

## Transmission Price Control Review: Draft licence modifications

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**Target audience:** Licensees, gas transporters and shippers, users of the transmission and transportation networks, consumer groups and interested parties

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### Overview:

The Transmission Price Control Review (TPCR) will set out proposals for the revised electricity and gas transmission price controls to apply from 1 April 2007. To give effect to these proposals we will need to modify the licences of each transmission company.

This document outlines the licence changes we think are needed, and sets out the process for completing this work. We believe that it is important to engage stakeholders at an early stage in the process. Where possible we have included working drafts of the relevant proposed licence conditions to help inform debate. In other cases we provide a narrative description of the changes we envisage.

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## Context

The Transmission Price Control Review (TPCR) has been taken forward through a series of five consultation documents starting in July 2005. We will publish Final Proposals in December 2006. Implementation of our Final Proposals will require formal modifications of the licences of each of the electricity transmission companies and National Grid Gas National Transmission System's (NGG NTS) gas transporters licence.

We published an open letter last month setting our views on how the licence might need to be amended in relation to our proposals for gas offtake. This document sets out our current thinking on the changes we're proposing to NGG NTS's licence and the three electricity transmission licences. This reflects the position we set out in our September Updated Proposals document but is subject to change in light of consideration of responses to that document and further consultations.

## Associated Documents

- Transmission Price Control Review: Draft Licence Modifications Supplementary Appendices, November 2006 (Ref No. xx)
- TPCR 2007-2012 Updated Proposals, September 2006 (Ref No. 170/06)
- TPCR 2007-2012 Updated Proposals, Appendices, September 2006 (Ref No. 170/06a)
- TPCR 2007-2012 Initial Proposals, June 2006 (Ref No. 104/06)
- TPCR 2007-2012 Initial Proposals, Main Appendices, June 2006 (Ref No. 104b/06)
- TPCR 2007-2012: Third Consultation, March 2006 (Ref No. 51/06)
- TPCR 2007-2012: Third Consultation, Supplementary Appendices, March 2006 (Ref No. 51/06b)
- TPCR Second Consultation, December 2005 (Ref No. 277/05)
- TPCR Initial Consultation, July 2005 (Ref No. 172/05)

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## Summary

The Transmission Price Control Review (TPCR) will result in revised electricity and gas transmission price controls to apply for a five year period from 1 April 2007. Our proposals have been developed over a series of five public consultation documents, starting in July 2005. We will be publishing our final proposals next month.

To give effect to these proposals we will need to modify the licences of each of the three electricity transmission licensees and NGG NTS. In October we published an open letter consulting on licence changes that might be required in relation to the proposals for gas offtake. This document outlines the licence changes we propose in relation to the electricity and gas entry elements of our TPCR proposals. This will involve changes to the transmission licences of National Grid Electricity Transmission plc (NGET), Scottish Power Transmission Limited (SPTL) and Scottish Hydro Electric Transmission Limited (SHETL) and the gas transporters licence of NGG NTS.

This document explains the rationale for our proposed changes and provides details of them. Wherever possible we have included detail of our proposed licence modifications appendices. We hope that this will aid understanding of the proposed changes. Where this is not possible, we provide narrative describing the changes we currently envisage. However, our proposed licence conditions are at a relatively early stage and are subject to change in light of further consultation.

We would welcome views on any aspect of the proposed changes set out in this document. Following consideration of respondents' views, we intend to publish a second consultation document on licence drafting shortly after our final proposals in December. The final notices to propose modifications to the licences will be published in February 2007.

## 1. Introduction

### Chapter Summary

This chapter provides an overview of the rationale for, and the structure of, this document.

### Questions

There are no questions in this section.

## Outline of this document

1.1. This document focuses on the proposed changes to the electricity transmission licences of NGET, SPTL and SHETL and the gas transporters licence of NGG NTS which arise as a result of the proposals developed through the TPCR process. These proposals have been consulted on in various documents, including our September document. The changes we propose in this document relate to a number of policies which are the subject of ongoing consultation. As the deadline for responses to our September document has only just passed, we have not been able to update our proposals in light of responses to that document. Therefore, any proposals or supporting text in this document are subject to change and should not be treated as definitive. Nevertheless, we have sought to provide further detail on the possible licence changes that our proposals will necessitate in the appendices to this document in as many instances as practicable.

1.2. The amendments we would need to make to give effect to our proposals cover a number of different licence conditions, within NGG NTS's gas transporter licence and within the three electricity transmission licences. This document first discusses changes to the gas entry regime, in Chapter 2, before considering proposed changes to the electricity transmission licences in Chapters 3 – 7. NTS gas offtake arrangements are being consulted on separately as mentioned below.

## Gas Entry

1.3. This section explains our approach to the licence drafting for the System Operator incentives that relate to the availability of entry capacity. The licence drafting concerning TO aspects of gas entry arrangements is not covered here and will be consulted on separately.

1.4. The current revenue restriction licence condition is structured in a series of relatively independent sections. We propose to retain this modular approach - including by separating the material out into separate licence conditions in some

instances. The details of the entry capacity arrangements will be contained in new Special Condition C8D.

1.5. We published for consultation on 20 October our thoughts on licence drafting for the proposed NTS gas offtake arrangements. This chapter complements the material published in that consultation.

1.6. We intend that Special Condition C8D would have six main parts, specifying:

- Obligations for NGG NTS to release capacity;
- Obligations to facilitate capacity transfer and trade;
- How NGG NTS's capacity release obligation will change in response to demands for additional capacity;
- How NGG NTS's revenues would adjust if it takes on additional obligations to release capacity;
- The incentive on NGG NTS regarding operational buy-back, and
- The incentive on NGG NTS regarding incremental buy-back.

1.7. Chapter 2 explains what we expect to be included in each section. Appendix 5 sets out in tabular form how the issues covered in each part of the existing licence conditions would be captured in the new proposed structure for Special Condition C8D. Appendix 6 contains preliminary draft legal text for three important proposed new parts of NGG NTS's licence:

- The capacity substitution obligation;
- The capacity transfer facilitation obligation, and
- The capacity trade facilitation obligation.

1.8. This draft text will be subject to further changes pursuant to further Ofgem internal review and in response to any comments we receive regarding the consultation of 20 October.

1.9. As well as incorporating the proposed changes to our policy relating to gas entry arrangements, we also consider that the revisions provide an opportunity to simplify the drafting of the gas entry licence conditions. While there is an inevitable element of complexity to the entry arrangements that has to be captured in the licence conditions, we consider it is important where possible, that the licence conditions are as simple as possible, to aid stakeholder understanding.

1.10. The principal mechanism by which we intend to simplify the licence conditions is by removing the calculation of many of the detailed terms from the licence and having them subject to annual (or more frequent where appropriate) reporting requirements for NGG NTS. The approach to calculating the terms will be specified in the licence. We would appreciate views on whether simplifying the licence conditions in this way would be appropriate, and any specific provisions that interested parties consider should be included to ensure that NGG NTS reports information accurately.

## Electricity

1.11. Electricity transmission licences have two distinct sections. Special licence conditions contain provisions which are specific to an individual licensee, while standard licence conditions are common across all licences of a particular type. This document details proposed changes to the special licence conditions of NGET, SPTL and SHETL and the standard conditions common to all three licensees.

1.12. At a high level, we are proposing to consolidate all conditions which relate to a revenue flow in a single location and all conditions which place obligations on licensees to report on either these revenues or other relevant aspects of the price control in a single location. To help navigate what is, necessarily, a complex area we have grouped the licence changes into chapters on the revenue restriction of NGET, the revenue restriction of the Scottish transmission licensees, the revised regulatory reporting requirements (standard conditions B) and proposed changes to standard conditions C and D. The remainder of the document is structured as follows:

- Chapter 3 - Discusses the changes we propose to make to the special conditions contained within NGET's transmission licence. The chapter has two sections. The first discusses proposed changes to the conditions relating to NGET's transmission asset owner (TO) activities and the second describes proposed changes to conditions relating to NGET's System Operator (SO) activities;
- Chapter 4 - Describes the changes we propose making to the special licence conditions of the two Scottish transmission licensees, SPTL and SHETL;
- Chapter 5 - Discusses proposed amendments to the standard licence conditions contained within section B of the three transmission licences and describes two new standard conditions, which deal with the revised regulatory reporting requirements, which we propose introducing;
- Chapter 6 - Describes the limited number of changes proposed to the SO related standard licence conditions contained with section C of the transmission licences;
- Chapter 7 - Discusses a number of proposed changes to the TO related standard licence conditions contained within section D of the transmission licences, and
- Chapter 8 - Outlines the issues on which we would particularly welcome views, provides detail of how to respond to the document and discusses the process and way forward.

1.13. The electricity section of the document has a number of appendices which provide text relating to our proposed modifications to the electricity transmission licences and more details on Ofgem's role. These appendices are structured as follows:

- Appendix 7 - Provides details of the licence modifications we consider are required to amend existing licence conditions, and introduce a number of new special licence conditions relating to NGET's TO function;
- Appendix 8 - Contains details of the proposed text of the modified licence conditions relating to the internal SO incentive;

- Appendix 9 - Contains details of the proposed text of the modified licence conditions necessary to give effect to our proposals to amend an existing condition and introduce a number of new special conditions into the licences of SPTL and SHET, and
- Appendix 10 - Provides proposed text of the modified licence conditions relating to our proposed changes to the standard licence conditions contained within Section B of the transmission licences and provides a draft version of two new standard conditions.

