduced. These respondents considered that, as it was likely that only the SO would be able to raise an IAE due to its informational advantage, steps should be taken to ensure that the industry was not at a disadvantage when assessing the value of the IAE, whether an IAE meets the prescribed criteria, and if so, whether it should be approved.

<sup>16</sup> See: [http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/3775\\_Drax\\_IAE\\_DecisionvFINAL1.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/3775_Drax_IAE_DecisionvFINAL1.pdf)

<sup>17</sup> See: [http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/7765\\_15304\\_income\\_adjusting.pdf](http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/7765_15304_income_adjusting.pdf)

- 3.4. Respondents to the May 2004 consultation were, on the whole, supportive of the proposed revisions tabled by Ofgem. In addition to addressing issues regarding information asymmetry, Ofgem undertook a broader review to assess whether, and where, improvements could be made to afford relevant parties with better protection when an IAE occurs.
- 3.5. This chapter outlines the proposed revisions to NGC's transmission licence and Transco's GT licences that Ofgem considers are appropriate following its review of the existing IAE provisions contained therein. The main revisions are described below. In addition, there are some changes of a housekeeping nature. The full revised drafting of NGC's transmission licence and Transco's GT licences is contained in Appendix 1 and Appendix 2 respectively.

### ***Details contained within a proposed income adjusting event notice***

- 3.6. Under the current IAE provisions, an IAE notice must give details of:
- ◆ the event to which the notice relates;
  - ◆ the amount of costs and/or expenses considered to have been caused or saved by the event and the method of calculating such costs and/or expenses; and
  - ◆ the amount of proposed income adjustment as a consequence of the event.
- 3.7. Ofgem considers that, in order to enhance the transparency of the IAE process, it is appropriate to require additional relevant information to be supplied in any notice of a proposed IAE. Ofgem considers that as additional requirements a notice should:
- ◆ outline the reason(s) why the party submitting the notice considers the event to be an IAE;

- ◆ outline the method used to calculate the proposed income adjustment<sup>18</sup>;
- ◆ provide supporting analysis which is considered by the party submitting the notice to be sufficient to enable both Ofgem and market participants to assess the proposed IAE. Ofgem would have the ability to request that the supporting analysis be supplemented with additional information that it considers appropriate for the assessment of the event. Ofgem considers that this additional requirement should not in any way serve to limit its ability to request and make use of confidential information<sup>19</sup> in its assessment if required; and
- ◆ provide any other analysis or information that the person submitting the notice considers to be sufficient to enable the Authority and relevant parties to fully assess the event to which the notice relates.

### ***Ensuring that a proposed income adjusting event notice is in the public domain***

- 3.8. The existing IAE provisions do not stipulate a requirement for an IAE notice to be in the public domain, they merely provide that the Authority will consult with the licensee and such other persons as it considers desirable, when determining how to progress a proposed IAE. Ofgem considers that, in the interests of transparency, a notice should be published by the Authority in order to highlight that an IAE has been proposed. Ofgem has acted consistently with this approach of ensuring enhanced information transparency, when on 20 April 2004 Ofgem released a statement highlighting the existence of the SSRT IAE and outlined the process that Ofgem expected to adopt to handle the proposed IAE<sup>20</sup>.
- 3.9. Placing the IAE notice in the public domain will result in the disclosure of all information contained within the notice which is not genuinely confidential or commercially sensitive. In order to facilitate this requirement, the proposed

<sup>18</sup> At present, the licence drafting requires information on the amount of any income adjustment proposed, but not the method of calculating the proposed adjustment.

<sup>19</sup> The Authority will restrict from publication information in the notice which the Authority considers would or might seriously prejudicially affect the interests of a person to which it relates.

<sup>20</sup> For more information on the IAE to which this notice relates, see footnote 14.

revisions include drafting intended to address any concerns associated with information disclosure. In the event that there is dispute as to what constitutes commercially confidential information, the Authority shall make the final determination, having regard to:

- ◆ whether disclosure of such information prejudicially affects the interests of the person to which the notice relates; and
- ◆ the extent to which the information enables the Authority and relevant parties to fully assess the event to which the notice relates.

### ***Statutory licence consultation in respect of proposed Income Adjusting Events***

3.10. The current IAE provisions state that Ofgem shall reach its decision in relation to a proposed IAE after consultation with the licensee and such other persons as considered desirable. Ofgem considers that the parties consulted should be more specifically defined to ensure that those market participants that are directly affected by the approval of an IAE are referred to in the IAE provisions. Therefore, Ofgem suggests that the licensee, BSC Parties and CUSC parties in the transmission licence, and shippers in the GT licences should be specifically mentioned as being amongst those to be consulted prior to the Authority's determination.

### ***The Authority's determination***

3.11. The present drafting of the IAE provisions states that, should no determination be made by the Authority within three months of receipt of a notice of an IAE, the allowed income adjustment would be that specified by the person raising the notice. In short, where a determination is not issued by the Authority within three months, an automatic allowed income adjustment is made equal to the proposed IAE value specified in the notice of the IAE.

3.12. The revised drafting retains the automatic allowed income adjustment if a determination is not made by the Authority within three months of receipt of the notice of an IAE. However, where a determination can not be made as a

consequence of the supporting evidence provided to the Authority being insufficient to make such a determination, the value of the income adjustment will be set at zero. When considering whether this information is sufficient, the Authority will have regard to whether it is sufficient not only for the Authority to accurately assess the IAE, but also whether it is sufficient to enable relevant parties (BSC Parties and CUSC parties in the transmission licence, and shippers in the GT licences) to assess the IAE. This therefore provides further protection to customers, and places the onus on the proposer to provide accurate and detailed supporting evidence to supplement its notice.

### ***Revocation of a determination***

- 3.13. The current IAE provisions enable the Authority to revoke approval of an income adjusting event with the consent of the relevant licensee. At present, there is no requirement for consultation on the revocation or for the revocation decision to be in the public domain.
- 3.14. The revised IAE provisions have been re-drafted such that the Authority may revoke approval of an income adjusting event with the consent of the licensee, following consultation with the licensee and relevant parties. The consultation process ensures that the market is able to provide views on whether a revocation is appropriate, ensuring that the premise of enhanced transparency engendered throughout the revised provisions is retained. The revised drafting also ensures that revocation decisions will be in the public domain.

### ***Disapplying the threshold amount for network gas supply emergencies***

- 3.15. At present, the electricity transmission licence does not apply the threshold amount of £2 million to a security period, as defined in special condition AA5D. However, the GT licences treat an analogous concept, a network gas supply emergency, differently by applying the threshold. There is no apparent reason why there should remain different treatment for these equivalent concepts. Ofgem proposes to remove the threshold amount from applying to network gas supply emergencies in the GT licences, in order to align the two licences.

## ***Housekeeping changes***

- 3.16. In addition to the specific changes outlined above, Ofgem's suggested drafting also includes a number of housekeeping changes. These include minor revisions to the wording and alterations to the ordering of the IAE provisions to more closely reflect the process flow associated with IAEs. These changes are not being suggested in order to change the intent of the IAE provisions but rather to improve upon the way in which the IAE provisions are described.

## ***Summary***

- 3.17. In this chapter, Ofgem has outlined its suggested revisions to the IAE provisions within NGC's transmission licence and Transco's GT licences. Ofgem considers that the proposals, if implemented, will serve to enhance the transparency surrounding proposed IAEs and to clarify the process associated with the progression of proposed IAEs. Ofgem welcomes views in relation to the revisions proposed to the IAE provisions in respect of NGC's transmission licence and Transco's GT licences. These revisions are discussed further in the next chapter.

