

Explanatory note on proposed licence modifications relating to gas offtake

1. The aim of this note is to provide a detailed explanation of the proposed licence modifications relating to the activities undertaken by National Grid Gas plc's National Transmission System business (NGG NTS) in respect of its management of the provision of capacity for the offtake of gas from the NTS (gas exit).

2. However, before describing the licence modifications proposed in relation to gas offtake specifically, it is necessary to provide an overview of our proposed restructuring of the price control provisions within the NTS licence such that the gas offtake related licence modification drafting can be considered in context.

Proposed restructuring of Special Condition C8B

3. At present, Special Condition C8B of the NTS licence contains all of the key price control provisions for both the NTS transportation owner (TO) and NTS system operation (SO) activities including the incentives placed upon NGG NTS with respect to its SO activities at gas entry and gas exit and with respect to gas balancing and internal costs. This licence condition will require extensive revision in order to implement our TPCR proposals. Given the length of this condition and in order to make these key price control provisions easier to navigate, it is our proposal to delete Special Condition C8B and replace it with six new (and shorter) licence conditions as follows:

- Special Condition C8B (The NTS transportation owner activity revenue restriction), which incorporates the TO price control;
- Special Condition C8C (The NTS system operation activity revenue restriction), which contains the high-level provisions in respect of the SO price control;
- Special Condition C8D (NTS gas entry incentives, costs and revenues), which includes the licence provisions relating to gas entry to inform the derivation of TO and SO revenues in Special Conditions C8B and C8C respectively;
- Special Condition C8E (NTS gas exit incentives, costs and revenues), which includes the licence provisions relating to gas exit to inform the derivation of TO and SO revenues in Special Conditions C8B and C8C respectively;
- Special Condition C8F (Other NTS System Operator external incentives, costs and revenues), which includes the licence provisions relating to SO activities such as system balancing, residual gas balancing and the quality of information to inform the derivation of SO revenues in Special Condition C8C; and
- Special Condition C8G (NTS System Operator internal incentives, costs and revenues), which includes the licence provisions relating to the management of SO internal costs to inform the derivation of SO revenues in Special Condition C8C.

4. In Annex 1, we map the existing provisions of the current draft of Special Condition C8B to these six new conditions.

5. In order to provide context for the gas exit licence drafting contained within Special Condition C8E, we have attached initial drafts for the two conditions that will contain the key TO and SO principal formulae. The drafting proposed for

these conditions (Special Condition C8B and Special Condition C8C) is described briefly below.

New Special Condition C8B (The NTS transportation owner activity revenue restriction)

6. As illustrated by the mapping table in Annex 1, the new Special Condition C8B will contain the provisions that relate to the TO activity. We note that these provisions are currently held within Part 1a of the current draft of Special Condition C8B. We propose that the structure of these TO provisions in the new Special Condition C8B should remain largely unchanged relative to the current drafting of Part 1a.

7. Other than changes to amend cross-references, revise the dates consistent with the next price control period and insert blanks for the key revenue allowances that will be determined by the Final Proposals in December 2006, the main changes proposed relative to the current TO provisions include the following:

- removal of the detailed derivation of gas exit revenues (as represented by the term TOExR) such that this is provided in the new gas exit condition Special Condition C8E;
- deletion of sub-paragraph (b) in the derivation of prescribed rates given that this provision relates to the allocation of prescribed rates costs prior to the sale, by Transco plc, of four of its GDNs, which occurred on 1 June 2005; and
- deletion of the customer safety net provisions which were inserted into the NTS licence to provide protection to gas customers in the event that National Grid Transco (NGT) only sold one of its GDNs (or sold a number of its GDNs to a single purchaser). Such provisions are no longer required given that NGT sold four of its GDNs to three purchasers on 1 June 2005.

New Special Condition C8C (The NTS system operation activity revenue restriction)

8. As illustrated by the mapping table in Annex 1, the new Special Condition C8C will contain the following high-level provisions that relate to the SO activity:

- the principal restriction in what was Part 2, paragraph 12 of Special Condition C8B;
- the principal formula for NTS system operation revenue (SOR_t) in what was Part 2, paragraph 13(1) of Special Condition C8B;
- the principal formula for maximum NTS system operation revenue ($SOMR_t$) in what was Part 2, paragraph 14(1) of Special Condition C8B;
- the income adjusting event provisions ($SORA_t$) in what was Part 2, paragraph 14(11) of Special Condition C8B
- the NTS SO revenue adjustment factor (SOK_t) derivation in what was Part 2, paragraph 14(4) of Special Condition C8B;
- the reporting obligations in what was paragraph 15 of Special Condition C8B; and
- the disapplication provisions in what was paragraph 16 of Special Condition C8B.

9. Other than changes to amend cross-references and revise the dates consistent with the next price control period, the main changes made to the provisions of the current Special Condition C8B as listed above include the following:

- amendment of the definition of $RCOM_t$ to ensure that there is clarity regarding the inclusion of revenues resulting from the sale of gas purchased by the licensee in respect of its use of constrained storage facilities to avoid transportation constraints;
- removal of the detailed derivation of gas exit revenues (as represented by the term $SOExRF_t$) such that this is provided in the new gas exit condition Special Condition C8E; and
- redefinition of the principal formula for maximum NTS SO revenue ($SOMR_t$) such that the key parameters that feed into this formula reflect the new structure of price control conditions with terms for incentive revenues and costs in relation to gas entry, gas exit and other areas respectively.