1.14. Where text relating to possible licence changes is included in appendices, we have not included any figures. We consider that this will allow parties to understand the form of the proposed conditions, on which we would welcome views, while the process of finalising parameters is concluded. Further details will be included in our TPCR final proposals document in December.

### **Rationale for the proposed changes**

1.15. We consider that the changes discussed in this document would be required, assuming the decision is taken to proceed with the relevant proposals, for a number of reasons:

- To give effect to the proposals, consulted on and developed through the TPCR process to date;
- To consolidate the reporting requirements of licensees, in respect of costs and revenues, in a single location. We consider that this may be expected to improve the transparency of the licences and simplify the processes for regulatory reporting. It is also consistent with our commitment to better regulation, and
- As far as practicable to ensure consistency between the three electricity transmission licences and to ensure they are up to date and fit for purpose. In particular, this will reflect any amendments required to replace or amend conditions or provisions relating to the introduction of the British Electricity Transmission and Trading Arrangements (BETTA) which have now become obsolete following the successful implementation of BETTA.

### **Way forward and responses**

1.16. We are in the process of developing proposals in a number of areas as part of our ongoing TPCR consultation process. We issued updated proposals in September and will be issuing final proposals in December. We then aim to finalise the licence changes required to codify the proposals in February 2007.

1.17. Our proposals include amendments to various licence conditions. The process of amending licences will be carried out in accordance with the procedures set out in Section 11 and Section 11A of the Electricity Act 1989 and Section 23 of the Gas Act. Our proposed changes will be informed by responses to this document and to our final proposals.

1.18. Responses should be received by 1 December 2006 and should be sent to:

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Office of Gas & Electricity Markets,  
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1.19. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website [www.ofgem.gov.uk](http://www.ofgem.gov.uk). Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.20. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.21. Any questions on this document should, in the first instance, be directed to:

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## 2. NGG NTS - Gas Entry

### Chapter Summary

This chapter explains how we intend to take forward the development of the licence modifications to implement our proposals for the new transmission price control for NGG NTS relating to gas entry arrangements.

### Questions

**Question 2.1:** We would welcome views on our approach to gas entry licence drafting set out in this chapter? In particular, do you agree with our proposed approach to simplify the gas entry licence conditions?

**Question 2.2:** What are your views on the draft legal text for the "capacity reallocation obligations" set out in the appendix to this chapter?

**Question 2.3:** Are there other important gas entry licence drafting issues, not already covered in this chapter that we should be taking into account?

2.1. Our proposals for gas entry arrangements in the new transmission price control are set out in the Initial and Updated Proposals that were published in June and September 2006. We will set out our final proposals in December 2006.

2.2. This chapter explains our approach to the licence drafting for the System Operator incentives that relate to the availability of entry capacity. The licence drafting concerning TO aspects of gas entry arrangements is not covered here and will be consulted on separately.

### Approach to gas entry licence drafting

2.3. The current revenue restriction licence condition is structured in a series of relatively independent sections. We propose to retain this modular approach - including by separating the material out into separate licence conditions in some instances. The details of the entry capacity arrangements will be contained in new Special Condition C8D.

2.4. We published for consultation on 20 October our thoughts on licence drafting for the proposed NTS gas offtake arrangements. This chapter complements the material published in that consultation.

2.5. We intend that Special Condition C8D would have six main parts, specifying:

- Obligations for NGG NTS to release capacity;
- Obligations to facilitate capacity transfer and trade;
- How NGG NTS's capacity release obligation will change in response to demands for additional capacity;
- How NGG NTS's revenues would adjust if it takes on additional obligations to release capacity;
- The incentive on NGG NTS regarding operational buy-back, and
- The incentive on NGG NTS regarding incremental buy-back.

2.6. We explain below what we expect to be included in each section. Appendix 5 sets out in tabular form how the issues covered in each part of the existing licence conditions would be captured in the new proposed structure for Special Condition C8D. Appendix 6 contains preliminary draft legal text for three important proposed new parts of NGG NTS's licence which are explained in the corresponding sections below, namely:

- The capacity substitution obligation
- The capacity transfer facilitation obligation, and
- The capacity trade facilitation obligation.

2.7. This preliminary draft legal text will be subject to further changes pursuant to Ofgem internal review and in the light of comments received in respect of all prior relevant consultation processes.

2.8. As well as incorporating the proposed changes to our policy relating to gas entry arrangements, we also consider that the revisions provide an opportunity to simplify the drafting of the gas entry licence conditions. While there is an inevitable element of complexity to the entry arrangements that has to be captured in the licence conditions, we consider it is important where possible, that the licence conditions are as simple as possible, to aid stakeholder understanding.

2.9. The principal mechanism by which we intend to simplify the licence conditions is by removing the calculation of many of the detailed terms from the licence and having them subject to annual (or more frequent where appropriate) reporting requirements for NGG NTS. The approach to calculating the terms will be specified in the licence. We would appreciate views on whether simplifying the licence conditions in this way would be appropriate, and any specific provisions that interested parties consider should be included to ensure that NGG NTS reports information accurately.

2.10. We have set out below the proposed sections of the new Special Condition C8D and explain what each section is intended to cover.

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## Obligations for NGG NTS to release capacity

### Capacity release obligation

2.11. NGG NTS will be obliged under its licence to release at each entry point and at each moment in time over the next price control period a minimum amount of firm entry capacity (the "**capacity release obligation**").

2.12. The capacity release obligation shall be defined in Special Condition C8D by using two main concepts: "**baseline entry capacity**" and "**obligated incremental entry capacity**": The licence condition will:

- define baseline entry capacity (specified in units of GWh per day) for all entry points at the start of the price control period, and
- provide for the recognition of obligated incremental entry capacity when the need for such capacity is signalled to NGG NTS through bidding in the quarterly system entry capacity (QSEC) auctions ("**QSEC auctions**").

2.13. For the avoidance of doubt, this proposed definition of capacity release obligation differs from the current concept of baseline capacity. For example, assume the baseline capacity at St Fergus is 1,700 GWh/d at the start of the price control period. This means that its capacity release obligation at this point in time is also 1,700 GWh/d. If NGG NTS receives a user commitment signal in a QSEC auction held in September 2007, for delivery of 300 GWh/d of obligated incremental entry capacity 42 months later, its capacity release obligation for St Fergus will increase to 2,000 GWh/d 42 months later, i.e. from April 2011 (Q2 2011). However the baseline capacity for St Fergus will remain at 1,700 GWh/d (at least until the start of the next price control period). This example shows that, towards the end of the price control period, capacity release obligations can start varying on a quarterly basis.

### Interaction of capacity release obligations with auction regime

2.14. The capacity release obligation reflects the minimum amount of capacity that NGG NTS will be obliged to offer for sale in the various auctions in which shippers can book gas entry capacity. Details of how these auctions work are specified in the Uniform Network Code ("**UNC**") (the terms of which are subject to modification). The mechanics of how the auctions work does not therefore form part of Ofgem's TPCR proposals.

2.15. NGG NTS will be deemed to have already released any capacity that has been sold previously. NGG NTS will be obliged, at least once every year, to publish a table showing how much capacity it is obliged to release (i.e. the sum of baseline entry

capacity and obligated incremental entry capacity) and how much capacity has already been sold for each entry point, for a defined period going forward.

2.16. Using the St Fergus example above, in a QSEC auction held in September 2007, under Ofgem's Updated proposals and the current UNC rules, NGG NTS would be obliged to offer for sale a minimum quantity of 1,700 GWh/d of entry capacity for the "capacity period" from April 2009 to March 2024 (i.e., the period for 2 to 16 years following the auction date), minus any amounts already sold over the capacity period (and minus 10% of capacity withheld<sup>1</sup> for the shorter term auctions).

2.17. Having received a user commitment signal for delivery of an additional 300 GWh/d from April 2011 in a September 2007 auction, in a QSEC auction held in September 2008, NGG NTS would still be obliged to offer for sale a minimum quantity of 1,700 GWh/d, for the capacity period that starts a year later i.e. from April 2010 to March 2025. This amount will however be augmented by an additional minimum quantity of 300 GWh/d from April 2011, which NGG NTS will be obliged to offer for sale to March 2025 also. Again, the sum of baseline entry capacity and obligated incremental entry capacity will be net of capacity already sold over the capacity period (and 10% of withheld baseline entry capacity for the shorter term auctions will be subtracted from the baseline capacity of 1,700 GWh/d, but not from the additional 300 GWh/d).

2.18. Similar examples could be constructed for the AMSEC (annual monthly system entry capacity) auctions, the RMSEC (rolling monthly system entry capacity auctions), the DSEC (daily system entry capacity) auctions, and the DISEC (daily interruptible system entry capacity) auctions. In each case, under the current UNC rules, NGG NTS would be obliged to offer for sale an amount of capacity over the relevant "**capacity period**", as defined in the UNC, that equals the capacity release obligations for the corresponding period, minus any amounts already sold.

### **Capacity substitution obligation**

2.19. We also propose to introduce an obligation for NGG NTS to use all reasonable endeavours to identify capacity substitution opportunities of unsold entry baseline capacity from other entry points, before seeking the release of obligated incremental entry capacity at an entry point. This obligation will be known as the "**capacity substitution obligation**".