## 4. Licence modification

- 4.1. Revision of the IAE provisions requires modification of NGC's transmission licence and Transco's GT licences. In order to amend these licences to take account of the proposed revisions to the IAE provisions, statutory notices of the proposed licence modifications under section 11(2) of the Electricity Act 1989 and section 23(3) of the Gas Act 1986 are required. The statutory notices for NGC's transmission licence and Transco's GT licences are contained within Appendices 1 and 2 respectively and contain revised versions of the IAE provisions in NGC's transmission licence and Transco's GT licences respectively.
- 4.2. The statutory notice under section 11 of the Electricity Act 1989 and section 23 of the Gas Act 1986 specify a period of 28 days during which interested parties can make representations or objections to the proposed licence modifications, following which, revisions to the proposed licence modification will be made if it is considered appropriate. It is therefore Ofgem's intent to align the consultation periods for the licence modifications to both NGC's transmission licence and Transco's GT licences. Ofgem invites any representations on or objections to the proposed licence modifications. Responses should be submitted in writing by 23 December 2004 addressed to:

Steve Smith

Managing Director, Markets

Office of Gas and Electricity Markets

9 Millbank

London

SW1P 3GE

- 4.3. Electronic responses may be sent to: [wholesale.markets@ofgem.gov.uk](mailto:wholesale.markets@ofgem.gov.uk).
- 4.4. Respondents may mark their replies as confidential although Ofgem would prefer, as far as possible, to be able to place responses to this paper in the

Ofgem library. Unless clearly marked 'confidential', responses will be published by placing them in the Ofgem library and on the Ofgem website.

- 4.5. In order for the proposed licence modification to be made, NGC and Transco are required to provide their written consent to the modification. If this is received, and subject to consideration of any responses to the statutory notice, Ofgem will direct the modification of NGC's transmission licence and Transco's GT licences in line with the proposed licence modifications.

# Appendix 1 Notice under section 11(2) of the Electricity Act 1989

The Gas and Electricity Markets Authority (“the Authority”) hereby gives notice pursuant to section 11(2) of the Electricity Act 1989 (“the Act”) as follows:

1. The Authority proposes to modify the conditions of the transmission licence treated as granted to National Grid Company plc (“NGC”) under section 6(1)(b) of the Act by **replacing paragraphs 10 – 12 of Special Condition AA5A (Revised Restrictions on Revenue) with the text set out in Schedule 1 to this Notice.**
2. For the avoidance of doubt, no amendments are being proposed to paragraphs 1 – 9 inclusive and 13 – 16 inclusive of Special Condition AA5A. As such, nothing in these proposed modifications alters the text of these paragraphs.
3. Subject to the outcome of this statutory consultation and consideration of respondents' views, it is the intention of the Authority that these proposed licence modifications shall be deemed to take effect from 00:00 hours on 26 January 2005.
4. The reasons why the Authority proposes to make the licence modifications appearing in paragraph 1 and their effect, are set out in paragraph 5 and by the Authority in the following documents:
  - a. “Income adjusting event under NGC’s 2002/03 system operator incentive scheme, A decision document, Ofgem, June 2003”;
  - b. “Income adjusting event under National Grid Company’s 2003/04 system operator incentive scheme, A consultation document, Ofgem, May 2004”;
  - c. “Income adjusting event under National Grid Company’s 2003/04 system operator incentive scheme, A decision document, Ofgem, July 2004”; and

d. "Review of the Income Adjusting Event provisions in NGC's and Transco's licences, Statutory licence consultation, Ofgem, November 2004".

5. In summary, the effects of the proposed licence modifications are as follows:

The proposed amendments seek to revise the relevant sections in order to accommodate the proposals for enhancing the Income Adjusting Event provisions in NGC's electricity transmission licence.

The proposed licence drafting seeks to improve the transparency associated with the Income Adjusting Event provisions, and the quality of information concerning Income Adjusting Events to which market participants are able to gain access.

The revisions target any consultation document pursuant to a notice of an Income Adjusting Event onto those parties that are directly affected by the Income Adjusting Event.

Automatic approved income adjustments equal to the proposed income adjustment value three months after the receipt of an Income Adjusting Event notice will be prevented by the proposed modification in circumstances where the Authority considers that supporting evidence provided by the person giving notice of an Income Adjusting Event is insufficient to enable the Authority and market participants to assess the Income Adjusting Event to which the notice relates.

The proposed revisions, which allow the Authority to revoke an Income Adjusting Event with the consent of the licensee, will be amended to ensure that any potential revocation would be consulted on and that any revocation decision would be in the public domain.

6. Respondents should note that Ofgem has today issued a separate but parallel section 23 notice under the Gas Act relating to proposed modifications to Transco's Gas Transporter licences, pursuant to the proposed sale by NGT of some of its Distribution Networks (the "Second Notice").

The Second Notice proposes changes to Transco's original Gas Transporter licence and five substantially similar Gas Transporter licences issued to Transco in order to accommodate a potential sale and is limited at this stage to changes relating to separation of the price controls for the National Transmission System and the Distribution Networks. For the avoidance of doubt, the issue of this Second Notice does not fetter the Authority's discretion regarding Distribution Network sales.

Without fettering the Authority's discretion, it is likely that the modifications to the Gas Transporter licences envisaged by this notice would be directed on 26 January 2005. The modifications proposed pursuant to the Second Notice are likely to be directed on 27 January 2005 and will take effect at a later date.

The modifications proposed in the Second Notice and the modifications proposed in this notice are capable of being made without the other.

7. A copy of the proposed licence modifications and other documents referred to in this notice are available (free of charge) from the Ofgem library (telephone 020 7901 1600) or on the Ofgem website ([www.ofgem.gov.uk](http://www.ofgem.gov.uk)).
8. Any representations or objections to the proposed licence modifications may be made in writing before 23 December 2004 to:

Steve Smith  
Office of Gas and Electricity Markets  
9 Millbank  
London  
SW1P 3GE

or by email to [wholesale.markets@ofgem.gov.uk](mailto:wholesale.markets@ofgem.gov.uk)



**Steve Smith**

**Duly authorised on behalf of the Authority**

**25 November 2004**

# Schedule 1: NGC's proposed transmission licence drafting: Special Condition AA5A

**No amendments are proposed to paragraphs 1 – 9 and 13 - 16 inclusive of Special Condition AA5A and nothing in this text alters the operation of paragraphs 1 – 9 and 13 – 16 inclusive of Special Condition AA5A.**

10. Income adjusting events under the balancing services activity
- (a) An income adjusting event may arise from any of the following:
- (i) an event or circumstance constituting force majeure under the BSC;
  - (ii) an event or circumstance constituting force majeure under the CUSC;
  - (iii) a security period as defined in special condition AA5D; and
  - (iv) an event or circumstance other than listed above which is, in the opinion of the Authority, an income adjusting event and is approved by it as such in accordance with paragraph 12(a) of this special licence condition,
- where the event or circumstance has, for relevant year  $t$ , increased or decreased the value of  $IBC_t$  by more than £2,000,000 (the "threshold amount"). This threshold amount does not apply in respect of sub-paragraph 10(a)(iii) above.
- (b) For the purpose of relevant year  $t$  commencing on 1 April 2004 and ending on 31 March 2005, events or circumstances arising directly from

the implementation or otherwise of the following proposed modifications and amendments (both the original and any alternative) listed in tables 1 and 2 below shall not qualify as an income adjusting event for the purpose of paragraph 10(a) above:

**Table 1: Proposed modifications to the BSC**

<b>BSC Modification Proposal</b>	<b>BSC Modification Title (as entitled by the proposer of the modification)</b>
P124	Revision of mandatory half-hour metering criteria
P131	Further provisions relating to Trading Disputes
P132	Redefinition of Credit Cover requirements for reconciliation charges
P136	Marginal Definition of the 'main' Energy Imbalance Price
P137	Revised Calculation of System Buy and System Sell Price
P139	Removal of Trading Unit Restriction on Interconnector Users
P140	Revised Credit Cover Methodology for Interconnector BM Units
P142	Allow Level 2 Default Cure Period in Defined Circumstances
P146	New Participation Category to the BSC - Clearing House
P147	Introduction of a Notified Contract Capacity
P150	Targeting costs of PNE appeals to unsuccessful appellants
P151	Housekeeping Modification
P152	Reduction of Credit Cover for a Trading Party in Default
P153	Support Competition in Distribution Networks
P154	Rectification of Inconsistencies in the Change Process
P156	Zonal Allocation of Transmission Losses
P157	Replacement of current Supplier Charges rules