Proposed licence modifications relating to gas offtake

10. The licence modifications proposed in relation to gas exit are predominantly driven by the need to implement appropriate incentives and obligations for the duration of the next price control consistent with our current proposals for the TPCR. However, certain aspects of the drafting are contingent upon the implementation of enduring offtake reform, which is currently the subject of the Uniform Network Code (UNC) process.

11. On 13 September 2006, NGG NTS raised a proposed modification of the UNC in order to implement enduring offtake reform (Modification Proposal 0116 (Reform of the NTS offtake arrangements)). We note that this proposal, and the three alternative Modification Proposals raised, are subject to the UNC process and that nothing in this consultation can fetter the discretion of the Authority in considering this or any other modification proposal. However, in order to inform industry participants of the interaction of any such modification proposal and the provisions within the licence held by NGG NTS, we have outlined what the proposed licence modification drafting to accompany such reforms would look like.

12. The licence conditions which we propose to modify in order to implement our proposals at gas exit are as follows:

- Special Condition C8E (NTS gas exit incentives, costs and revenues) – a new condition that we propose to introduce as part of the restructuring of the current Special Condition C8B;
- Special Condition C8A (Revenue restriction definitions in respect of the NTS transportation owner activity and NTS system operation activity), which requires definitional changes consistent with the proposed drafting of Special Condition C8E¹;

¹ It will also be necessary to make consequential amendments to Special Condition C14 (Information to be provided to the Authority in connection with the transportation system revenue restriction in respect of the NTS transportation owner activity and NTS system operation activity). However, this condition is subject to development as a result of changes proposed to ensure consistency in financial reporting and, as such, a draft of the proposed changes is not available for consultation at this time.

- Special Condition C18 (Licensee’s methodology for determining incremental exit capacity volumes) consistent with the potential introduction of enduring offtake arrangements;
- the potential removal of Standard Special Condition A55 (Enduring Offtake Arrangements); and
- the potential removal of Special Condition C17 (Exit Code Statement).

13. We discuss our proposals in relation to each of these licence conditions in turn below before briefly describing other exit related licence drafting issues. Licence drafting is provided for comment. These modification proposals are consistent with our September TPCR: Update proposals² (September Proposals) and will be subject to change if our policy is subsequently revised.

Special Condition C8E (NTS gas exit incentives, costs and revenues)

14. The new Special Condition C8E will contain the provisions of the current Special Condition C8B that relate to gas exit where it is our proposal to retain these for the transitional period as well as introducing a number of new provisions in relation to incentives that would apply were enduring offtake reform to proceed.

15. As such the new Special Condition C8E is subdivided into three main paragraphs:

- Paragraph 1 derives the gas exit related allowed revenues and costs (SOExIRC_t) that feed into the determination of the maximum SO revenue (SOMR_t) in Special Condition C8C. This is then further sub-divided into the following incentives and cost categories:
 - the buy-back and interruptions incentive;
 - the proposed CLNG incentive;
 - the exit capacity investment incentive;
 - the long run contracting incentive;
 - the non-obligated capacity incentive;
 - a mechanism to cap incremental investment buy-back exposure; and
 - an allowance for charges foregone.
- Paragraph 2 derives NTS gas exit revenues that feed into the determination of actual TO revenue (TOR_t) and actual SO revenue (SOR_t) in Special Condition C8B and Special Condition C8C respectively;
- Paragraph 3 outlines the gas exit related statements that the licensee is obliged to provide to the Authority.

16. The table in Annex 2 provides an overview of the proposed structure of Special Condition C8E and the applicability of each of the provisions of this condition to different periods within the next price control period.

Derivation of SOExIRC

17. Paragraph 1 of Special Condition C8E derives the gas exit related allowed revenues and costs (SOExIRC_t) that feed into the determination of the maximum SO revenue (SOMR_t) in Special Condition C8C.

² Transmission Price Control Review: Updated Proposals, Ofgem, September 2006 (Ref No. 170/06)

18. Sub-paragraph 1(a) of Special Condition C8E provides the principal formula for the derivation of $SOExIRC_t$. Each of the parameters defined as part of this formula are discussed in turn below.

Buy-back and interruptions incentive ($ExCBBIIR_t$)

19. A buy-back and greater than 15 day interruptions incentive currently applies to NGG NTS. This is a sliding scale incentive (with a cap and collar) that establishes a target for the costs of interrupting sites greater than 15 days each year and a target for buy-back costs. Under current arrangements, additional rebates are given to those sites that are interrupted for greater than 15 days each year. If the costs of these rebates and any capacity buy-backs undertaken by NGG NTS exceed the target that is set then NGG NTS bears a share of these costs.

20. In our June TPCR: Initial Proposals consultation³ (June Proposals) and the subsequent September Proposals, we proposed that:

- the current buy-back and interruptions incentive should apply for the period until 30 September 2008;
- the greater than fifteen day interruptions element of the incentive should continue (in the form of a sliding scale incentive) for the duration of the transitional period until 30 September 2010; and then
- the incentive should cease to apply in the enduring period i.e. the period from 1 October 2010 onwards.