2.20. Using the St Fergus example, if NGG NTS can meet 150 GWh/d of the increased demand for capacity of 300 GWh/d at St Fergus signalled in the September 2007 auctions by substituting 150 GWh/d of unsold baseline entry capacity from, say, Barrow to St Fergus, then the baseline entry capacity for Barrow will be reduced by 150 GWh/d and the baseline entry capacity for St Fergus will be increased by 150 GWh/d. The resulting figures, for example of 1,850 GWh/d for St Fergus, will be known as "post-substitution baseline entry capacity".

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<sup>1</sup> See section on "Withholding of entry capacity" below for details.

2.21. Defining NGG NTS's capacity release obligation referred to in paragraph 1.10 reflects the combined effect of:

- The baseline capacities in paragraph 2.12;
- The new user commitment signals for obligated incremental entry capacity that NGG NTS receives from the auctions for quarterly system entry capacity (QSEC) in paragraph 2.12, and
- the capacity substitution obligation in paragraph 2.19.

### **Withholding of entry capacity**

2.22. Under its licence, NGG NTS will be required to withhold until 18 months before the start of the gas day 10% of baseline capacity, net of any amounts substituted to/from each entry point as a result of NGG NTS's application of its capacity substitution obligation. In other words, the 10% is withheld from the post-substitution baseline capacities defined in paragraph [1.19]. The 18 month period applies under NGG NTS's current licence and we do not propose to lengthen or reduce it.

2.23. NGG NTS will be obliged at least once every year to publish a table showing how much capacity for each entry point each year will be withheld from sale under this mechanism.

### **Reporting obligations**

2.24. The proposed licence obligations described above for this section imply a number of new reporting obligations upon NGG NTS. The reporting obligations will also be captured in the licence changes we proposed to give effect to our TPCR proposals. We would welcome views on the detailed specification of these reporting obligations.

### **Capacity transfer and trade facilitation obligations**

2.25. NGG NTS will be obliged to facilitate the transfer of unsold baseline entry capacity and obligated incremental entry capacity and the trading of sold baseline entry capacity and obligated incremental entry capacity by shippers between entry points. To give effect to this overall obligation, NGG NTS will have two specific obligations:

- To offer capacity exchange rates to shippers, who request them, prior to an auction, to facilitate the transfer of unsold capacity between entry points ("**Capacity transfer facilitation obligation**"); and
- To offer capacity exchange rates to two or more shippers who request them to facilitate the trade of sold capacity between entry points ("**Capacity trade facilitation obligation**").

2.26. NGG NTS can limit the time for which the exchange rates apply. If the shippers confirm that they want to transfer or trade the capacity in accordance with the exchange rates then NGG NTS must undertake the exchange.

2.27. New Special Condition C8D will specify that the exchange rates offered by NGG NTS must be in accordance with a published methodology developed by NGG NTS and approved by Ofgem. The methodology will have the objectives of reflecting physical possibilities of exchange, facilitating competition between shippers, and being non-discriminatory and transparent. NGG NTS will have an obligation to consult on its proposed methodology.

2.28. NGG NTS will be entitled to charge shippers on a non-discriminatory basis for the work required to provide exchange rate information. We are proposing that charges would be netted off shippers' payments for any capacity bought in the auctions that were subject to the exchange rate.

### **Reporting obligations**

2.29. The proposed licence obligations described above for this section imply a number of new reporting obligations upon NGG NTS. The reporting obligations will also be captured in the licence changes we proposed to give effect to our TPCR proposals. We would welcome views on the detailed specification of these reporting obligations.

### **Changes to obligations for NGG NTS to release capacity**

2.30. As under the current licence, NGG NTS will be able, after the QSEC auctions, to request that we approve the release of additional obligated incremental entry capacity at specific entry points for specific quarters. This request will be in response to demands for additional entry capacity revealed through bidding in the QSEC auctions.

2.31. If we approve such requests, obligated incremental entry capacity will be added to the baseline entry capacity. Obligated incremental entry capacity will not be subject to the requirement to withhold until 18 months before the start of the gas day at least 10% of capacity. NGG NTS will be obliged at least once every year to publish a table showing how much baseline entry capacity and obligated incremental entry capacity it is obliged to release for relevant entry points over a defined period following any Ofgem agreement to release obligated incremental entry capacity.

2.32. We do not intend to make material changes to the process currently set out in the licence for NGG NTS to make a request for obligated incremental entry capacity, and for Ofgem to approve the request. This process refers to NGG NTS being obliged

to consult on, and submit for periodic approval to us, an obligated incremental entry capacity release methodology statement (the "**capacity release statement**").

### **Reporting obligations**

2.33. The proposed licence obligations described above for this section imply a number of new reporting obligations upon NGG NTS. The reporting obligations will also be captured in the licence changes we proposed to give effect to our TPCR proposals. We would welcome views on the detailed specification of these reporting obligations.

### **Revenue drivers for changes to NGG NTS's obligations to release capacity**

2.34. This section of Special Condition C8D will set out how NGG is to be remunerated if it releases additional entry capacity. A new concept we propose to introduce as part of the TPCR is to allow additional funding for obligated incremental entry capacity only if NGG NTS has used all reasonable endeavours to identify capacity substitution opportunities in compliance with its capacity substitution obligation. The notion is a simple one, i.e. that NGG should make use of existing spare capacity on the network before it builds new capacity.

2.35. To underpin this obligation, Special Condition C8D will oblige NGG NTS to publish a statement setting out its approach to assessing substitution opportunities. This statement will need to be published following open consultation and approval by Ofgem.

2.36. Once NGG NTS has applied its methodology to the specific demands for obligated incremental entry capacity revealed through the QSEC auctions, the net additional amount of obligated incremental entry capacity will trigger additional revenue allowances. The additional revenue entitlement will be calculated by multiplying the relevant volume(s) of capacity by the revenue driver function at each entry point. Ofgem is proposing a revenue driver function rather than a single value to reflect the different costs of capacity increments depending on the size of the increment. The revenue driver function will ensure that there are no discontinuities in the cost allowances as capacity release increments increase.

2.37. NGG NTS will be obliged to publish this calculation annually, showing the amount of obligated incremental entry capacity for which additional revenue will be earned at each entry point for a defined period, and the amount of additional revenue that will be earned after multiplying the quantity of capacity by the revenue driver.

## Reporting obligations

2.38. The proposed licence obligations described above for this section imply a number of new reporting obligations upon NGG NTS. The reporting obligations will also be captured in the licence changes we proposed to give effect to our TPCR proposals. We would welcome views on the detailed specification of these reporting obligations.

## The incentive on NGG NTS regarding operational Buy-back

2.39. This section of Special Condition C8D will set out how NGG NTS's revenue allowances be adjusted in the light of the level of costs it incurs in buying back capacity other than obligated incremental entry capacity.

2.40. Under the current licence there is one form of buyback. We are proposing to introduce two types of buy-back – operational and incremental. Operational buy-back are incurred in the general operation of the network, e.g. as a result of a failure to deliver capacity because of unexpected network maintenance. We will define operational buy-back as all buy-backs that are not captured by the definition of incremental buy-back.

2.41. The operational buy-back incentive will incorporate costs incurred when making buy-back and revenue earned when selling all forms of firm capacity over and above the total of baseline entry capacity and obligated incremental entry capacity ("**non-obligated firm entry capacity**"). Interruptible entry capacity is not included in the incentive because this is not a firm entry capacity right.

2.42. The September Update document proposed a two sided incentive with a cap of £36m and a collar of -£36m around a target operational buy-back allowance. Ofgem is proposing 50% sharing factors on either side of the target allowance. In terms of the form of the licence drafting to give effect to this structure of incentive, we believe that we can make use of the existing text in the associated part of the current revenue restriction licence condition.

## The incentive on NGG NTS regarding incremental Buy-back

2.43. This section of Special Condition C8D will set out how NGG NTS's revenue allowances will be adjusted in the light of the level of costs it incurs in buying back obligated incremental entry capacity released pursuant to QSEC auctions undertaken after 1 April 2007.

2.44. The September Update document set out a proposal to cap NGG NTS's potential liability at £36m a year. It also proposed the introduction of a cap on the maximum price at which NGG NTS would buy-back obligated incremental entry

capacity. The licence text in this section will specify the parameters of the scheme and the associated definitions.

### **Reporting obligations**

2.45. The proposed licence obligations described above for this section could imply a number of new reporting obligations upon NGG NTS. The reporting obligations will also be captured in the licence changes we proposed to give effect to our TPCR proposals. We would welcome views on the detailed specification of these reporting obligations.

### **Other gas entry licence drafting issues**

#### **Revenue entitlements accruing from the existing price control**

2.46. There are some revenue entitlements for the period of the next price control that NGG NTS has accrued during this control, e.g. revenue from the release of obligated incremental entry capacity. The monetary value of these revenue streams will be confirmed and included in the relevant part of the licence condition.

#### **Additional issues that can be addressed without licence modifications**

2.47. Ofgem's initial and updated TPCR proposals included some additional proposals, which will be given effect without the requirement for licence modifications.

#### *Change in approach by NGG NTS to the user commitment test*

2.48. Currently NGG NTS uses the parameters of its revenue drivers under the current price control as the basis for this test, while in the future we will interpret its licence obligations as requiring it to use expected future transmission charges as the basis for the NPV test. This change in policy can be given effect in the way NGG NTS interprets its "capacity release statement" and how we enforce compliance with the licence provisions underpinning capacity release.