**Table 2: Proposed amendments to the CUSC**

<b>CUSC Amendment Proposal</b>	<b>CUSC Amendment Title (as entitled by the proposer of the amendment)</b>
CAP049	Alternative Amendments
CAP050	Review Process for implemented Urgent Amendment Proposals
CAP051	Initiation of the Amendment Procedures by the Amendments Panel
CAP052	Removal of Land Charges
CAP053	Revision of Site Specific Maintenance Charges
CAP054	Adoption of Year Round TNUoS Charges
CAP055	Users' Demand Forecasts
CAP056	Incorrect Reference to the Grid Code in Section 11 – Definitions
CAP057	Removal of References to TSUoS Charges
CAP058	Reinstatement of words lost from Legal Text following implementation of CAP043
CAP059	Addition of word "Paragraph" to Paragraph 2.17.9
CAP060	Incorrect spelling of "Judgment" in Paragraph 6.6.4
CAP061	Addition of "CUSC Panel Secretary" to Exhibit F, Note 10
CAP062	Amendment to National Grid address in various exhibits

<b>CUSC Amendment Proposal</b>	<b>CUSC Amendment Title (as entitled by the proposer of the amendment)</b>
CAP063	Amendment to National Grid address in various exhibits
CAP064	Minor Reference error in Paragraph 7.2, Schedule 2, Exhibit 3
CAP065	Removal of various paragraphs referring to NETA Go Live
CAP066	Removal of historic transitional provisions that no longer have any application
CAP067	Clarification of Contractual Relationship Required for Embedded Generation (CUSC 6.5.1)
CAP068	Competing Requests for TEC
CAP069	Users' Forecasts Used in the Calculation of TNUoS Charges
CAP070	Short Term Firm Access Service

11. Notice of proposed income adjusting event

- (a) Where the licensee considers, and can provide supporting evidence that, in respect of relevant year t, there have been costs and/or expenses that have been incurred or saved by an income adjusting event, then the licensee shall give notice of this event to the Authority.
- (b) Where any other Party (as defined in the BSC) considers, and can provide supporting evidence that, in respect of relevant year t, there have been costs and/or expenses that have been incurred or saved by an income adjusting event, then that Party may give notice of this event to the Authority.
- (c) A notice provided to the Authority under paragraphs 11(a) and 11(b) shall, in the case of the licensee, and should, in so far as is practicable in the case of any other Party, give particulars of:
  - (i) the event to which the notice relates and the reason(s) why the person giving the notice considers this event to be an income adjusting event;
  - (ii) the amount of any change in costs and/or expenses that can be demonstrated by the person giving the notice to have been

caused or saved by the event and how the amount of these costs and/or expenses has been calculated;

- (iii) the amount of any allowed income adjustment proposed as a consequence of that event and how this allowed income adjustment has been calculated; and
  - (iv) any other analysis or information which the person submitting the notice considers to be sufficient to enable the Authority and the relevant parties to fully assess the event to which the notice relates.
- (d) If the Authority considers that the analysis or information provided in sub-paragraphs 11(c)(i) to 11(c)(iv) above is insufficient to enable both the Authority and the relevant parties to assess whether an income adjusting event has occurred and/or the amount of any allowed income adjustment that should be approved, the Authority can request that the supporting evidence be supplemented with additional information that it considers appropriate.
- (e) A notice of an income adjusting event shall be given as soon as is reasonably practicable after the occurrence of the income adjusting event, and, in any event, not later than three months after the end of the relevant year in which it occurs.
- (f) The Authority will make public, excluding any confidential information, any notice of an income adjusting event following its receipt.
- (g) Any notice submitted to the Authority under either paragraphs 11(a) or 11(b) above should clearly identify whether any of the information contained in the notice is of a confidential nature. The Authority shall make the final determination as to confidentiality having regard to:
- (i) the need to exclude from disclosure, so far as is reasonably practicable, information whose disclosure the Authority considers

would or might seriously prejudicially affect the interests of a person to which it relates; and

- (ii) the extent to which the disclosure of the information mentioned in sub-paragraph 11(g)(i) is necessary for the purposes of enabling the relevant parties to fully assess the event to which the notice relates.

12. The Authority's determination

- (a) Following consultation with relevant parties, including the licensee, BSC Parties and CUSC parties, the Authority shall determine:

- (i) whether any or all of the costs and/or expenses given in a notice pursuant to paragraphs 11(a) or 11(b) were caused or saved by an income adjusting event;
- (ii) whether the event or circumstance has increased or decreased the value of IBCt by more than the threshold amount, save in the case of sub-paragraph 10(a)(iii) where the threshold amount shall not apply; and
- (iii) if so, whether the amount of the proposed income adjustment ensures that the financial position and performance of the licensee are, insofar as is reasonably practicable, the same as if that income adjusting event had not taken place, and if not, what allowed income adjustment would secure that effect.

- (b) In relation to the relevant year t, the allowed income adjustment (RTt) shall be:

- (i) the value determined by the Authority under paragraph 12(a) above; or

- (ii) if the Authority has not made a determination under paragraph 12(a) above within three months of the date on which notice of an income adjusting event was provided to the Authority, the amount of the allowed income adjustment proposed as a consequence of the event in the notice given to the Authority under sub-paragraph 11(c)(iii); or
  - (iii) in all other cases zero, including situations where the Authority has not made a determination under paragraph 12(a) above within three months of the date on which notice of an income adjusting event was provided to the Authority and the Authority has, before the end of that three month period, informed the relevant parties that the Authority considers that the analysis or information provided in accordance with paragraphs 11(c) and/or 11(d) is insufficient to enable the Authority and relevant parties to assess whether an income adjusting event has occurred and/or the amount of any allowed income adjustment.
- (c) The Authority's decision in relation to any notice given under paragraphs 11(a) or 11(b) shall be in writing, shall be copied to the licensee and shall be in the public domain.
- (d) The Authority may revoke an approval of an income adjusting event and allowed income adjustment with the consent of the licensee, following consultation with the licensee and relevant parties. Revocation of any income adjusting event and allowed income adjustment shall be in writing, shall be copied to the licensee and shall be in the public domain.

# Appendix 2 Notice under section 23(3) of the Gas Act 1986

The Gas and Electricity Markets Authority (the Authority) hereby gives notice pursuant to section 23(3) of the Gas Act 1986 (the Act) as follows:

1. The Authority proposes to modify the conditions of the Gas Transporter Licence treated as granted to Transco plc (“Transco”) under section 7 of the Act by **replacing paragraph 14(11) of Special Condition 28B (Definition of maximum NTS system operation revenue (SOMR)) with the text set out in Schedule 1 to this Notice.**
2. For the avoidance of doubt, no amendments are being proposed to subparagraphs 1 – 10 inclusive of paragraph 14 of Special Condition 28B. As such, nothing in these modifications alters the text of these paragraphs.
3. Subject to the outcome of this statutory consultation and consideration of respondents’ views, it is the intention of the Authority that these proposed licence modifications shall be deemed to take effect from 00:00 hours on 26 January 2005
4. The reasons why the Authority proposes to make the licence modifications appearing in paragraph 1 and their effect are set out in paragraph 5 and by the Authority in the following documents:
  - a) “Income adjusting event under NGC’s 2002/03 system operator incentive scheme, A decision document, Ofgem, June 2003”;
  - b) “Income adjusting event under National Grid Company’s 2003/04 system operator incentive scheme, A consultation document, Ofgem, May 2004”;
  - c) “Income adjusting event under National Grid Company’s 2003/04 system operator incentive scheme, A decision document, Ofgem, July 2004”; and

d) "Review of the Income Adjusting Event provisions in NGC's and Transco's licences, Statutory licence consultation, Ofgem, November 2004".

5. In summary, the effects of the proposed licence modifications are as follows:

The proposed amendments seek to revise the relevant sections in order to accommodate the proposals for enhancing the Income Adjusting Event provisions in Transco's Gas Transporter licences.