21. The drafting of sub-paragraph 1(b) therefore retains much of the drafting for the buy-back and interruptions incentive currently present within the NTS licence, however:

- the value of $ExCBBIIR_t$ is set to zero for the period from 1 October 2010 (or such date that the Authority may otherwise direct in writing); and
- for the period up to 30 September 2010 (or such date that the Authority may otherwise direct in writing), $ExCBBIIR_t$ is defined such that NGG NTS is able to recover relevant buy-back and interruptions costs ($ExCBBICP_t$) but is subject to gains and losses around this cost-recovery level through the application of a sliding scale incentive where:
 - the component of relevant buy-back and interruptions costs ($ExCBBICP_t$) which relates to buy-back actions takes a value of zero for all days from 1 October 2008 (or such date that the Authority otherwise directs in writing) – this reflects our proposal that the buy-back incentive be removed from this date leaving only the greater than 15 day incentive;
 - the greater than 15 day target and the incentive collar change on 1 October 2008 (or such date that the Authority otherwise directs in writing) consistent with our proposals; and
 - a cap is no longer applied to the sliding scale incentive in the event that the relevant costs incurred ($ExCBBICP_t$) are less than the defined target ($ExCBBIIIT_t$) as such a provision is not necessary⁴.

³ TPCR 2007-2012 Initial Proposals, Ofgem, June 2006 (Ref No. 104/06)

⁴ For the period up to 30 September 2008, the cap is defined to be equal to the incentive target, however, given that costs can only be positive, the maximum incentive revenue through out-performing the target is the target subject to the 75% sharing factor, which

22. We note that, given that the framework of offtake arrangements is expected to change in October 2008 and October 2010 (consistent with the gas year calendar which runs from October to September), the incentive parameters determined for formula years 2008/9 and 2010/11 are required to change or fall away mid-way through a formula year. It is our intention to clarify the treatment of such parameters in these years within the licence drafting and we would welcome views on the appropriate methods for pro-rating or adjusting these parameters given that they have been determined consistent with application over a full formula year, yet will only apply for half of that formula year.

CLNG target (ExCIT_t)

23. The CLNG incentive is intended to ensure that NGG NTS uses LNG facilities efficiently when managing network constraints. Due to NGG NTS's ownership of constrained LNG storage facilities (through National Grid LNG), the scheme is currently separate from the exit investment scheme with no caps and collars and 100% sharing factors. This structure eliminates the scope for distorting behaviour between the regulated gas transmission business and the LNG businesses that are wholly owned by the National Grid Group.

24. In our June Proposals and the subsequent September Proposals, we proposed that the constrained LNG (CLNG) incentive that currently applies to NGG NTS should be retained in its current form with the incentive target value updated. In our September Proposals, a range of values for the incentive target was outlined based on different assumptions, for example in respect of the remuneration of gas costs incurred.

25. In the proposed licence drafting presented, we have considered the modifications that would be necessary under the scenarios where the costs of procuring gas for CLNG transmission support are not funded directly through the CLNG incentive target (scenarios 2 and 3 as presented in our September Proposals). As such, and under either of these scenarios, we believe that it would be appropriate to modify the definition of RCOM_t such that any revenues from the sale of such gas are excluded (and therefore retained by NGG NTS) and therefore the costs of procuring gas for CLNG can be recovered by the retention of revenues from the locational sale of gas elsewhere in the network as a result of the use of CLNG. Text for the definition of RCOM_t is provided in the draft of Special Condition C8C. The appropriate drafting will be reconsidered in our January 2007 licence consultation following confirmation of our Final Proposals in this area.

26. In order to replicate the effect of a sliding scale incentive with 100% sharing factors and no caps or collars, it is simply necessary to define a target for CLNG costs. This is done in sub-paragraph 1(c) - any deviations of out-turn costs from the defined target are borne in full by the licensee.

Exit capacity investment incentive (ExCIIR_t)

27. In our June Proposals consultation and subsequent September Proposals, we proposed that the delivery of capacity above baseline levels would be

by definition, will be less than the target so the cap can never be binding. Similarly, in the period from 1 October 2008 to 30 September 2010, the target is defined to be zero and, as such, out-performing the target is not possible.

remunerated through the application of pre-specified revenue drivers as appropriate.

28. We proposed:

- a zonal revenue driver for all capacity increments in the south west quadrant that are less than 15GWh/day in size; and
- nodal, project specific revenue drivers for all projects above this threshold regardless of their location.

29. The licence drafting in sub-paragraph 1(d) implements this policy through the specification of two variables (both of which are indexed for inflation):

- $ExCIIR_t^{projspec}$: which determines allowed revenue for specific, anticipated projects that are greater than or equal to 15GWh/day; and
- $ExCIIR_t^{swquad}$: which determines allowed revenue for smaller investments yielding capacity increments of less than 15GWh/day in the south west quadrant.

30. $ExCIIR_t^{projspec}$ is defined as the sum across all anticipated projects of the applicable project specific revenue drivers. A variable $CDEL_{p,t}$, that either takes a value of zero or one, determines which revenue drivers are applicable in any given formula year with this variable taking a value of one in formula years t , $t + 1$, $t + 2$, $t + 3$ and $t + 4$ if the anticipated project (p) is delivered in formula year t following the receipt of an appropriate long term user signal (as specified in the Exit Capacity Release Methodology Statement pursuant to Special Condition C18). As such, the revenue drivers apply on a five year rolling basis from contractual delivery as previously outlined in our TPCR proposals.

31. The relevant project specific revenue drivers are provided in a table, and each of the projects is defined to ensure that the lump sum allowance specified for the project is not applied to similar projects of differing scale or scope.

32. $ExCIIR_t^{swquad}$ is defined to be non-zero where the incremental capacity delivered, in a given formula year, across all nodes in the south west quadrant is less than 15 GWh/day. In such an instance, $ExCIIR_t^{swquad}$ is defined to be equal to the zonal revenue driver specified multiplied by the appropriate incremental exit capacity.