#### *Investment lead time extension*

2.49. Currently we agree with NGG NTS a lead time for projects immediately prior to the QSEC auctions taking place, so that (if appropriate) NGG NTS can reflect any revised lead times in the amounts of capacity it offers for sale in future quarters. There is a default lead time of 36 months, but we can approve longer lead times prior to the QSEC auctions if NGG claims there are project specific factors that could delay the project and we accept such claims.

2.50. We are proposing to retain the same process through the consideration of whether to approve the release of incremental obligated entry capacity, for agreeing investment lead times, but to change the default lead time to 42 months, and to limit the occasions when NGG NTS will be able to seek extensions to lead times. In particular, we are proposing that NGG NTS will have a limited number of lead time extension permits that it can "play" prior to the QSEC auctions in order to extend lead times. We are also considering whether NGG NTS should be able to gain additional lead time extension permits by declaring delivery of projects in a shorter period than the default lead time.

*Bilateral agreements between NGG NTS and shippers*

2.51. Any revenue accruing to NGG NTS from bilateral agreements between NGG NTS and shippers to vary buyback prices, scope of work and timescales would be treated as excluded revenue under the overall provisions for excluded revenue under the new price control.

## 3. NGET

### Chapter Summary

This chapter outlines the licence conditions we are proposing to modify or introduce in order to give effect to our TPCR proposals for NGET. It summarises what each of the relevant conditions currently does, and explains why changes are required. It also explains why we consider that certain new conditions are required.

It also sets out a number of areas, on which we have not consulted to date, which might require amendments to licence conditions if we are to 'future proof' the special condition AA5A. It invites views on the appropriate treatment of these areas.

### Questions

There are no specific questions, but views are invited on any of the issues raised in this chapter.

## Overview

3.1. The detailed mechanics of NGET's revenue restriction are set out in special conditions AA5 to AA5H of its electricity transmission licence. Special condition AA5A is the main revenue restriction licence condition for NGET in respect of its transmission network activities. It is subdivided into two parts - the first, the transmission network revenue restriction, sets out the formula that defines the maximum amount of transmission revenue that NGET is permitted to recover in any given year through transmission charges (in effect, this covers NGET's TO functions). The second, the balancing services activity revenue restriction, contains details of the internal and external system operator incentive schemes which define the amount of revenue recoverable by NGET in carrying out its role as GBSO.

3.2. This chapter first considers the proposed changes to the transmission network revenue restriction, including highlighting a number of new areas for consultation, before considering changes to the balancing services activity revenue restriction.

## Part 1 - Transmission Network Revenue Restriction

3.3. The main output of the TPCR project, from NGET's perspective, is embodied in changes to part 1 of special condition AA5A. Our proposed changes will re-set the starting level of maximum allowed revenue for 1 April 2007, and define how this value changes each year up to and including the year commencing 1 April 2011.

3.4. This will involve the modification of existing terms and the introduction of new terms in the main formula, to allow for:

- An amended Reliability Incentive;
- SF6 incentives;
- Innovation Funding Incentive (IFI), and
- It might also need to include new terms relating to the operation of our proposed revenue drivers and capex incentives.

3.5. There are also a number of developments which may be expected to occur during the price control period and which might warrant the introduction of new terms as a means of 'future proofing' the condition.

3.6. These contingencies are:

- Treatment of telecoms revenues;
- Recovering minor discrepancies between the charges that other transmission companies levy on NGET and the charges that NGET's own charging methodology permits it to recover;
- Participation in an Inter-Transmission System Operator (TSO) Compensation scheme at the EU level, and
- Costs incurred by licensees in paying compensation following the temporary physical disconnection of a user from the transmission system.

3.7. The remainder of this section first discusses changes to the existing parameters within the transmission network revenue restriction, including AA5A itself. It then discusses the changes that would be required to give effect to our proposals to introduce the new terms outlined above.

3.8. Where possible we have sought to include the draft text of proposed licence conditions to support the changes explained in the main body of the text. Appendix 7 contains the drafting relating to a number of proposed TO conditions and Appendix 8 contains drafting relevant to our proposals to amend conditions relating to the SO incentive on internal costs.

## **Price control mechanics - existing conditions**

### **Special Condition AA5 - Definition of terms**

3.9. This condition defines several terms used throughout special conditions AA5A to AA5H and in Schedule A and Schedule B. As a result of our proposals, it is likely that there will be a need to make consequential changes to this condition to reflect the introduction of new terms in AA5A and the corresponding conditions or to clarify the meaning of existing terms.

**Special Condition AA5A - The Transmission Network Revenue Restriction (Existing terms)**

3.10. This condition contains the terms that define the maximum revenue which may be recovered by NGET in a given year. The formula was last reviewed when NGET's price control was extended by one year, in order to run concurrently with the controls of the Scottish transmission licensees. As such, a number of consequential changes are required.

3.11. We propose to reinstate an  $RPI_t$  term. This will be based on a published arithmetic average of the Retail Price Index (RPI) and will ensure that revenues follow changes in inflation. We will also need to restate the value of  $PR_t$ , the base transmission revenue, and update values of other terms in the formula, including  $U_t$ , the adjustment relating to changes in non-domestic rates and the licence fee, and  $L_t$ , the difference between the licence fee payable and an amount determined by the Authority.

3.12. Changes to the  $U_t$  term will reflect our proposal on the treatment of rates. Our current policy provides an ex-ante allowance at the start of the price control period which can be passed through to customers via charges. In addition, at the end of the price control period, a reconciliation between outturn and forecast costs is undertaken and any difference is passed through. As consulted on in September, we are proposing to maintain this position until 2009. However, after rating valuations are reset in 2010, we intend to remove the opportunity for licensees to pass through differences between outturn costs and ex-ante allowances. This proposal will be discussed further in our final proposals document.

**Special Condition AA5B - Accuracy of revenue recovery**

3.13. This condition sets out the provisions that govern the relationship between regulated transmission revenue and maximum transmission revenue. It limits the deviation between the two and describes mechanisms by which charges may be adjusted should the deviation be greater than certain specified percentages.

3.14. We are not currently proposing any substantive changes to this condition.

**Special Condition AA5C - Information to be provided to the Authority in Connection with the Transmission Network Revenue Restriction**

3.15. This condition details the reporting obligations placed on NGET regarding the terms defined in the revenue restriction condition. This information allows us to monitor the conduct of the licensee and assure ourselves that they are complying with their licence obligations and statutory objectives.

3.16. Our intention is to consolidate all reporting requirements in a single location through the introduction of two standard licence conditions. As such, we propose that the requirements currently contained with special condition AA5C should become part of standard condition B16. B16 as proposed sets out the frameworks for revenue reporting and is supported by a Regulatory Instructions and Guidance (RIGS) document, which details the exact nature of reporting requirements and parameters. We expect to consult on RIGS later in the year and currently expect to make no significant amendments to the requirements currently contained within special condition AA5C.

#### **Special Condition AA5D - Allowances in respect of Security Costs**

3.17. This condition details the actions to be taken by the licensee during a security period and the Authority's powers to amend or suspend the revenue restriction.

3.18. We are not currently proposing any changes to this condition.

#### **Special Condition AA5E - Duration of the Transmission Network Revenue Restriction**

3.19. Special condition AA5E sets out the arrangements for 'switching off' the revenue restriction conditions for NGET's network activities.

3.20. We are currently proposing to make minimal changes to this condition to ensure that the dates at which a disapplication request may be received reflect the revised dates of the price control. No drafting is provided.

#### **Special Condition AA5F - Transmission Network Reliability Incentive**

3.21. This special condition sets out the detailed formula for the calculation of incentive payments or penalties associated with the licensee's performance against the transmission network reliability incentive. This condition was introduced for NGET in 2003.

3.22. Our current proposal, as outlined in the September document, is to introduce a penalties only scheme for network reliability. We also remain of the view that output measures are an important part of the overall regime. We remain in the process of developing this policy and will update these in our December document.

3.23. The proposed amendments to the licence that would be required to introduce these changes are detailed in Appendix 7. In addition to the introduction of a penalties only scheme, we propose removing paragraphs 2, 3, 4 and 5 of special condition AA5F, as these paragraphs relate to elements of the reliability incentive which are now obsolete.

3.24. We also propose including the requirements to report on performance against the scheme within the generic regulatory reporting standard condition B16. As such, we propose removing paragraphs 12 and 13 of special condition AA5F and housing them within the framework of proposed standard licence condition B16. We expect the requirements of the existing condition to be unaltered, although they may be contained in a RIGS document rather than a licence condition.

### **Special Conditions AA5G - Transmission Investment for Renewable Generation (TIRG)**

3.25. This condition sets out the revenue entitlements related to the specific investment projects included in the Transmission Investment for Renewable Generation (TIRG) revenue allowance mechanism. This is a separate mechanism, introduced in 2005, to provide additional funding for investment to support the connection of new, renewable generating capacity.

3.26. The TIRG mechanism is outside the scope of the TPCR. As such, we are not proposing any changes to the condition arising directly from TPCR.

### **Special Condition AA5H - TIRG Reporting**

3.27. This condition supports AA5G and details the information which must be provided regarding the investments approved as part of the TIRG project.

3.28. Consistent with our intention to house all regulatory reporting requirements in the same location, we propose removing this condition and including it within the framework of new standard condition B16, which covers all revenue reporting requirements. While we propose to move the location of the condition, to the RIGs document pursuant to proposed standard condition B16, we do not propose any significant changes to the drafting of the condition.