The proposed licence drafting seeks to improve the transparency associated with the Income Adjusting Event provisions, and the quality of information concerning Income Adjusting Events to which market participants are able to gain access.

The revisions target any consultation document pursuant to a notice of an Income Adjusting Event onto those parties that are directly affected by the Income Adjusting Event.

Automatic approved income adjustments equal to the proposed income adjustment value three months after the receipt of an Income Adjusting Event notice will be prevented by the proposals in circumstances where the Authority considers that supporting evidence provided by the person giving notice of an Income Adjusting Event, is insufficient to enable the Authority and market participants to assess the Income Adjusting Event to which the notice relates.

The proposed revisions, which allow the Authority to revoke an Income Adjusting Event with the consent of the licensee, will be amended to ensure that any potential revocation would be consulted on and that any revocation decision would be in the public domain.

In order to fully align the provisions relating to Income Adjusting Events in Transco's Gas Transporter licences with those in NGC's electricity transmission licence, it is proposed that the threshold amount should not apply when there is a network gas supply emergency.

6. Respondents should note that Ofgem has today issued a separate but parallel section 23 notice under the Gas Act relating to proposed modifications to

Transco's Gas Transporter licences, pursuant to the proposed sale by NGT of some of its Distribution Networks (the "Second Notice").

The Second Notice proposes changes to Transco's original Gas Transporter licence and five substantially similar Gas Transporter licences issued to Transco in order to accommodate a potential sale and is limited at this stage to changes relating to separation of the price controls for the National Transmission System and the Distribution Networks. For the avoidance of doubt, the issue of this Second Notice does not fetter the Authority's discretion regarding Distribution Network sales.

Without fettering the Authority's discretion, it is likely that the modifications to the Gas Transporter licences envisaged by this notice would be directed on 26 January 2005. The modifications proposed pursuant to the Second Notice are likely to be directed on 27 January 2005 and will take effect at a later date.

The modifications proposed in the Second Notice and the modifications proposed in this notice are capable of being made without the other.

7. A copy of the proposed licence modifications and other documents referred to in this notice are available (free of charge) from the Ofgem library (telephone 020 7901 1600) or on the Ofgem website ([www.ofgem.gov.uk](http://www.ofgem.gov.uk)).
8. Any representations or objections to the proposed licence modifications may be made in writing before 23 December 2004 to:

Steve Smith  
Office of Gas and Electricity Markets  
9 Millbank  
London  
SW1P 3GE

or by email to [wholesale.markets@ofgem.gov.uk](mailto:wholesale.markets@ofgem.gov.uk)



**Steve Smith**

**Duly authorised on behalf of the Authority**

**25 November 2004**

# **Schedule 1: Transco's proposed Gas Transporter licences drafting: paragraph 14(11) of Special Condition 28B**

**No amendments are proposed to paragraphs 1 – 10 inclusive of paragraph 14 of Special Condition 28B (Definition of maximum NTS system operation revenue (SOMR<sub>t</sub>)) and nothing in this text alters the operation of paragraphs 1 – 10 inclusive of paragraph 14 of Special Condition 28B.**

**(11) Determination of any adjustment factor to be applied to SOMR<sub>t</sub> (SORA<sub>t</sub>)**

- (a) An income adjusting event may arise from any of the following:
  - (i) an event or circumstance constituting force majeure under the licensee's Network Code;
  - (ii) an event or circumstance resulting in the declaration of a network gas supply emergency (having the meaning given to such term in the licensee's Network Code);
  - (iii) where the revenues derived by the licensee from the sale of obligated entry capacity pursuant to sub-paragraph 14(5)(c)(iii) are less than the revenues that would have been derived from the original sale of that capacity had the original purchaser of the capacity not been served with a termination notice (having the meaning given to that term in the licensee's Network Code); and
  - (iv) an event or circumstance other than listed above which is, in the opinion of the Authority, an income adjusting event and is

approved by it as such in accordance with paragraph 14(11)(i) of this special licence condition,

where the event has, for relevant formula year *t*, increased or decreased the value of SOIC<sub>*t*</sub> (having the meaning given to that term in paragraph 14(3) of Part 2 of this Special Condition) by more than £2,000,000 (the “threshold amount”). This threshold amount does not apply in respect of sub-paragraphs 14(11)(a)(ii) or 14(11)(a)(iii) above.

- (b) Where the licensee considers, and can provide supporting evidence that, in respect of relevant formula year *t*, there have been costs and/or expenses that have been incurred or saved by an income adjusting event, then the licensee shall give notice of this event to the Authority.
- (c) Where any shipper considers, and can provide supporting evidence that, in respect of formula year *t*, there have been costs and/or expenses that have been incurred or saved by an income adjusting event, then that shipper may give notice of this event to the Authority.
- (d) A notice provided to the Authority under paragraphs 14(11)(b) and 14(11)(c) shall, in the case of the licensee, and should, in so far as is practicable in the case of any shipper, give particulars of:
  - (i) the event to which the notice relates and the reason(s) why the person giving the notice considers this event to be an income adjusting event;
  - (ii) the amount of any change in costs and/or expenses that can be demonstrated by the person giving the notice to have been caused or saved by the event and how the amount of these costs and/or expenses has been calculated;
  - (iii) the amount of any allowed income adjustment proposed as a consequence of that event and how this allowed income adjustment has been calculated; and

- (iv) any other analysis or information which the person submitting the notice considers to be sufficient to enable the Authority and shippers to fully assess the event to which the notice relates.
- (e) If the Authority considers that the analysis or information provided in sub-paragraphs 14(11)(d)(i) to 14(11)(d)(iv) above is insufficient to enable both the Authority and shippers to assess whether an income adjusting event has occurred and/or the amount of any allowed income adjustment that should be approved, the Authority can request that the supporting evidence be supplemented with additional material that it considers appropriate.
- (f) A notice of an income adjusting event shall be given as soon as is reasonably practicable after the occurrence of the income adjusting event, and, in any event, not later than three months after the end of the relevant formula year t in which it occurs.
- (g) The Authority will make public, excluding any confidential information, any notice of an income adjusting event following its receipt.
- (h) Any notice submitted to the Authority under either paragraphs 14(11)(b) or 14(11)(c) above should clearly identify whether any of the information contained in the notice is of a confidential nature. The Authority shall make the final determination as to confidentiality having regard to:
  - (i) the need to exclude from disclosure, so far as is reasonably practicable, information whose disclosure the Authority considers would or might seriously prejudicially affect the interests of a person to which it relates; and
  - (ii) the extent to which the disclosure of the information mentioned in sub-paragraph 14(11)(h)(i) is necessary for the purpose of enabling shippers to fully assess the event to which the notice relates.

- (i) Following consultation with relevant parties, including the licensee and shippers, the Authority shall determine:
  - (i) whether any or all of the costs and/or expenses given in a notice pursuant to paragraphs 14(11)(b) or 14(11)(c) were caused or saved by an income adjusting event;
  - (ii) whether the event or circumstance has increased or decreased the value of SOIC<sub>t</sub> by more than the threshold amount, save in the case of sub-paragraphs 14(11)(a)(ii) and 14(11)(a)(iii) where the threshold amount shall not apply; and
  - (iii) if so, whether the amount of the proposed income adjustment ensures that the financial position and performance of the licensee are, insofar as is reasonably practicable, the same as if that income adjusting event had not taken place, and if not, what allowed income adjustment would secure that effect.
  
- (j) In relation to formula year t, the approved allowance in respect of an income adjustment (SORA<sub>t</sub>) shall be:
  - (i) the value determined by the Authority under paragraph 14(11)(i) above; or
  - (ii) if the Authority has not made a determination under paragraph 14(11)(i) above within three months of the date on which the notice of an income adjusting event was provided to the Authority, the amount of the allowed income adjustment proposed as a consequence of the event in the notice given to the Authority under sub-paragraph 14(11)(d)(iii); or
  - (iii) in all other cases zero, including situations where the Authority has not made a determination under paragraph 14(11)(i) above within three months of the date on which notice of an income

adjusting event was provided to the Authority and the Authority has, before the end of that three month period, informed the relevant parties that the Authority considers that the analysis or information provided in accordance with paragraphs 14(11)(d) and/or 14(11)(e) is insufficient to enable the Authority and shippers to assess whether an income adjusting event has occurred and/or the amount of any allowed income adjustment.