33. The appropriate volume of incremental exit capacity is defined separately for the periods preceding and following 1 October 2010 (or such date that the Authority otherwise directs in writing):

- prior to 1 October 2010, incremental capacity can be remunerated via the zonal revenue driver if the licensee has either:
 - received a specific user commitment; or
 - the Authority has so determined (this latter provision addresses the fact that investment may be appropriate absent a specific user commitment in advance of the introduction of a full user commitment model); and
- on or after 1 October 2010, it is made clear that “NTS obligated incremental exit flat capacity” (the definition of which is provided in Special Condition C8A) can be remunerated through this mechanism.

34. In both cases, a variable $RDEL_{z,t}$ that either takes a value of zero or one is specified such that the revenue driver, again, applies on a five year rolling basis from contractual delivery as previously outlined in our TPCR proposals.

35. In addition to this incentive, sub-paragraph 1(d)(iii) states the appropriate capacity release obligations applicable to the licensee in the enduring period consistent with our September Proposals, and as such imposes the following obligations:

- to release baseline capacity up to and including on the gas day;
- to release obligated incremental capacity for which an appropriate user commitment has been received up to and including on the gas day;
- to substitute capacity release obligations (baselines) between nodes such that the level of obligated incremental capacity that requires additional remuneration is minimised (the substitution obligation); and
- to revise capacity release obligations (baselines) upwards in the event that the release of obligated incremental entry capacity increases the availability of NTS exit capacity.

Long run contracting incentive ($ExLRCIR_t$)

36. In our June Proposals consultation and the subsequent September Proposals, we proposed that, in the enduring period, there should be an upwards adjustment of a number of nodal baselines in the south west quadrant above the physical capability of the network, where such sites had historically interruptible status. We proposed that such adjustments should be accompanied by an additional revenue allowance to remunerate efficiently incurred contracting costs at the relevant sites. In the September Proposals, we proposed a value for the target and stated our view that 50% sharing factors should be applied to the extent that NGG NTS deviates from the target determined.

37. Sub-paragraph 1(e) implements this policy by defining the parameter $ExLRCIR_t$ such that it allows the recovery of the costs incurred with respect to the delivery of baseline capacity at the relevant sites with additional up-side or down-side determined by a sliding scale incentive whereby the licensee bears 50% of all deviations from the target level of costs.

Non-obligated capacity incentive ($ExNOCIR_t$)

38. In our June Proposals and subsequent September Proposals, we proposed that the release of non-obligated capacity by NGG NTS should be incentivised through a sliding scale incentive, with a zero target, that would allow NGG NTS to retain 50% of revenues from the sale of:

- non-obligated incremental flat capacity;
- non-obligated incremental flexibility capacity; and
- interruptible capacity sold at the day ahead stage.

39. This policy is implemented through the determination of the parameter $ExNOCIR_t$ in sub-paragraph 1(f) which is derived through a sliding scale incentive.

Cap on incremental investment buy-back exposure (ExIBBC_t)

40. In our September Proposals, we proposed that investment related buy-back costs should be treated as excluded revenue. However, following further consideration of the potential exposure of NGG NTS to buy-back actions associated with incremental investment, we stated that an absolute cap on such exposure of £36m per annum would be appropriate in respect of gas exit.

41. This policy is implemented through the determination of the parameter ExXSIBBC_t in sub-paragraph 1(g).

Charges foregone (ExNTSSIC_t)

42. In the current NTS licence, the total accrued value in respect of charges foregone as a result of the discount to capacity charges offered to interruptible customers feeds into the assessment of actual TO revenues such that TO charges are determined as if such charges had not been foregone. However, an equal and opposite allowance for charges foregone is made such that this amount feeds into allowed SO revenue for the licensee such that these costs can be recovered through the SO business. In addition, there is at present an incentive upon the level of charges foregone such that deviations for an assumed target increase or decrease the allowed revenue of the licensee.

43. In our June Initial Proposals consultation and the subsequent September Proposals, we proposed to remove the incentive in place in relation to charges foregone. This remains our proposal and, as such, no incentive is included in the licence drafting presented. However, it remains necessary for the level of charges foregone to feed into the allowed SO revenue (SOMR_t) until implementation of the enduring offtake regime (at which time the principle of charges foregone and the interruptible discount are assumed to no longer apply). As such, sub-paragraph 1(h) retains the drafting currently within the NTS licence in this regard, setting the level of charges foregone (ExNTSSIC_t) to zero for all days from 1 October 2010 onwards (or such date that the Authority otherwise directs in writing).

Derivation of NTS gas exit revenues

44. Paragraph 2 of Special Condition C8E derives NTS gas exit revenues that feed into the determination of actual TO revenue (TOR_t) and actual SO revenue (SOR_t) in Special Condition C8B and Special Condition C8C respectively.

NTS transportation owner revenues (TOExR_t)

45. Sub-paragraph 2(a) derives the gas exit revenues (TOExR_t) that feed into the determination of actual TO revenues. As is the case in the NTS licence at present, TOExR_t is defined as the sum of:

- TOExRF_t, which, in the drafting proposed, represents gas exit related TO revenues in the period prior to 1 October 2010 (or such date that the Authority otherwise directs in writing);
- TOExNTSSIC_t, which is the accrued value of charges foregone, which is derived in sub-paragraph 1(g) and discussed above; and
- TOREVBExC_t which, in the drafting proposed, represents gas exit related TO revenues in the period from 1 October 2010 (or such date that the Authority otherwise directs in writing).