### **Schedule A - Excluded services**

3.29. Part A of this Schedule sets out the provisions in relation to excluded services. It specifies which transmission business services are excluded in respect of chargeable activities. It also details the terms used in the balancing services activity revenue restriction.

3.30. A number of the references to legislation in all the Schedules within the licences are outdated. We therefore propose updating these, although no draft text is included.

3.31. We are in the process of reviewing the excluded services provisions and will include any proposals to amend the Schedule in subsequent documents. Changes to the second part of the condition, relating to the balancing services activity revenue

restriction, may be considered in light of the conclusions of the ongoing consultation on SO incentives<sup>2</sup>.

### **Schedule B -Supplementary provisions**

3.32. This schedule defines certain parameters relating to TIRG, including costs and output measures.

3.33. We currently consider that no changes will be required to this condition as a direct consequence of TPCR.

### **Schedules 1 and 2**

3.34. Schedule 1 defines the scope of the transmission licence and Schedule 2 contains details of how it can be revoked. No changes are currently proposed.

## **Price control mechanics - new special conditions**

3.35. We propose to introduce a number of new special conditions into the transmission network revenue restriction of NGET's transmission licence. Where possible, we have included indicative text relating to the modifications described in Appendix 7.

### **Capex incentives and revenue drivers**

3.36. In our most recent consultation document, we set out our present policy position on capex incentives and revenue drivers. We proposed that, in effect, NGET should be exposed (in Net Present Value terms) to 25% of the difference between our allowances for capital expenditure and the actual capital expenditure that is incurred.

3.37. The mechanics of the proposed capex incentive involves a one-off adjustment to NGET's revenue at the end of the price control period when a full set of information on actual expenditure is available. It is an ex-post adjustment to revenues (albeit one in which the rules for calculating the adjustment are set ex-ante). It is important that the rules for calculating the adjustment are clearly and unambiguously defined. We are still considering how to give effect to this position, and considering how it impacts on the licence drafting. We have not therefore included in this document any draft legal text.

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<sup>2</sup> Ref: 179/06: National Grid Electricity Transmission and national Grid Gas System Operator Incentives from 1 April 2007, Preliminary views consultation, 2 October, 2006"

3.38. Our current position for NGET is that the same approach can be used for revenue drivers as for the proposed capex incentives. Therefore, the parameters through which the overall allowance will be adjusted for differences between actual and assumed generation (and potentially demand) growth will be clearly and precisely documented. These calculations will be undertaken after the end of the price control period. Again, we are still considering how to give effect to this position, and considering how it impacts on the licence drafting, therefore we have not included any draft legal text in this document.

### **Sulphur Hexafluoride (SF6) incentive**

3.39. In our updated proposals document we discussed our intention to introduce an incentive scheme designed to provide licensees with incentives to reduce emissions of Sulphur Hexafluoride (SF6), a potent greenhouse gas used as an insulating agent in high voltage switchgear. SF6 falls outside the scope of the EU Emissions Trading Scheme (EU ETS). As such, the licensees have weaker financial incentives to reduce emissions of SF6 relative to emissions covered by EU ETS.

3.40. We propose to introduce a new special licence condition setting out the detail of how this adjustment mechanism will operate. At this stage we anticipate a relatively simple mechanism with a one-off revenue adjustment at the end of the price control period to reflect performance against a target level of emissions in each of the five years. The proposed text of the licence condition is included in Appendix 7. We will consult further on the details of the SF6 incentive in our December document.

### **Innovation Funding Incentive**

3.41. In our updated proposals document, we confirmed our intention to introduce an Innovation Funding Incentive (IFI) for electricity transmission, to promote efficient investment in Research and Development (R&D), which we consider will benefit present and future consumers. We are currently working with the Energy Networks Association (ENA) to ensure that our proposals for IFI can be implemented by 1 April 2007. This work will also inform our decision as to the final parameters of the IFI.

3.42. The text of the proposed special licence condition relating to IFI is set out in Appendix 7 for NGET and Appendix 9 for SPTL and SHETL. It outlines how we might specify the calculation of charge restriction adjustments arising from IFI. The proposed scheme allows for a proportion of total revenue to be available for projects falling within the scope of the IFI. As stated, we are yet to confirm the specific parameters of the scheme, in particular the size and profile of cost pass-through, amount eligible for carry forward and the proportion of IFI that may be allocated to internal expenditure. However, we feel that the drafting gives a good indication of the structure of the proposed scheme, and the licence condition designed to support it.

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## Additional policy issues

3.43. There are a number of relatively minor policy issues which we are currently minded to reflect in the licence drafting. These can be divided into two categories. The first category includes issues which will alter revenues from the start of the price control period and will require changes to special condition AA5A from 1 April 2007. These are:

- Telecoms Revenues, and
- discrepancies in revenue recovery

3.44. The second category includes factors which might potentially result in a change to revenues during the price control period. These are:

- Participation in an Inter Transmission System Operator (TSO) compensation scheme, and
- A mechanism for the recovery of costs arising as a result of the payment of compensation to generators following the temporary physical disconnection of a generator from the transmission system. These costs flow from the approval of Connection and Use of System Code (CUSC) Amendment Proposal 48 (CAP048).

3.45. We would welcome views on the appropriate treatment of these issues. In respect of the items in the second category, we are currently considering two alternative treatments. It would be possible to include terms within the relevant revenue restrictions as of 1 April 2007, initially set to zero, to reflect these likely costs. Alternatively, no change could be made to the revenue restriction at the start of the price control period and individual licence consultations and amendments could be undertaken as and when the details of the revenues or costs become clearer.

### Telecoms revenues

3.46. Following our consultation on network companies and telecoms revenues in 2001<sup>3</sup>, we propose including a term in special condition AA5A of NGET's licence to recover half of the revenue earned by NGET's affiliate Gridcom. This proposal will be discussed in more detail in our final proposals document. No draft text is currently included.

### Revenue recovery discrepancy

3.47. Under the current regulatory framework there is the potential for discrepancies to arise between the income that SPTL and SHETL are permitted to recover from NGET, and the income NGET is permitted to recover from network users for the same

scope of activities. These potential discrepancies arise because of differences in the relevant charging methodologies and statements of the transmission licensees. In particular, it is driven by differences in the permitted rate of return on pre-vesting connection assets.

3.48. We are currently proposing to make a one-off adjustment to allowed revenues in 2007/08 to 'true up' the discrepancies that arose in 2005/06 and 2006/07. However, we are still in the process of considering the detail of this mechanism and the appropriate treatment of any differences that might endure beyond 2007/08. We have yet to consult formally on this issue, which has come to light relatively recently, and will include further detail in our December document. However, one option is to include a parameter as part of the revenue recovery formula to allow for the possibility of similar 'true up' adjustments going forward.

### **Inter TSO Compensation**

3.49. The European Commission, in tandem with the Council of European Energy Regulators (CEER) and the European Transmission System Operators (ETSO), is seeking to develop an enduring Inter Transmission System Operator (TSO) compensation mechanism. This scheme would compensate TSOs for hosting cross border transit flows which cause costs on their transmission networks. A voluntary scheme is currently in place (in which the GB does not participate) with a view to implementing an enduring scheme in the near future.

3.50. If the scheme were to become mandatory (which is anticipated) there would be a net payment or net contribution which would flow from or to NGET. The extent to which the UK would make a net contribution or payment would be determined by the detail of the scheme.

3.51. As mentioned previously, we would welcome comments on whether or not it is appropriate to include an anticipatory term allowing for a revenue adjustment which might occur in future, albeit one which will be set to zero from April '07.

### **Recovering the costs of temporary physical disconnection**

3.52. Connection and Use of System Code (CUSC) Amendment Proposal 048 (CAP048): " Firm Access and Temporary Physical Disconnection" was approved by the Authority on 19 March 2004<sup>4</sup>. It established a compensation mechanism within the CUSC that required NGET to compensate generators for planned or unexpected temporary disconnection from the transmission system. The proposal now applies GB wide and, depending on the nature of the funding mechanism, could impact on the revenues of all three transmission licensees.

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<sup>4</sup> For additional background see the CAP048 Amendment Report at [http://www.nationalgrid.com/uk/indinfo/cusc/pdfs/CAP048\\_Amendment\\_Report\\_v\\_1\\_0.pdf](http://www.nationalgrid.com/uk/indinfo/cusc/pdfs/CAP048_Amendment_Report_v_1_0.pdf)

3.53. No funding mechanism for CAP048 was in place for the period 2004/2005. Ofgem undertook to develop arrangements for funding compensation costs from 2005/6 onwards. On 7 April 2005, Ofgem published an open letter which invited views on possible approaches to recovery of costs of compensation payments for temporary physical disconnection.

3.54. Respondents' views to that letter were mixed and there was no consensus as to the appropriate funding mechanisms. It also came to light that the basis on which NGET had made its forecast of outage costs had changed as a result of BETTA. We therefore intend to revisit this issue in the near future and issue an open letter consultation. However, we would welcome any views on the appropriate treatment of this issue within the transmission licences.