- (k) The Authority's decision in relation to any notice given under paragraphs 14(11)(b) or 14(11)(c) shall be in writing, shall be copied to the licensee and shall be in the public domain.
  
- (l) The Authority may revoke an approval of an income adjusting event and allowed income adjustment with the consent of the licensee, following consultation with the licensee and shippers. Revocation of any income adjusting event and allowed income adjustment shall be in writing, shall be copied to the licensee and shall be in the public domain.

## Appendix 3 NGC's current transmission licence drafting

10. Income adjusting events under the balancing services activity
- (a) An income adjusting event is any of the following:
- (i) an event or circumstance constituting force majeure under the BSC;
  - (ii) an event or circumstance constituting force majeure under the CUSC made between the licensee and others and providing for connection to and use of the licensee's transmission system;
  - (iii) a security period as defined in special condition AA5D; and
  - (iv) an event or circumstance which is, in the opinion of the Authority, an income adjusting event and approved by it as such.
- (b) For the purpose of relevant year t commencing on 1 April 2004 and ending on 31 March 2005, the following items listed in tables 1 and 2 below shall not qualify as an income adjusting event for the purpose of sub-paragraph (a) above:

**Table 1:**

<b>Modification No.</b>	<b>Modification Title</b>
P124	Revision of mandatory half-hour metering criteria
P131	Further provisions relating to Trading Disputes
P132	Redefinition of Credit Cover requirements for reconciliation charges
P136	Marginal Definition of the 'main' Energy Imbalance Price
P137	Revised Calculation of System Buy and System Sell Price
P139	Removal of Trading Unit Restriction on Interconnector Users
P140	Revised Credit Cover Methodology for Interconnector BM Units
P142	Allow Level 2 Default Cure Period in Defined Circumstances
P146	New Participation Category to the BSC - Clearing House
P147	Introduction of a Notified Contract Capacity

<b>Modification No.</b>	<b>Modification Title</b>
P150	Targeting costs of PNE appeals to unsuccessful appellants
P151	Housekeeping Modification
P152	Reduction of Credit Cover for a Trading Party in Default
P153	Support Competition in Distribution Networks
P154	Rectification of Inconsistencies in the Change Process
P156	Zonal Allocation of Transmission Losses
P157	Replacement of current Supplier Charges rules

**Table 2:**

<b>Amendment No.</b>	<b>Amendment Title</b>
CAP049	Alternative Amendments
CAP050	Review Process for implemented Urgent Amendment Proposals
CAP051	Initiation of the Amendment Procedures by the Amendments Panel
CAP052	Removal of Land Charges
CAP053	Revision of Site Specific Maintenance Charges
CAP054	Adoption of Year Round TNUoS Charges
CAP055	Users' Demand Forecasts
CAP056	Incorrect Reference to the Grid Code in Section 11 – Definitions
CAP057	Removal of References to TSUoS Charges
CAP058	Reinstatement of words lost from Legal Text following implementation of CAP043
CAP059	Addition of word "Paragraph" to Paragraph 2.17.9
CAP060	Incorrect spelling of "Judgment" in Paragraph 6.6.4
CAP061	Addition of "CUSC Panel Secretary" to Exhibit F, Note 10
CAP062	Amendment to National Grid address in various exhibits
CAP063	Amendment to National Grid address in various exhibits
CAP064	Minor Reference error in Paragraph 7.2, Schedule 2, Exhibit 3
CAP065	Removal of various paragraphs referring to NETA Go Live
CAP066	Removal of historic transitional provisions that no longer have any application
CAP067	Clarification of Contractual Relationship Required for Embedded Generation (CUSC 6.5.1)
CAP068	Competing Requests for TEC
CAP069	Users' Forecasts Used in the Calculation of TNUoS Charges
CAP070	Short Term Firm Access Service

(c) The Authority's approval of an income adjusting event shall be in writing, shall be copied to the licensee and shall be in the public domain; and the Authority may revoke this approval with the consent of the licensee.

11. (a) Where it appears to the licensee that there have been in respect of relevant period t costs and/or expenses which:

(i) have been caused or saved by an income adjusting event; and

- (ii) have, for relevant period  $t$ , increased or decreased by more than £2,000,000 the value of  $IBC_t$  save that in the case of paragraph 10(a)(iii) only the threshold of £2,000,000 shall not apply

then the licensee shall give notice thereof to the Authority.

- (b) Where it appears to any other Party (as defined in the BSC) that there have been in respect of relevant year  $t$  costs and/or expenses which:

- (i) have been caused or saved by an income adjusting event; and
- (ii) have, for the relevant period  $t$ , increased or decreased by more than £2,000,000 the value of  $IBC_t$  save that in the case of paragraph 10(a)(iii) only the threshold of £2,000,000 shall not apply

then that Party (as defined in the BSC) may give notice thereof to the Authority.

- (c) The notice provided for in subparagraphs (a) and (b) shall give particulars of:

- (i) the income adjusting event to which the notice relates;
- (ii) the amount of any change in costs and/or expenses which appear to the person giving the notice to have been caused or saved by the event and the method of calculating such costs and/or expenses; and
- (iii) the amount of any allowed income adjustment proposed as a consequence of that income adjusting event.

- (d) A notice of an income adjusting event shall be given as soon as is reasonably practicable after the occurrence of the income adjusting

event, and may not be given more than 3 months after the end of the relevant period in which it occurs.

12. (a) The Authority shall determine (after consultation with the licensee and such other persons as it considers desirable):
- (i) whether any or all of the costs and/or expenses given in a notice pursuant to paragraph 11 are caused or saved by an income adjusting event;
  - (ii) whether the amount specified for the purpose of paragraph 11(c)(iii) has increased or decreased the value of  $IBC_t$  by more than £2,000,000 save that in the case of paragraph 10(a)(iii) only, the threshold of £2,000,000 shall not apply; and
  - (iii) if so, whether the amount of the proposed income adjustment ensures that the financial position and performance of the licensee are, insofar as is reasonably practicable, the same as if that income adjusting event had not taken place, and if not, what allowed income adjustment would secure that effect.
- (b) In relation to the relevant period  $t$ , the allowed income adjustment  $RT_t$  shall be
- (i) the value determined by the Authority under subparagraph (a);
  - (ii) if the Authority has not made a determination in accordance with subparagraph (a) within 3 months of the date of the notice under paragraph 11, the respective values given to them in that notice; or
  - (iii) in any other case, zero.

# Appendix 4 Transco's current Gas Transporter licences drafting

## (11) Determination of any adjustment factor to be applied to $SOMR_t$ ( $SORA_t$ )

- (a) An income adjusting event is any event or circumstance:
  - (i) constituting force majeure under the licensee's Network Code;
  - (ii) resulting in the declaration of a network gas supply emergency (having the meaning given to such term in the licensee's Network Code);
  - (iii) where the revenues derived by the licensee from the sale of obligated entry capacity pursuant to paragraph 14(5)(c)(iii) are less than the revenues that would have been derived from the original sale of that capacity had the original purchaser of the capacity not been served with a termination notice (having the meaning given to that term in the licensee's Network Code) and in respect of this sub-paragraph only, the threshold specified in paragraphs 14(11)(c)(ii), (d)(ii) and (g)(ii) shall not apply; and
  - (iv) that is, in the opinion of the Authority, an income adjusting event and approved by it as such.
- (b) The Authority's approval of an income adjusting event shall be in writing and shall be in the public domain and the Authority may revoke this approval with the consent of the licensee.
- (c) Where it appears to the licensee that there have been in respect of formula year  $t$  costs and/or expenses which:

- (i) have been caused or saved by an income adjusting event; and
  - (ii) have, in respect of formula year  $t$ , increased or decreased by more than £2,000,000 the value of  $SOIC_t$  (having the meaning given to that term in paragraph 14(3) of Part 2 of this Special Condition) (for the avoidance of doubt, in the case of paragraph 14(11)(a)(iii) only the threshold of £2,000,000 shall not apply), then the licensee shall give notice thereof to the Authority.
- (d) Where it appears to any shipper that there have been in respect of formula year  $t$  costs and/or expenses which:
- (i) have been caused or saved by an income adjusting event; and
  - (ii) have, in respect of formula year  $t$ , increased or decreased by more than £2,000,000 the value of  $SOIC_t$  (having the meaning given to that term in paragraph 14(3) of Part 2 of this Special Condition) (for the avoidance of doubt, in the case of paragraph 14(11)(a)(iii) only the threshold of £2,000,000 shall not apply), then that shipper may give notice thereof to the Authority.
- (e) The notice provided for in paragraphs 14(11)(a) and 14(11)(b) of Part 2 of this Special Condition shall give particulars of:
- (i) the income adjusting event to which the notice relates;
  - (ii) the amount of any change in costs and/or expenses which appear to the person giving the notice to have been caused or saved by the event and the method of calculating such costs and/or expenses; and
  - (iii) the amount of any allowed income adjustment proposed as a consequence of that income adjusting event.