46. TOExRF_t is derived in sub-paragraph 2(a)(i). The derivation of this term has been refined relative to the drafting currently within the NTS licence, as the definition of nodal baselines for the three capacity products in the period prior to 1 October 2010 (NTS exit flat capacity⁵, NTS exit flow flexibility⁶, and NTS exit shipper capacity⁷) allows the term to be specified as the sum of:

- revenues in respect of the provision of NTS baseline exit shipper capacity (TREVBSC_t);
- revenues in respect of the provision of NTS baseline exit flat capacity (TREVExC_t); and
- revenues in respect of the provision of NTS baseline exit flow flexibility (TREVBFF_t).

47. TOREVBExC_t, is derived in sub-paragraph 2(a)(ii). The derivation of this term has, again, been refined relative to the drafting within the NTS licence (which is currently dormant) as it is our proposal that the obligation to make baseline capacity available in the enduring period will be up to and including on the gas day. As such, we do not believe that it is either appropriate or necessary to deduct revenues from on the day sales of baseline capacity as is currently the case.

NTS system operation revenues (SOExRF_t)

48. Sub-paragraph 2(b) derives the gas exit revenues (SOExRF_t) that feed into the determination of actual SO revenues. SOExRF_t is defined as the sum of:

- SO revenues in the period up to 1 October 2010 (or such date that the Authority otherwise directs in writing), which are defined to be gas exit revenues from the sale of NTS exit flat capacity, NTS exit flow flexibility and NTS exit shipper capacity net of revenues captured by the term TOExRF_t which is discussed above, and therefore include revenues for the sale of incremental and interruptible capacity; and

⁵ In the transitional period, this is the flat capacity product offered at GDN offtakes

⁶ In the transitional period, this is the flat capacity product offered at GDN offtakes

⁷ This is a transitional period product offered at TCC offtakes in place of the two separate products offered at GDN offtakes.

- SO revenues in the period from 1 October 2010 (or such date that the Authority otherwise directs in writing), which are defined to be the sum of:
 - revenues from the sale of NTS obligated incremental exit flat capacity;
 - revenues from the sale of NTS obligated incremental exit flow flexibility; and
 - revenues from the sale of NTS non-obligated exit capacity (the composition of which was discussed above in relation to the non-obligated capacity incentive).

49. The definition of the terms quoted above are discussed further in our discussions of the modifications proposed to Special Condition C8A below.

Statements required from the licensee

50. Paragraph 3 outlines the gas exit related statements that the licensee is obliged to provide to the Authority. These include the following:

- statement of actual interruption;
- statement of incremental investment in the transitional period;
- methodology statement for baseline revision;
- request for baseline revision; and
- statement of incremental obligated capacity in the enduring period.

51. Each of these statements are considered in turn below.

Statement of actual interruption

52. Sub-paragraph 3(a) states that the licensee shall be obliged to publish daily statements of actual interruption. This obligation currently applies to NGG NTS and it is our intention to retain this obligation in its current form for the duration of the forthcoming price control period.

Statement of incremental investment in the transitional period

53. Sub-paragraph 3(b) states that the licensee shall be obliged to provide the Authority with a written statement of any NTS incremental exit capacity that is scheduled for delivery within the transitional period (from 1 October 2008 to 30 September 2010 (or such dates that the Authority otherwise directs in writing)) which leads to depreciation, capex or financing costs being incurred within the next price control period.

54. Where the licensee has not received an explicit and appropriate user commitment, the licensee must explain the basis upon which it has reached the view that demand will be sufficient to justify the provision of such NTS exit capacity. In such cases, the Authority shall consider such information and shall determine whether the NTS exit capacity concerned may be treated, for revenue driver purposes, as if such a user commitment had been received.

Methodology statement for baseline revision

55. Sub-paragraph 3(c) states that the licensee shall be obliged to provide the Authority with a methodology statement for exit baseline revision setting out the methodology by which it will determine its proposals for the revision of baselines within the enduring period pursuant to its obligations in this regard (as discussed above).

56. The initial statement and revisions to such a statement shall be subject to a consultation process. The licensee will also be obliged to comply with the methodology outlined in this statement in performing baseline revisions.

57. We would welcome views on whether the licence should state methodology objectives for such a statement and, if so, what these should be.

Request for baseline revision

58. Sub-paragraph 3(d) states that the licensee shall be obliged to provide the Authority with a written statement of any proposed exit baseline revisions setting out the basis for such revisions consistent with its obligations in this regard (as discussed above). The Authority shall consider such information and shall determine whether to consent to the revisions proposed. Following the granting of any such consent, the licensee shall publish an "NTS exit baseline statement" incorporating such revisions. We note that the initial baselines will be as set out in our Final Proposals document scheduled for publication in December.

Statement of incremental obligated capacity in the enduring period

59. Sub-paragraph 3(e) states that the licensee shall be obliged to provide the Authority with a written statement, each year, of any proposed NTS obligated incremental exit capacity in the enduring period. Such a statement shall require the licensee to state the basis upon which the licensee has reached the view that the demand triggering such NTS obligated incremental capacity cannot be satisfied in full by the substitution or revision of baselines in order for the Authority to establish compliance with the obligations to substitute or revise baselines (as discussed above).

Interaction with enduring offtake reform

60. Where possible, the licence drafting of Special Condition C8E has been constructed such that, should enduring offtake reforms not proceed, or proceed such that they apply to a period other than the period from 1 October 2010 onwards, the Authority would be able to direct a later date for the introduction of such contingent licence drafting, as appropriate. However, as the legal drafting for any such modification proposal develops, it may be necessary to refine the licence drafting proposed, particularly where the drafting references the network code.