## **Part 2 - Balancing Services Activity Revenue Restriction**

3.55. The balancing services activity revenue restriction has three parts:

- The first, the balancing services activity revenue restriction on external costs determines the costs which are incurred by NGET in performing its role as GBSO (and the incentives to minimise these costs). These include, for example, the costs of taking actions in the balancing mechanism to correct energy or systems imbalances;
- The second, the balancing services activity revenue restriction on internal costs, determines the costs it can incur (and the incentives to minimise these costs) in fulfilling its role of GBSO. This includes, for example, the costs of systems or premises required to carry out this function, and
- The third section contains the information on which NGET must report.

3.56. Ofgem is consulting on the form and structure of the SO internal and external cost items of this condition in a separate consultation, coordinated with, but outside the TPCR process. Nonetheless, there are a number of changes to the internal cost conditions that are appropriate to include at this time, such as changes to reflect the proposed duration (2007-2012), proposed policy changes (consistent with TPCR), and changes to eliminate redundant or outdated references. The changes to the internal and external cost conditions are discussed in the remainder of this chapter. Text describing the proposed modifications to the SO internal scheme only is included in Appendix 8.

### **SO External Costs**

3.57. At this time, there are no proposed changes to the licence conditions relating to external SO incentive scheme. However, as part of the current Preliminary Views consultation, we have asked parties to comment on whether the current Income Adjusting Event (IAE) provisions are appropriate. In December, we will be consulting on the specific form and the structure of the SO incentive parameters, including any revisions to the IAE provisions that may be considered appropriate,

with the resulting licence conditions to be published as part of the final proposals and statutory licence consultation.

3.58. In terms of the structure of the electricity licences, our longer term goal is to consolidate all TO and SO reporting requirements in the transmission licences in a single condition, which would result in reporting requirements contained in special condition AA5A relating to SO external incentives being transferred into a new condition.

## SO Internal Costs

3.59. It should be noted that the regulation of internal SO costs through the setting of allowed revenues based on approved operating and capital costs is very similar to the framework that applies with respect to network transmission assets. For this reason, there has historically been a close alignment between the design of the internal SO incentive scheme and the transmission price control that applies to NGET.

3.60. To maintain consistency with the transmission price control, and previous internal SO incentive schemes, it is proposed that the current scope of the internal incentive scheme should be retained. However, we propose to include separate terms for operating expenditure (opex), capital expenditure (capex), pensions and tax.

3.61. In addition to the 'incentivised capex' discussed above, there remains a 'non incentivised' element from the split of NGET's RAV between SO and TO businesses in 2001. This element of capex is depreciated on a "straight line" basis and will be fully depreciated by 2010/11.

3.62. We propose a number of additional changes to maintain consistency with our approach on the transmission price control. We intend to use a post tax cost of capital, which means that we will need to establish a tax allowance for 2007-12. We have also calculated a separate allowance for NGET's pension costs. The pension allowances have been calculated on the same basis as those for NGET's transmission price control.

3.63. We also propose removing a number of terms which have become redundant, because of, for example, the successful implementation of NETA and BETTA, and changing the location of a number of terms to aid clarity. We propose to remove the Neta Profiling Index (NPI), as well as the  $PSC_t$ ,  $BI_t$ ,  $TSPN_t$  and  $TSHN_t$  terms. We are also proposing to change the location of the definition of the  $IAT_t$  term, so that defined terms appear in the order in which they're specified in the accompanying formula. Finally, we propose removing any terms relating to rates, as we believe there are no rateable SO assets. These changes are reflected in our proposed text in Appendix 8.



## 4. SPTL and SHETL

### Chapter Summary

This chapter outlines the licence conditions we are proposing to modify or introduce in order to give effect to our TPCR proposals for SPTL and SHETL. It summarises what each relevant condition currently does, and explains why changes are required. This chapter also explains why, in our view, certain new conditions are required.

### Questions

There are no specific questions, but views are invited on any of the issues raised in this chapter.

## Overview

4.1. The transmission licences of SPTL and SHETL are identical in structure and numbering, and the TPCR proposals impact on each licence in the same manner. The remainder of this chapter describes the changes we propose to each of the special licence conditions. Legal drafting relating to new policy areas is contained in Appendix 9.

### Special Condition J - Restriction on transmission charges

4.2. Special Condition J is the main revenue restriction licence condition for SPTL and SHETL. It sets out the formula that defines the maximum amount of transmission revenue that SPTL and SHETL are permitted to recover in any given year.

4.3. The main output of the TPCR project in respect of SPTL and SHETL is embodied in changes to this condition. Our proposed changes will re-set the starting levels of maximum transmission revenues for 1 April 2007, and define how these values change each year up to and including the year commencing 1 April 2011. This will involve the modification of existing terms and the introduction of new terms in the main formula, to allow for:

- An amended Reliability Incentive;
- SF6 incentives;
- An Innovation Funding Incentive (IFI), and
- In addition, there might also be a need to introduce something into the special condition to give effect to capex incentives and revenue drivers.

4.4. The remainder of this chapter first discusses changes to the existing parameters within the revenue restriction. It then discusses the changes required to give effect

to our proposals to introduce the new terms outlined above. Drafting reflecting our new proposals is contained in Appendix 9. This Appendix does not contain details of our proposed changes to existing special licence conditions.

## **Price control mechanics - existing conditions**

### **Special Condition I - Definition of terms**

4.5. This special condition defines the words and expressions used in special conditions J to Q and Schedules A to C of the electricity transmission licences of SPTL and SHETL. There will be consequential changes to this condition to reflect the introduction of new terms and, if appropriate, to clarify the meaning of existing terms.

### **Special Condition J**

4.6. We are proposing to modify the two Scottish transmission licenses, as well as that of NGET, to reflect our policy on rates. We currently provide an ex-ante allowance at the start of the price control period which can be passed through. In addition, at the end of the price control period, a reconciliation between outturn and forecast costs is undertaken and any difference is passed through. As consulted on in September, we are proposing to maintain this position until 2009. However, after rating valuations are reset in 2010, we intend to remove the opportunity for licensees to pass through differences between outturn costs and ex-ante allowances.

### **Special Condition J3 - BETTA adjustment (capital contributions)**

4.7. As a consequence of the introduction of BETTA, the role of the Scottish Transmission licensees changed. The role of system operator, which the Scottish licensees had previously fulfilled in their designated areas of Scotland, passed to NGET on a GB wide basis. This meant that agreements between connected parties and the Scottish licensees needed to be novated - or "run off". A consequence of this process was the need to repay a number of capital contributions made to the licensees by customers in respect of the provision of connections. Licence condition J3 contains the obligations placed on the licensees to report on the level of capital contributions.

4.8. The licensees have made considerable progress in running-off the majority of agreements. However, a number remain outstanding. The Authority has also stressed the need to resolve outstanding issues as quickly as practicable. Given that this condition relates to regulatory reporting on a revenue stream, we propose including it within the framework of new standard condition B16. However, we would also welcome views on whether this condition should be removed and the triggers or criteria which should be met prior to this removal taking place.

**Special Condition K - Revenue recovery accuracy**

4.9. This condition sets out the provisions that govern the relationship between regulated transmission revenue and maximum transmission revenue. It limits the deviation between the two and describes mechanisms by which charges may or may not be adjusted should the deviation be greater than certain percentages.

4.10. We are not proposing any changes to this condition.

**Special Condition L - Information to be provided to the Authority**

4.11. This special condition details the reporting obligations placed on SPTL and SHETL regarding the terms defined in the revenue restriction condition. This information allows us to monitor the conduct of the licensees and assure ourselves that they are complying with their licence obligations and statutory objectives.

4.12. Consistent with our intention to consolidate the reporting requirements in a single licence condition, we propose removing the condition and replacing it with standard condition B16. Changes to regulatory reporting requirements are discussed in detail in Chapter 5.

**Special Condition N - Duration of charge restriction conditions**

4.13. This condition sets out the arrangements for 'switching off' the revenue restriction conditions for the licensees transmission network activities.

4.14. We are currently proposing to update this condition to reflect the revised duration of the price control, although no drafting is currently attached.

**Special Condition O - TIRG**

4.15. This condition sets out the revenue entitlements for the specific investment projects included in the Transmission Investment for Renewable Generation (TIRG) revenue allowance mechanism. This is a separate mechanism, introduced to provide additional allowances for investment to support the connection of new, renewable generating capacity.

4.16. The TIRG mechanism is outside the scope of the TPCR, therefore we propose making no changes to the substance of the licence condition arising directly from TPCR.

**Special Condition P - TIRG reporting**

4.17. Special Condition P details the information which licensees are required to provide to the Authority in connection with Special Condition O.

4.18. As with Special Condition AA5H in NGET's licence, we propose to include this condition within the new regulatory reporting standard licence condition. As such, we propose removing this condition and replicating it within the framework of new standard condition B16. Therefore, we envisage making no substantive changes to the existing condition but placing the detail in the RIGS pursuant to the new standard licence condition.

**Special Condition Q - Reliability incentive**

4.19. This condition sets out the detailed formula for the calculation of incentive payments or penalties associated with performance against the transmission network reliability incentive scheme. This condition was introduced into the licences of SPTL and SHETL in 2005.

4.20. The September document consulted on the precise nature of possible changes to this scheme. Our current proposal is to introduce a penalties only incentive scheme. The proposed licence condition detailing the changes required to give effect to this proposal are included in Appendix 9. The final details of the reliability incentive scheme will be discussed in our December document.