- (f) A notice of an income adjusting event shall be given as soon as is reasonably practicable after the occurrence of the income adjusting event, and may not be given more than 3 months after the end of the relevant formula year in which it occurs.
- (g) The Authority shall determine (after consultation with the licensee and such other persons as it considers desirable):
- (i) whether any or all of the costs and/or expenses given in a notice pursuant to paragraph 14(11)(c) or 14(11)(d) of Part 2 of this Special Condition are caused or saved by an income adjusting event;
  - (ii) whether the amount specified for the purpose of paragraph 14(11)(e)(iii) of Part 2 of this Special Condition has increased or decreased the value of SOIC<sub>t</sub> by more than £2,000,000 (for the avoidance of doubt, in the case of paragraph 14(11)(a)(iii) only the threshold of £2,000,000 shall not apply); and
  - (iii) if so, whether the amount of the proposed income adjustment ensures that the financial position and performance of the licensee are, insofar as is reasonably practicable, the same as if that income adjusting event had not taken place, and if not, what allowed income adjustment would secure that effect.
- (h) In respect of formula year  $t$ , the approved allowance in respect of an income adjustment (SORA<sub>t</sub>) shall be:
- (i) the value determined by the Authority under paragraph 14(11)(g) of Part 2 of this Special Condition;
  - (ii) if the Authority has not made a determination in accordance with paragraph 14(11)(a) of Part 2 of this Special Condition within 3 months of the date of the notice under paragraph

14(11)(c) or 14(11)(d) of Part 2 of this Special Condition, the respective values given to them in that notice; or

(iii) in any other case, zero.

## Appendix 5 Components of IBC

5.1 NGC's SO incentive scheme payment or receipt is determined by the level of its Incentivised Balancing Costs (IBC) at the end of the incentive period. IBC are calculated from a number of different components<sup>21</sup>:

- ◆ the cost of bids and offers in the Balancing Mechanism accepted in the relevant period less the total non-delivery charge for that period. This is referred to as Daily System Operator Balancing Mechanism Cashflow (CSOBM);
- ◆ the costs of contracts for the availability or use of balancing services, excluding costs covered by CSOBM (but including charges made by the SO for the provision of balancing services to itself), i.e. this component consists of the costs of balancing services not procured through the Balancing Mechanism. This is referred to as Balancing Services Contract Costs (BSCC);
- ◆ the volume of transmission losses multiplied by the Transmission Losses Reference Price (TLRP) for each Settlement Period, summed across all Settlement Periods. This is referred to as the Transmission Losses Adjustment (TLA);
- ◆ the system imbalance volume multiplied by the Net Imbalance Volume Reference Price (NIRP) for each Settlement Period, summed across all Settlement Periods. This factor, the Net Imbalance Adjustment (NIA), is deducted from CSOBM to reflect the fact that NGC has little control over the extent to which participants choose not to balance their positions;
- ◆ the revenue from the provision of balancing services to others (OM) during the relevant incentive period; and

<sup>21</sup> In addition to the terms outlined below, Ofgem is expecting to consult shortly on the inclusion of a further term (the IPi term linked to CUSC Amendment Proposal CAP048: "Firm Access and Temporary Physical Disconnection").

- ◆ the amount of any allowed income adjustment (RT) during the relevant incentive period.

## Appendix 6 Components of SOR

6.1 Transco's NTS SO incentive scheme payment or receipt is determined by the level of revenue derived from its NTS system operation activity (SOR) at the end of the incentive scheme period. SOR is calculated from a number of different components as follows:

- ◆ The revenue derived by the licensee from charges levied on shippers in respect of NTS SO activities provided by the licensee. It includes charges to recover both costs and net payments in respect of reducing the costs arising from system operation activities, excluding revenue earned from SOExRF, SORCAP and SOROC below. This is referred to as RCOM;
- ◆ The revenue derived by the licensee from the sale of incremental exit capacity. This is calculated as the difference between the revenue derived by the licensee in respect of its provision of NTS firm exit capacity and its provision of NTS firm baseline exit capacity. Derived revenue is positive when the revenue from the provision of NTS firm exit capacity exceeds the revenue from the provision of NTS firm baseline exit capacity. This is referred to as system operator exit capacity revenue (SOExRF);
- ◆ The revenue derived by the licensee from the sale of entry capacity. This includes revenue derived from the on the day sales of NTS SO baseline entry capacity, the sales of obligated incremental entry capacity, the sales of non-obligated incremental entry capacity, the sales of interruptible entry capacity and the sales of permanent obligated incremental entry capacity relating to periods more than five years after the first day to which such capacity is related. This is referred to as system operation revenue from capacity sales (SORCAP); and
- ◆ The revenue derived by the licensee through associated charges, including those derived from balancing neutrality charges, system entry overrun charges and charges levied on shippers in respect of any failure

to interrupt. This is referred to as system operation revenue from overrun charges SOROC.

## Appendix 7 Components of SOMR

7.1 The IAE provisions in Transco's GT licences affect the value of maximum NTS system operator revenue (SOMR). Where the IAE provisions are utilised, the value of the adjustment would be to SOMR, such that where extra costs of Transco's NTS SO activity have arisen that were unforeseen, SOMR would be increased by the amount of the proposed IAE where it is approved. This would therefore result in an increase to the level of Transco's NTS SO revenue restriction. Conversely, where an IAE has been raised where savings have been made under Transco's NTS SO activity that were unforeseen, SOMR would be decreased by the amount of the proposed IAE where it is approved. This would therefore result in a decrease to the level of Transco's NTS SO revenue restriction. SOMR is calculated from a number of different components as follows:

- ◆ The revenue derived from the NTS SO incentive, including revenue from entry capacity investment incentive, exit capacity investment incentive, buy back incentive, NTS system balancing incentive, residual gas balancing incentive and the internal cost incentive revenue. This is referred to as the NTS system operator revenue (SOIR);
- ◆ The costs derived from the NTS SO incentive, including the revenue equivalent to the exit capacity costs incurred by the licensee, the revenue equivalent to the total entry capacity constraint costs, the revenue equivalent to the second capacity adjustment neutrality amount, the revenue equivalent to the system balancing costs incurred by the licensee, an amount equal to the revenue equivalent to the net residual balancing costs incurred by the licensee, the revenue equivalent to the internal costs incurred by the licensee and the NTS SO revenue adjustment factor. This is referred to as the NTS system operation costs (SOIC); and
- ◆ Any allowance in respect of an approved income adjusting event. This is referred to as system operation revenue adjustment (SORA).

# Appendix 8 The regulatory framework

## *Introduction*

- 8.1 This appendix summarises the current regulatory framework for the electricity and gas industries. It outlines the current legislative, licensing and regulatory regimes and describes the relationship between the Electricity Act 1989, the Gas Act 1986, the Utilities Act 2000, the Energy Act 2004, licences and industry codes and agreements.