Special Condition C8A (Revenue restriction definitions in respect of the NTS transportation owner activity and NTS system operation activity)

61. It will be necessary to modify Special Condition C8A within the current NTS licence to acknowledge definitions that are no longer required as well as new terms introduced as a result of the modifications proposed to Special Conditions C8B to C8F.

62. In this section, we consider the modifications that are required to Special Condition C8A as a result of the proposed drafting of Special Condition C8E (discussed above).

63. As stated earlier, many of the changes outlined to Special Condition C8E are contingent upon the progression of NTS enduring offtake reform. In the event that the enduring period provisions within Special Condition C8E do not become active, then the associated definitions with Special Condition C8A will lie dormant. However, it should also be noted that, as the legal drafting of any UNC modification proposal to implement enduring offtake reform is developed, it will be necessary to ensure that the terms used in both Special Condition C8A and Special Condition C8E remain consistent with the drafting of the UNC.

64. We first discuss exit related terms that are no longer required within Special Condition C8A before discussing new terms that we propose to introduce and terms that we propose to modify.

65. The modifications to Special Condition C8A appended to this document only consider the modifications needed with regards to gas offtake related changes. As such, further definitional changes will be required consistent with modifications proposed to other areas of price control drafting such as gas entry.

Exit related terms that we propose to remove

66. As a result of our proposed modifications to the exit related provisions of what is currently Special Condition C8B, it is no longer necessary to include definitions of the following terms within Special Condition C8A:

- “DM connected system exit point”, “DM supply meter point”, “NDM connected system exit point”, and “NDM supply meter point”: which are no longer required as these terms currently feed into the charges foregone and investment incentive which we are not proposing to apply during the next price control period;
- “exit capacity curtailment rights”: which has been deleted as this was performing the same function as “NTS exit capacity curtailment rights” and was therefore unnecessary;
- “NTS baseline firm exit capacity”: which is no longer needed as baselines are specified for the separate NTS exit capacity products applicable during the next price control period; and
- “NTS baseline interruptible exit capacity”: which is no longer needed as interruptible baselines are not proposed.

New exit related terms that we propose to introduce

67. As a result of our proposed drafting for Special Condition C8E, as discussed above, it is necessary to introduce the following terms into Special Condition C8A:

- “NTS baseline exit flat capacity release obligations” and “NTS baseline exit flow flexibility release obligations”: to denote the capacity release obligations represented by the baselines defined for the enduring period to which the substitution obligation applies;
- “NTS exit baseline statement”: to denote the statement of baselines as set out in our Final Proposals or subsequently amended (with the Authority’s consent) through application of the substitution obligation or following relevant entry investments that impact upon exit capability⁸;
- “NTS firm exit flat capacity”, “NTS firm exit flow flexibility” and “NTS firm exit shipper capacity”: to denote the firm nature of the products offered and allow clarity in the drafting that the baselines and capacity release obligations relate to the contractual delivery of firm capacity;
- “NTS obligated incremental exit flat capacity” and “NTS obligated incremental exit flow flexibility”: to denote incremental capacity in the enduring period which has an appropriate user commitment and which the licensee is therefore obliged to release;
- “NTS non-obligated exit capacity”: to denote all NTS exit capacity that the licensee does not have an obligation to release;
- “NTS non-obligated incremental exit flat capacity” and “NTS non-obligated incremental exit flow flexibility”: to denote two of the types of NTS non-obligated exit capacity, namely incremental exit capacity for which an appropriate user signal has not been received; and
- “NTS short term interruptible capacity”: which denoted NTS interruptible exit capacity excluding capacity that is subject to exit capacity curtailment rights as a result of long term contracting to buy-back capacity in order to minimise or avoid the need for investment to deliver obligated capacity.

68. The concept of “NTS obligated incremental exit flow flexibility” is acknowledged in the proposed licence drafting even though, in the enduring regime, it is not expected that NGG NTS will be able to offer incremental flow flexibility in the long term over and above the baseline levels specified. The provision of such incremental capacity would be addressed on a case by case basis and subject to Authority consent, as acknowledged by the definition of this term, as well as requiring the specification of revenue drivers. However, the concept has been introduced into the licence drafting at this stage to cater, at least partially, for such situations should they arise. The introduction of such a term also allows us to be clear in specifying the definition of “NTS non-obligated incremental exit flow flexibility” which allows the release of additional flexibility capacity within investment lead times to be incentivised.

Exit related terms that we propose to modify

69. As a result of our proposed drafting for Special Condition C8E, as discussed above, we propose to modify the definitions of the following terms:

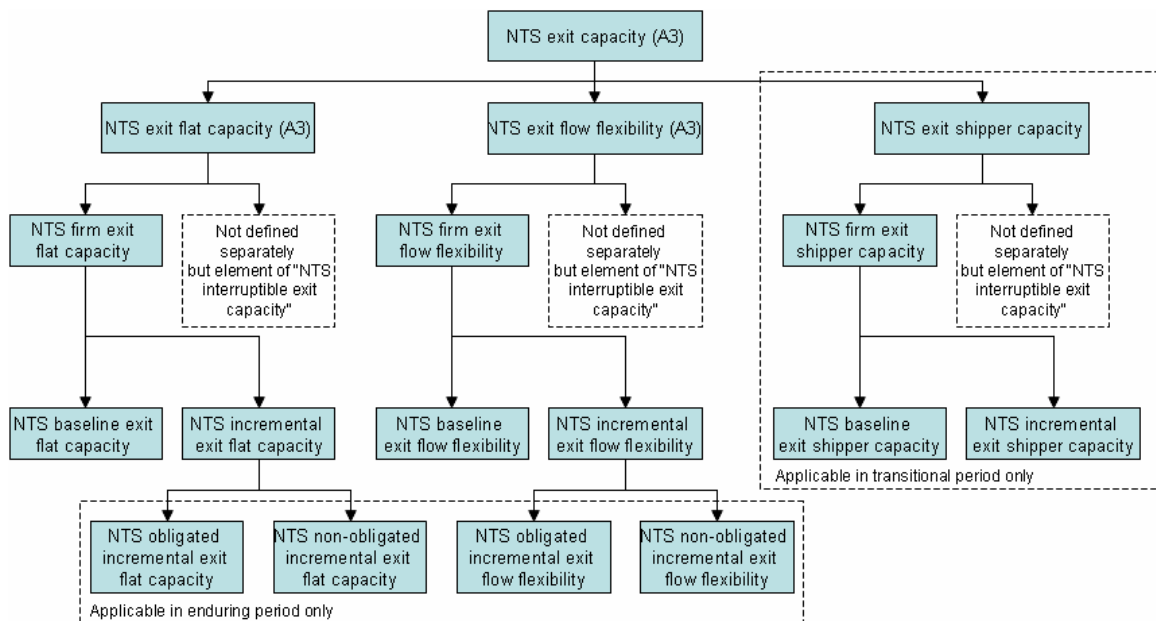
- “NTS baseline exit flat capacity”, “NTS baseline exit flow flexibility”, and “NTS baseline exit shipper capacity” such that it is clear that such capacity is firm in nature and such that the definitions reference the “NTS exit baseline statement” rather than Schedule A;

⁸ NGG NTS will be obliged to publish any revisions to this statement.

- “NTS incremental exit flat capacity”, “NTS incremental exit flow flexibility”, and “NTS incremental exit shipper capacity” such that it is clear that such capacity is firm in nature;
- “NTS exit capacity curtailment rights”: harmonising the definition applied with that for the removed term “exit capacity curtailment rights”; and
- “NTS incremental exit capacity” has been redefined as the sum of “NTS incremental exit flat capacity”, “NTS incremental exit flow flexibility” and “NTS incremental exit shipper capacity”.

70. The proposed hierarchy of exit capacity product definitions is illustrated in Figure 1 below.

Figure 1: Proposed hierarchy of exit capacity product definitions



71. As noted in the diagram above, certain definitions, which also apply within the GDN licences are defined in Standard Special Condition A3 (Definitions and Interpretation).

Special Condition C18 (Licensee’s methodology for determining incremental exit capacity volumes)

72. We have considered what changes may be necessary to Special Condition C18, particularly in the light of the potential introduction of enduring offtake reform. Given that NGG NTS’s current proposals for reform envisage a framework whereby all capacity booked and released in the long-term, over and above users’ prevailing rights, requires a user commitment regardless of whether it is above or below baseline levels, it is our view that the reference of the statement to “incremental” capacity will become less meaningful. Rather, we believe that it would be more helpful if NGG NTS were obliged to provide a methodology statement outlining the principles that will be applied with respect to the release of all capacity. As such, we propose to:

- rename Special Condition C18 such that it is called “Licensee’s methodology for determining the release of exit capacity volumes”;
- remove paragraph 1 which currently provides definitions of “incremental exit capacity” and “initial volume allocation” and remove “incremental” references which we believe are no longer necessary given the change in focus of this statement; and
- ensure that a methodology statement is in place on the first day of the next price control period, and will have been subject to consultation with gas shippers and DN operators, and that it is resubmitted in April, rather than July, each year in advance of the proposed capacity booking window in July each year.

73. Furthermore, we propose to amend the requirement, in what is now paragraph 2, such that the statement from appropriate auditors is required only if the Authority so directs rather than being required as a default, unless the Authority otherwise consents. This follows submissions from NGG NTS stating that such auditor statements are difficult and expensive to obtain.

Standard Special Condition A55 (Enduring Offtake Arrangements)

74. Standard Special Condition A55 was introduced in 2005 and requires the NTS and GDN licensees to use their best endeavours to implement enduring offtake reform. As such, should enduring offtake reform be implemented this condition will no longer be necessary and we therefore propose its deletion.

Special Condition C17 (Exit Code Statement)

75. Special Condition C17 requires NGG NTS to submit an exit code statement which provides a description of the services provided and revenue received by the licensee’s NTS activity and DN activity and therefore seeks to achieve clarity in the services and revenues shared between the NTS and GDN activities.

76. As part of the DN sales licence consultations in 2005, we stated our view that the requirements of this condition will cease to be necessary once enduring NTS exit arrangements have been implemented as there will be a transparent, external NTS-DN interface that will remove the need for publication of such a statement. We continue to hold this view and, as such, propose the deletion of this condition in the event that enduring offtake reform is implemented.

Other issues

77. There are other areas of licence drafting where there will be a potential interaction with gas exit issues.

78. Firstly, in determining the definition of “relevant system operation costs” in Special Condition C8A, it will be necessary to consider the appropriate cost categories against which the Income Adjusting Event threshold should be applied in paragraph 3(b)(ix)(B) of Special Condition C8C. Our initial thoughts are that, from a gas exit perspective, it would be appropriate for buy-back costs to be included within this term, as well as possibly the costs associated with the provision of CLNG. We would welcome views.