4.21. In addition to the changes described above, we propose replacing conditions which require licensees to report on performance against the incentive scheme with corresponding conditions in standard condition B16. This will involve the removal of paragraphs 8 and 9 of special condition Q and relocating them within the framework of B16. We intend to consult on the RIGS to accompany the condition shortly. While the condition will change location, no substantive changes are proposed.

**Schedule A - Supplementary Provisions of the Charge restriction conditions**

4.22. Schedule A of the licences of SPTL and SHETL describes the activities of the transmission licensees which are treated as excluded services.

4.23. All of the Schedules within the licences of SPTL and SHETL contain a number of references to legislation which are out of date. We thus propose to update these, although no text is currently provided. We propose no other changes to Schedule A at this point.

### **Schedule B - Defined terms in revenue restriction**

4.24. This condition details the values used for several terms used in special condition J, including adjustments for BETTA implementation costs.

4.25. Where necessary, the figures in this condition will be updated. We are also considering whether a number of the terms, for example relating to costs incurred during the implementation of BETTA, can be removed. We consider that paragraphs B3B and B3C may no longer be required and would welcome views on whether these, or any other, terms are now obsolete.

### **Schedule C - Supplementary provisions**

4.26. This schedule sets out a number of costs associated with the investment projects sanctioned by the Authority as part of the TIRG process. These schedules relate to Special Condition O. It also includes the output measures which the licensees are required to deliver.

4.27. At this stage, minimal changes are envisaged to the condition. We intend to make one amendment to Schedule C of SPTL's licence only to reflect an increase in the costs associated with the reinforcement of the circuits over the Cheviot Boundary (formally the England - Scotland Interconnector).

## **Price control mechanics - new conditions**

### **Capex incentives and revenue drivers**

4.28. In our most recent consultation document, we set out our present policy position on capex incentives and revenue drivers. We proposed that, in effect, SPTL and SHETL should be exposed (in Net Present Value terms) to 25% of the difference between our allowances for capital expenditure and the actual capital expenditure that is incurred.

4.29. The mechanics of the proposed capex incentive involves a one-off adjustment to revenues at the end of the price control period when a full set of information on actual expenditure is available. It is an ex-post adjustment to revenues (albeit one in which the rules for calculating the adjustment are set ex-ante). It is important that the rules for calculating the adjustment are clearly and unambiguously defined. We are still considering how to give effect to this position, and considering how it impacts on the licence drafting. We have not therefore included in this document any draft legal text.

4.30. For SPTL and SHETL we are additionally proposing mechanics to adjust the revenue allowances within the price control period itself in some circumstances. This is to address potential issues of financeability and cash flow, which are more material

for SPTL and SHETL given their relative sizes compared to NGET. These mechanisms will operate if actual volumes of generation vary from volumes assumed in setting the baseline allowances. We propose that a new licence condition will set out the detailed calculation of these adjustments and will involve a new term being added to special condition J. Again, at this stage no draft legal text is provided.

### **SF6 incentive**

4.31. In our updated proposals document we discussed our intention to introduce an incentive scheme to reduce the emissions of SF6, a potent greenhouse gas used as an insulating agent in high voltage switchgear. SF6 falls outside the scope of the EU Emissions Trading Scheme (EU ETS). The licensees therefore have weaker financial incentives to reduce emissions of SF6 relative to emissions covered by EU ETS. The proposed licence condition is provided in Appendix 9.

4.32. We plan to develop the detail of licence changes to implement the SF6 incentive in the run up to final proposals and consult on this in December. At this stage we anticipate a relatively simple mechanism perhaps with annual payments for beating pre-determined targets. The proposed drafting in Appendix 9 sets out the scope of a possible scheme although includes no figures.

### **Innovation Funding Incentive**

4.33. In our updated proposals document, we confirmed our proposal to introduce an Innovation Funding Incentive (IFI) for electricity transmission, to promote efficient investment in R&D, for the benefit of current and future consumers. We are currently working with the Energy Networks Association (ENA) to ensure that our proposals for IFI can be implemented by 1 April 2007. This work will also inform our final decision as to the final parameters of IFI.

4.34. The proposed licence condition in Appendix 9 sets out how we might specify the calculation of charge restriction adjustments arising from IFI. It allows for a proportion of total revenue to be available for projects falling within the IFI scheme. As stated, we are yet to confirm the specific parameters of the scheme, in particular the size and profile of cost pass-through, amount eligible for carry forward and the proportion of IFI that may be allocated to internal expenditure. However, we feel that the proposed condition gives a good indication of the structure of the scheme. Our final proposals document will detail and consult on the specific details of the scheme.

## 5. Revised regulatory reporting requirements

### Chapter Summary

This chapter provides details of our proposed changes to the standard licence conditions contained with section B of the transmission licences. It also outlines our proposals to introduce two new standard licence conditions to house cost and regulatory reporting requirements in a single location.

### Questions

We would welcome views on our proposed changes to the existing standard conditions, our proposals for two new standard conditions and on any other matters contained in the chapter.

## Introduction

5.1. In order to ensure that licensees are complying with the obligations placed on them by the transmission licence and the Electricity Act, it is clearly important to have in place robust regulatory reporting requirements. As far as practicable, these requirements should be transparent and understandable.

5.2. Recent regulatory reviews have highlighted that the strength of regulatory reporting requirements differ between electricity and gas distribution and electricity and gas transmission licensees. Given the importance of regulatory reporting, we have therefore sought to ensure a consistent level of obligation on all licensees. This has led to a relative strengthening of the regulatory reporting requirements.

5.3. The purpose of these measures is to improve the quality of information on factors included within the price control, which we use to monitor performance and set price controls and incentives. It is hoped that this information will benefit consumers in the setting of subsequent price control reviews.

5.4. At present, the information required of licensees is located in various conditions throughout the transmission licences. We are proposing to introduce new standard licence conditions which detail enhanced reporting requirements and place them into dedicated locations within the licences. We expect this will have a demonstrable improvement on the transparency and consistency of information received by ourselves and, where appropriate, made publicly available.

5.5. We are proposing to introduce two new standard conditions to the transmission licences to cover regulatory reporting. The first, standard condition B15, is a new condition introducing reporting requirements against various elements of the price control, including system characteristics, relevant outputs and performance, and the

second, standard condition B16, will house all conditions relating to revenue reporting. Each condition is discussed in more detail below, following a description of the other changes we propose to the standard licence conditions within Section B of the licences.

5.6. Each condition will be supported by RIGS. These documents will aid understanding of the conditions and contain a number of the specific details on which licensees are required to report. We currently plan to consult on draft RIGS later in the year.

5.7. We would welcome views on:

- The need for enhanced regulatory reporting requirements;
- The proposed new conditions B15 and B16;
- The proposed changes to existing standard conditions, and
- The extent to which other existing conditions require revision.

## **Regulatory Reporting - Existing Standard Conditions**

5.8. Standard Conditions B1 - B14 are general provisions which apply to all three transmission licensees. A limited number of changes are proposed to the existing conditions, along with the introduction of the two new conditions mentioned above. The proposed amendments are discussed in more detail below and proposed licence conditions are contained in Appendix 9.

### **Standard Condition B1 - Regulatory Accounts**

5.9. The purpose of this condition is to ensure the provision of financial statements by the licensees. Our proposed amendments seek to change the submission dates of these statements and to require the licensees to prepare the statements in accordance with either International Reporting Standards or UK Generally Accepted Accounting Principles (GAAP).

### **Standard Condition B2 - Change of financial year**

5.10. Condition B2 obliges the licensees to provide notification of a change in the financial year of the statutory accounts. We propose introducing amendments to ensure that the condition reflects changes to condition B1 (Regulatory Accounts) and the introduction of condition B15.

**Standard Condition B6 - Restriction on activity and financial ring fencing**

5.11. Standard licence Condition B6 ensures that licensees act as a stand alone entity. Our proposed amendments are designed to ensure consistency with the proposed changes to standard licence condition B1 (Regulatory Accounts).

**Standard Condition B7 - Availability of resources**

5.12. This standard condition requires licensees to provide notification of provision of an audited certificate, signed by the company's directors, to ensure it can operate as a going concern. The proposed amendments are required as a consequence of changes to other conditions and to introduce a requirement to provide a cash-flow statement, backed by supporting statements, to provide demonstrable evidence of the going concern.

**Standard Condition B9 - Indebtedness**

5.13. Standard licence condition B9 provides assurances on the liabilities incurred by the licensee. The amendments propose to place restrictions on the transactions entered into by the licensees should they fail to maintain an investment grade credit rating. The amendments also reflect developments related to the changes proposed in other areas.

**Standard Condition B10 - Credit Rating**

5.14. Standard licence condition B10 requires the licensees to maintain an investment grade credit rating. The proposed changes to the condition are required to reflect recent developments in rating methodologies.

**Standard Condition B13 - BETTA implementation**

5.15. As BETTA successfully went live on 1 April 2005, we do not consider that this standard licence condition remains relevant and hence we propose removing it from the licences.

**Regulatory Reporting - New Standard Conditions**

5.16. We propose to add two new standard conditions to the three transmission licences. New standard condition B15 relates to cost reporting and new standard licence condition B16 to revenue reporting. Both new conditions will be accompanied by a regulatory instructions and guidance (RIGS) document which will provide a detailed description of the rationale for, and operation of, the various parts of both conditions. We are in the process of developing this document, which will be

informed by responses to this consultation and subsequently consulted on. The proposed text of the new standard licence conditions is included in Appendix 10.