## *The Electricity Act 1989*

- 8.2 The Electricity Act 1989 (the “Electricity Act”), as amended by the Utilities Act 2000, provides the framework for the functions of the Gas and Electricity Markets Authority (the “Authority”) and sets out the licensing regime in relation to the supply, distribution, generation and transmission of electricity.
- 8.3 Under section 9(2) of the Electricity Act, holders of transmission licences are obliged to develop and maintain an efficient, co-ordinated and economical system of electricity transmission and to facilitate competition in the supply and generation of electricity.

## *The Gas Act 1986*

- 8.4 The Gas Act 1986 (the “Gas Act”), as amended by the Utilities Act 2000, provides for the regulation of the onshore gas regime in Great Britain and for the separate licensing of Gas Transporters (GTs), gas shippers and gas suppliers. Transco is the largest GT in Great Britain.
- 8.5 The duties of the Authority are set out in section 4AA of the Gas Act. The principal objective of the Authority in carrying out its functions under the Gas Act is to protect the interests of consumers in relation to gas conveyed through pipes, wherever appropriate by promoting effective competition between those engaged or concerned with the shipping, transportation or supply of gas or engaged in commercial activities relating to such activities. In carrying out its

functions under the Gas Act in a manner which is best calculated to further the principal objective, the Authority shall have regard to the following:

- ◆ the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met; and
- ◆ the need to secure that licence holders are able to finance the carrying on of the activities which they are authorised or required by their licences to carry on.

8.6 In performing such duties the Authority must have regard to the interests of those individuals that are disabled or chronically sick, or of pensionable age, or with low incomes or residing in rural areas.

8.7 The Authority may, in carrying out any of its functions, have regard to the interests of consumers in relation to electricity, telecommunications and water and sewerage services.

8.8 The Authority must carry out its functions in the manner it considers best calculated to:

- ◆ promote efficiency and economy on the part of authorised persons and the efficient use of gas;
- ◆ protect the public from dangers arising from the conveyance of gas through pipes or the use of such gas; and
- ◆ secure a diverse and viable long-term energy supply.

8.9 The Authority must also have regard to the effect on the environment of activities connected with the conveyance of gas through pipes.

## ***The Utilities Act 2000***

8.10 The Utilities Act 2000 (the “Utilities Act”) received Royal Assent on 28 July 2000. It introduced a new principal objective for the Authority, as defined in Section 3A of the Electricity Act. The Authority’s principal objective, in relation to electricity, is “to protect the interests of consumers in relation to electricity

conveyed by distribution systems, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the generation, transmission, distribution or supply of electricity”.

### ***The Energy Act 2004***

- 8.11 The Energy Act 2004 (the “Energy Act”) received Royal Assent on 22 July 2004. The Energy Act introduced a requirement that, subject to its principal objective and its general duties, the Authority (and the Secretary of State) should carry out its functions in a manner best calculated to contribute to the achievement of sustainable development.
- 8.12 The Energy Act 2004 additionally requires that the Authority (and the Secretary of State) should carry out its functions having had regard to “the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed” and any other principles appearing to represent best regulatory practice.

### ***NGC’s electricity transmission licence***

- 8.13 NGC owns and operates the national grid in England and Wales, which transports electricity at high voltage from the generators to the local distribution networks and to customers connected directly to the transmission system. NGC holds a transmission licence, which is treated as granted under section 6(1) of the Electricity Act.
- 8.14 On 26 August 2004, the Secretary of State exercised her powers under sections 134 and 137 of, and paragraph 1 of Schedule 17 to, the Energy Act 2004 to determine new standard conditions in relation to transmission licences, make a scheme in relation to existing transmission licences and modify the conditions of licences granted under section 6(1) of the Electricity Act 1989. On 31 August 2004, the Secretary of State further exercised her powers under sections 134 of the Energy Act to modify the conditions of transmission licences. The changes came into effect on 1 September 2004.

## Standard condition C16<sup>22</sup>

8.15 NGC's transmission licence contains several provisions relating to information provision and transparency:

- ◆ standard condition C16(1) requires the licensee to co-ordinate and direct the flow of electricity onto and over the GB transmission system in an efficient, economic and co-ordinated manner; and
- ◆ standard condition C16(2) prohibits the licensee from discriminating as between any persons or classes of persons in its procurement or use of balancing services.

## Standard condition C16 statements

8.16 NGC is required to procure any balancing services competitively and via transparent processes. In order to fulfil this requirement, NGC is obliged under standard condition C16 of the transmission licence to have in place two documents<sup>23</sup>:

- ◆ the Procurement Guidelines (PGs), which detail the types of balancing services that NGC may be interested in purchasing, together with the mechanisms envisaged for purchasing such balancing services. Table 3 within Part E of the PGs outlines NGC's approach to providing information relating to its procurement of balancing services in order to provide market participants and other interested parties with sufficient information without compromising the commercial position of any contracting party; and
- ◆ the Balancing Principles Statement (BPS), which defines the broad principles and criteria by which NGC will determine, at different times and in different circumstances, which balancing services it will use to assist in the operation of the transmission system.

<sup>22</sup> With effect from 1 September 2004 and following modifications made by the Secretary of State to the electricity transmission licence, what was formerly referred to as special condition AA4 of NGC's transmission licence became standard condition C16 of the electricity transmission licence.

<sup>23</sup> Details of the PGs, BPS and the BSAD Methodology Statement can be found at NGC's website [www.nationalgrid.com/uk/indinfo](http://www.nationalgrid.com/uk/indinfo).

## **Standard condition C16 reports and audit**

- 8.17 Standard condition C16 further requires ex-post reporting and an assessment of NGC's compliance in order to provide transparency in relation to NGC's actions. Standard condition C16 requires:
- ◆ NGC to prepare and publish annually a report in respect of the balancing services it has bought or acquired in the previous 12 months;
  - ◆ NGC to prepare and publish annually a report on the manner in which, and the extent to which, it has complied with the BPS in the previous 12 months<sup>24</sup>; and
  - ◆ NGC's auditors to prepare a statement to accompany the BPS review. In this statement, the auditors must provide their opinion as to the extent to which the licensee has complied with the BPS.

## **Special condition AA5A**

- 8.18 Special condition AA5A sets restrictions on the revenues that NGC is allowed to earn from its Transmission Business. For this purpose, NGC's activities are split between its Transmission Network Services (TNS) and its Balancing Services Activity (BSA).
- 8.19 The TNS activities are defined as including all NGC's authorised activities relating to the planning, development, construction and maintenance of the transmission system (except for its BSA and excluded services). The BSA covers procuring and using balancing services for the purpose of balancing the licensee's transmission system. As such, the TO carries out the TNS activities whilst the SO carries out the BSA activity.
- 8.20 Part 1 of special condition AA5A outlines the revenue restriction in relation to NGC's TNS, while Part 2 outlines the revenue restriction in relation to its BSA.
- 8.21 The TNS revenue restriction is in the form of an RPI-X price control. The current restriction started on 1 April 2001 and is due to finish on 31 March 2006.<sup>25</sup> The

<sup>24</sup> A six month report was prepared to cover the period between 1 April 2002 and 30 September 2002,

BSA revenue restriction consists of a profit-sharing (sliding-scale) incentive scheme, which has separate targets for NGC's internal and external SO costs.

### ***Transco's Gas Transporter licences***

- 8.22 A GT has a duty, under section 9 of the Gas Act, to develop and maintain an efficient and economical pipeline system for the conveyance of gas and, subject to that so far as it is economical to do so, to comply with any reasonable request to connect to that system and convey gas by means of that system to any premises. A GT has a further duty, also under section 9 of the Act, to avoid any undue preference or discrimination in the connection of premises to any pipeline system operated by it, or in the terms on which it undertakes the conveyance of gas by means of such a system.
- 8.23 The licence places certain obligations on the GT, including the requirement that the GT introduces a Network Code, which sets out the arrangements between the GT and shippers for the use of, and connection to, that GT's pipeline system. The Network Code is required to meet the following relevant objectives as set out in standard condition 9 of the licence:
- (a) the efficient and economic operation by the licensee of its pipeline system;
  - (b) so far as is consistent with sub-paragraph (a), the efficient discharge of its obligations under its licence;
  - (c) so far as is consistent with sub-paragraphs (a) and (b), the securing of effective competition between relevant shippers and between relevant suppliers; and
  - (d) so far as is so consistent, the provision of reasonable economic incentives for relevant suppliers to secure that the domestic supply security standards are satisfied as respects the availability of gas to their domestic customers.