79. Secondly, further licence modifications may be necessary in order to implement our proposals in relation to investment related buy-backs. We will confirm the modifications proposed in this regard in our next consultation.

Annex 1: Mapping Table for Proposed Replacement and Restructuring of NTS Special Condition C8B

It is assumed that Special Condition C8B will be replaced by six new licence conditions to aid navigation of the price control related conditions. The proposed scope of these new licence conditions is outlined below:

- Special Condition C8B: The NTS transportation owner activity revenue restriction (currently Part 1a)
- Special Condition C8C: The NTS system operation activity revenue restriction
- Special Condition C8D: NTS gas entry incentives, costs and revenues
- Special Condition C8E: NTS gas exit incentives, costs and revenues
- Special Condition C8F: Other NTS System Operator external incentives, costs and revenues
- Special Condition C8G: NTS System Operator internal incentives, costs and revenues
-

Provisions of the existing licence condition		The new licence conditions proposed						
		Special Condition C8B	Special Condition C8C	Special Condition C8D	Special Condition C8E	Special Condition C8F	Special Condition C8G	
Part 1a (The NTS transportation owner activity revenue restriction)		✓	-	-	-	-	-	
Part 2 (The NTS system operation activity revenue restrictions)	12. Principal restriction	-	✓	-	-	-	-	
	13. NTS system operation revenue (SOR)	-	✓	-	-	-	-	
	14. Definition of maximum NTS system operation revenue (SOMR)	(1) Principal formula	-	✓	-	-	-	-
		(2) NTS system operator incentive revenue (SOIR)	-	✓	-	-	-	-
		(3) NTS system operation costs (SOIC)	-	✓	-	-	-	-
(4) NTS SO revenue adjustment factor (SOK)		-	✓	-	-	-	-	

Provisions of the existing licence condition	The new licence conditions proposed					
	Special Condition C8B	Special Condition C8C	Special Condition C8D	Special Condition C8E	Special Condition C8F	Special Condition C8G
(5) Entry capacity investment incentive revenue (ECIIR)	-	-	-	✓	-	-
(6) Exit capacity investment incentive revenue (ExCIIR)	-	-	-	✓	-	-
(7) Entry capacity buy-back incentive revenue (BBIR)	-	-	✓	-	-	-
(8) System balancing incentive (SBIR)	-	-	-	-	✓	-
(9) Residual gas balancing incentive revenue (RBIR)	-	-	-	-	✓	-
(10) Internal cost incentive (ICIR)	-	-	-	-	-	✓
(11) Determination of any adjustment factor to be applied to SOMR (SORA)	-	✓	-	-	-	-
(12) NTS exit capacity buy-back and interruption incentive revenue (ExCBBIR)	-	-	-	✓	-	-
(13) Quality of information incentive	-	-	-	-	✓	-
15. Reporting obligations	-	✓	-	-	-	-
16. Disapplication of the NTS SO activity restriction	-	✓	-	-	-	-

Annex 2: Structure of Special Condition C8E

Provisions of Special Condition C8E		1/4/07 – 30/09/08	1/10/08 – 30/09/10	1/10/10 – 31/03/12	Comments
1. NTS system operation exit incentives and costs (SOExIRC)	(a) Principal formula	✓	✓	✓	High level formula outlining derivation of SOExIRC.
	(b) Buy-back and interruptions incentive revenue (ExCBBIIR)	✓	✓	-	Retention of the buy-back and interruptions incentive for the period to 30 September 2008, with the interruptions element of the incentive retained for the period from 1/10/08 to 30/09/10.
	(c) Constrained storage target (ExCIT)	✓	✓	✓	Applies throughout the next price control period.
	(d) Exit capacity investment incentive revenue (ExCIIR)	✓	✓	✓	Applies throughout the next price control period with different trigger mechanisms applying prior to introduction of the enduring period for zonal revenue drivers. Also includes capacity release obligations for the enduring period.
	(e) Long run contracting incentive revenue (ExLRCIR)	-	-	✓	Applies from the enduring period only.
	(f) Incentive revenue from sale of NTS non-obligated exit capacity (ExNOCIR)	-	-	✓	
	(g) Cap on incremental investment buy-back exposure	-	-	✓	

Provisions of Special Condition C8E		1/4/07 – 30/09/08	1/10/08 – 30/09/10	1/10/10 – 31/03/12	Comments
	(ExXSIBBC)				
	(g) Charges foregone (ExNTSSIC)	✓	✓	-	Applies until 30/09/10.
2. NTS gas exit revenues	(a) NTS transportation owner revenues (TOExR)	✓	✓	✓	Applies throughout the next price control period, but separate terms defined for the periods up to 1 October 2010 and beyond.
	(b) NTS system operation revenues (SOExRF)	✓	✓	✓	
3. Statements required from the licensee	(a) Statement of actual interruption	✓	✓	✓	Applies throughout the next price control period.
	(b) Statement of incremental investment in the transitional period	-	✓	-	Applies to the transitional period (i.e. from 1/10/08 to 30/09/10) only.
	(c) Methodology for baseline revision	-	-	✓	These statements relate to capacity in the enduring period only. However, given the length of investment lead times, the obligations to provide such statements apply for the duration of the next price control period.
	(d) Annual report on baseline revision	-	-	✓	
	(e) Statement of incremental obligated capacity in the enduring period	-	-	✓	