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however, future reports will cover a 12 month period and will be produced annually.

<sup>25</sup> Details of the current revenue restriction can be found in 'The transmission price control review of the National Grid Company from 2001: transmission asset owner, Final proposals', Ofgem, September 2000.

- 8.24 Standard condition 4D(1) of the licence requires the GT to conduct its transportation business in the manner best calculated to ensure that neither the GT nor any person related to it, nor any gas shipper nor gas supplier, obtains any unfair commercial advantage.
- 8.25 Standard condition 16(2) sets out certain gas security standards to which the licensee shall plan and develop its pipeline system. These standards require the pipeline system be capable of meeting a peak aggregate daily demand that is only likely to be exceeded in one year every 20 years.
- 8.26 Standard conditions 4 and 4A of the licence require the GT to establish and publish its Gas Transportation Charges and charging methodology. In making changes to its charging methodology, the GT must use all reasonable endeavours to give at least 150 days notice to the Authority of the proposed changes and, where the GT has decided to implement any such proposals, it must give the Authority one month notice before implementation of such changes. It must consult with relevant shippers for at least 28 days.

### **Special condition 28B**

- 8.27 Special condition 28B relates to the revenue restriction in respect of the NTS transportation owner activity, Distribution Network (DN) transportation activity and NTS system operation activity.
- 8.28 The NTS transportation owner activity is defined as the activities of the licensee connected with the development, administration and maintenance of the NTS and with the supply of NTS services. DN transportation activity relates to the activities of the licensee connected with the development, administration, maintenance and operation of the DN network, and with the supply of DN services. The NTS system operation activity is defined as engagements undertaken by the licensee pursuant to the operation of the NTS, being the procuring and using of balancing services for the purpose of balancing the NTS and the arranging with the NTS TO activity for the delivery of incremental entry capacity and NTS incremental exit capacity, including:

- (i) incremental entry capacity services;

- (ii) incremental exit capacity services;
- (iii) residual gas balancing services;
- (iv) system balancing services, which include services pursuant to paragraphs 5 and 6 of standard condition 7 (Provision of Information Relating to Gas Illegally Taken);
- (v) entry capacity constraint management services;
- (vi) exit capacity constraint management services; and
- (vii) the provision of services in relation to gas quality.

8.29 Part 1(a) of special condition 28B relates to the NTS transportation owner revenue restriction, part 1(b) relates to the DN transportation activity revenue restriction, while part 2 relates to the NTS system operation activity revenue restriction.

8.30 The NTS transportation owner revenue restriction and DN revenue restriction are in the form of an RPI-X price control. The current NTS transportation owner revenue restriction started on 1 April 2002 and is due to finish on 31 March 2007<sup>26</sup>. The NTS system operation revenue restriction consists of a series of incentive schemes.

## ***Industry Codes***

### **Balancing and Settlement Code**

8.31 NGC is required under standard condition C3 of the transmission licence to prepare the Balancing and Settlement Code (BSC). The BSC came into effect on 14 August 2001. Ahead of BETTA go-live, a suite of modifications was made to the BSC to create a GB BSC as part of the introduction of BETTA. These changes were made by way of designation by the Secretary of State on 1 September 2004.

<sup>26</sup> Details of the current revenue restriction can be found in 'Transco's National Transmission System system operator incentives 2002-07, Final proposals', Ofgem, December 2001.

- 8.32 The scope of the BSC is defined in general terms in the transmission, generation and supply licences. The BSC is a code that sets out the rules for the Balancing Mechanism and imbalance settlement process in the wholesale electricity trading arrangements and it is maintained by NGC under standard condition C3 of its transmission licence.
- 8.33 The BSC sets down the arrangements in respect of:
- ◆ making, accepting and settling offers and bids to increase or decrease electricity delivered to, or taken off, the total system (NGC's transmission system and the distribution systems) to assist NGC in balancing the system; and
  - ◆ determining and settling imbalances and certain other costs associated with operating and balancing the transmission system.
- 8.34 A BSC Panel has been created and charged with overseeing the management, modification and implementation of the BSC rules, as specified in Section B of the BSC. The Panel has twelve representatives made up from industry members, consumer representatives, independent members and NGC. The Authority appoints the Chairman of the Panel.
- 8.35 The Balancing and Settlement Code Company (ELEXON<sup>27</sup>) supports the BSC Panel. The primary purpose of ELEXON is to provide or procure a range of operational and administrative services (both directly and through contracts with service providers) and to implement the provisions of the BSC and modifications to it.
- 8.36 The details of the modification procedures are contained in Section F of the BSC. They are designed to ensure that the process is as efficient as possible whilst enabling as many parties as possible to propose modifications and have the opportunity to comment on modification proposals. Whilst Ofgem can not initiate any modifications, it is required to approve or reject all modifications to the BSC, according to defined criteria.

<sup>27</sup> The Balancing and Settlement Code Company was named ELEXON Limited on 7 June 2000.

8.37 NGC is required under the BSC to provide certain information to the market on an ex-ante basis. For example, NGC is required in accordance with Section Q.6 of the BSC to submit a number of data streams (e.g. the Indicated Margin and the National Indicated Imbalance) to the Balancing Mechanism Reporting Agent (BMRA) on an ex-ante basis. This data is made available for publication on the Balancing Reporting Mechanism Service (BMRS) to provide ex-ante information to market participants, enhancing transparency.

## **Connection and Use of System Code**

8.38 NGC is required under standard condition C10 of the transmission licence to prepare the Connection and Use of System Code (CUSC). The CUSC is a licence-based code, setting out the principal rights and obligations in relation to connection to and/or use of the transmission system and to the provision of certain balancing services. The CUSC was designated by the Secretary of State on 25 June 2001 and came into effect on 18 September 2001. Ahead of BETTA go-live, a suite of modifications was made to the CUSC to create a GB CUSC as part of the introduction of BETTA. These changes were made by way of designation by the Secretary of State on 1 September 2004.

8.39 A CUSC Panel has been charged with overseeing the CUSC amendment process as specified in Section 8 of the CUSC. The Panel has representatives made up from industry members, consumer representatives and NGC. The Chairman of the Panel is appointed by NGC and must be an executive director (or other senior employee) of NGC. NGC is responsible for implementing or supervising the implementation of Approved Amendments as outlined in paragraph 8.2.3.3 of the CUSC. As with the BSC, while Ofgem can not initiate amendments, it is required to approve or reject all amendments to the Code, according to defined criteria.

## **Transco's Network Code**

8.40 Transco's Network Code was put in place in March 1996. The mechanism for modifying the Network Code is set out in standard condition 9 of Transco's licence and in the Network Code modification rules. Under the modification rules, shippers, Transco and limited third parties such as Energywatch are able to

propose modifications to the Network Code. Ofgem is not itself able to propose modifications, although the implementation of all modifications requires the consent of the Authority.

- 8.41 The Authority may only direct that the Network Code should be modified if, in its opinion, the proposed modification would, as compared with the existing provisions of the Network Code or any alternative proposal, better facilitate the achievement of the relevant objectives as set out in standard condition 9 of the licence. In making such a direction, the Authority is bound by its duties under section 4AA of the Gas Act.

### **Transco's Operational Guidelines (OGs)**

- 8.42 The operational guidelines (OGs) are a set of rules that govern Transco's balancing operations and use of balancing tools. The OGs are not part of the Network Code but are established by a separate obligation under Transco's licence (special condition 17). Nevertheless, they are required by the licence to be consistent with the Network Code. The OGs are intended to ensure that Transco takes balancing actions that are consistent with the efficient and economical operation of the system. Only Transco is allowed to propose modifications to the OGs and these modifications require the consent of the Authority to be implemented.