### **Standard Condition B15 – Price control review information**

5.17. The proposed standard condition B15 proposes the establishment of a framework for the provision of information relating to price controls by licensees on an annual basis. The condition will ensure that data is collected on a consistent basis which will allow us to make more accurate comparisons of costs incurred against cost allowances set during periodic reviews. The condition will also include information on system characteristics, relevant outputs and performance, as well as rolling capex plans. The condition is structured as follows:

- Part A: Application and purpose;
- Part B: Preparation of price control review information;
- Part C: Delivery and review of price control review;
- Part D: Establishment of the price control review reporting rules, and
- Part E: Content of the price control review reporting rules.

### **Standard Condition B16 - Revenue reporting**

5.18. The proposed standard condition B16 proposes to house all the information which licensees are required to provide in respect of their revenues in a single location. The condition will outline requirements at a high level and be supported by RIGS providing more detail and aiding clarity.

5.19. We propose to include many of the existing reporting requirements within this framework, as well as including reporting requirements relating to the new terms that we've proposed. This will involve the transfer of a number of sections of existing special licence conditions into B16. However, in these circumstances, we are not proposing to significantly alter the requirements that currently exist. We envisage that this structure may be expanded to include system operator functions at some point in the future. This will be informed by responses to ongoing consultation.

5.20. The conditions which we are currently proposing to bring within the B16 framework are:

- Special condition AA5C from NGET's licence in its entirety;
- Special Condition L, in its entirety, from the Scottish licences;
- Paragraphs 12(a) - 12(d) of special condition AA5F in NGET's licence and paragraphs 3 and 8(d) of Special Condition Q in the Scottish transmission licences, in respect of performance against network reliability incentives, and
- Special condition AA5H in NGET's transmission licence and the Special Condition P in the Scottish licences, which detail requirements to report on TIRG.

5.21. As these proposals are still under development, the draft conditions in Appendix 10 are subject to change. The RIGS to accompany the conditions will be consulted on shortly.

## 6. System Operator Standard Conditions

### Chapter Summary

This chapter sets out our proposed changes to the system operator standard conditions contained within Section C of the transmission licences

### Questions

We would welcome views on our proposed changes and any other amendments which respondents consider necessary.

## Introduction

6.1. Section C of the transmission licences contains the system operator standard conditions. The vast majority of our TPCR proposals do not require any changes to the conditions within Section C. However, given the recent transition to BETTA, we have reviewed the conditions included within Section C in order to ensure they are relevant and accurate. Following this review, we have concluded that no changes are required to the conditions contained within Section C at this stage.

6.2. We have identified relatively few changes and would welcome views on the possible amendment described below and any other amendments that interested parties consider would aid the clarity and accuracy of conditions contained within Section C of the transmission licences.

### **C18 - Requirement to offer terms for connection or use of the GB transmission system during the transition period**

6.3. We note that standard condition C18: "Requirement to offer terms for connection or use of the GB transmission system during the transition period" is no longer relevant following the end of the transition period. However, we are aware that a number of determinations have been referred to us under this standard licence condition and, while these remain outstanding, we consider that it would be inappropriate to remove it. We will keep this situation under review and, in the event that no C18 determinations are outstanding at the time when we make our final licence modifications, we propose removing the standard condition.

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## 7. Transmission Owner Standard Conditions

### Chapter Summary

This chapter sets out our proposed changes to the transmission asset owner standard conditions contained within Section D of the transmission licences.

### Questions

We would welcome views on our proposed changes and any other amendments which respondents consider necessary.

## Introduction

7.1. Section D of the transmission licences contains the transmission owner standard licence conditions. As with the System Operator standard conditions discussed above, the vast majority of our TPCR proposals do not require any changes to the conditions within Section D. However, we consider it appropriate to review the accuracy and relevance of the standard conditions within section D of the transmission licences at this stage.

7.2. The conditions which we consider may require amendment are highlighted below. We would welcome views on the proposed changes to these conditions and details of any other areas of Section D where respondents consider that amendments would increase the accuracy or transparency of the licence. The proposed amendments are discussed in turn below.

### D12 - Scottish Settlement Agreement

7.3. This standard condition requires the licensee to comply with the terms of the Settlement Agreement for Scotland (SAS), unless otherwise directed by the Authority, relating to the terms contained in special condition I of the electricity distribution licences of SP Distribution Limited, and Scottish Hydro-Electric Power Distribution Limited.

7.4. The SAS came to an end on 31/3/06 and the relevant special licence conditions that required SPDL and SHEPD to have the SAS in place were removed by licence modification on 05/06/06. We therefore consider that it would be appropriate to remove this condition from the electricity transmission licences.

**D15 - Obligations relating to the preparation of TO offers during the transition period**

7.5. The principal objective of this condition is to require the licensee to make TO offers to the system operator for the purposes of supporting the system operator in its achievement of the principal objectives specified in standard condition C18 (Requirement to offer terms for connection or use of the GB transmission system during the transition period). It requires the licensee to have in place agreements governing the connection and use of the transmission system, with all users by the BETTA Go-Live date.

7.6. As the provisions of this condition shall only apply to existing users and to any application made by an applicant before the BETTA go-live date, we consider that it would be now be appropriate to remove it from the licences.

## Appendices

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6	NGG NTS Gas Entry: Draft legal text - Capacity reallocation obligations
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8	Draft legal text - NGET SO conditions
9	Proposed new Scottish licence conditions
10	Draft legal text - Amended Standard Conditions B

Note that the Supplementary Appendices are found in a separate appendices document.

## Appendix 1 - Consultation Response and Questions

Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

Responses should be received by 1 December 2006 and should be sent to:

Robert Hull  
Director - Transmission  
Office of Gas & Electricity Markets,  
9 Millbank,  
London,  
SW1P 3GE

Tel: 020 7901 7050  
email: [tpcr.responses@ofgem.gov.uk](mailto:tpcr.responses@ofgem.gov.uk)

Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website [www.ofgem.gov.uk](http://www.ofgem.gov.uk). Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

Any questions on this document should, in the first instance, be directed to:

Colin Green  
Senior Manager - Transmission Price Control Review  
Office of Gas & Electricity Markets,  
9 Millbank,  
London,  
SW1P 3GE

Tel: 020 7901 7143  
email: [colin.green@ofgem.gov.uk](mailto:colin.green@ofgem.gov.uk)

Having considered the responses to this consultation, Ofgem intends to publish final proposals for the price controls in December 2006. These will set out our revised views of the revenue allowances for each of the transmission businesses and further quantify our proposals for the incentive framework that will apply to gas and electricity transmission.

### CHAPTER: 1

There are no questions in this chapter.

**CHAPTER: 2**

**Question 2.1:** We would welcome views on our approach to gas entry licence drafting set out in this chapter? In particular, do you agree with our proposed approach to simplify the gas entry licence conditions?

**Question 2.2:** What are your views on the draft legal text for the "capacity reallocation obligations" set out in the appendix to this chapter?

**Question 2.3:** Are there other important gas entry licence drafting issues, not already covered in this chapter that we should be taking into account?

**CHAPTER: 3**

There are no specific questions, but views are invited on any of the issues raised in this chapter.

**CHAPTER: 4**

There are no specific questions, but views are invited on any of the issues raised in this chapter.

**CHAPTER: 5**

There are no specific questions, but views are invited on any of the issues raised in this chapter.

**CHAPTER: 6**

There are no specific questions, but views are invited on any of the issues raised in this chapter.

**CHAPTER: 7**

There are no specific questions, but views are invited on any of the issues raised in this chapter.

**CHAPTER: 8**

There are no questions in this chapter.

## Appendix 2 – The Authority’s Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority (“the Authority”), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority’s powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Act 2004, as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.<sup>5</sup>

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly<sup>6</sup>.

1.4. The Authority’s principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of consumers, present and future, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.5. The Authority must when carrying out those functions have regard to:

- 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;
- The need to secure that all reasonable demands for electricity are met;
- The need to secure that licence holders are able to finance the activities which are the subject of obligations on them<sup>7</sup>; and
- The interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.<sup>8</sup>

1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

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<sup>5</sup> Entitled “Gas Supply” and “Electricity Supply” respectively.

<sup>6</sup> However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

<sup>7</sup> Under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.

<sup>8</sup> The Authority may have regard to other descriptions of consumers.

- Promote efficiency and economy on the part of those licensed<sup>9</sup> under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- Protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity;
- Contribute to the achievement of sustainable development; and
- Secure a diverse and viable long-term energy supply.

1.7. In carrying out the functions referred to, the Authority must also have regard, to:

- The effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- 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 that appear to it to represent the best regulatory practice; and
- Certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.8. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation<sup>10</sup> and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

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<sup>9</sup> Or persons authorised by exemptions to carry on any activity.

<sup>10</sup> Council Regulation (EC) 1/2003

## Appendix 3 - Glossary

### A

#### Access Reform Options Development Group (ARODG)

Group set up by Ofgem which is intended to be a helpful pre-cursor to (and not substitute for) parties considering whether they wish to raise specific modification proposals to industry codes and is designed to stimulate debate and discussion. The group met weekly during March and April, and has published a report for consultation.

### B

#### Baseline

Baselines define the reference levels of capacity that the transmission licensee is to release. Baselines also determine the levels above (or below) which incremental capacity is defined.

#### Baseline Capital Expenditure

Baseline capital expenditure is the total amount of capex required in association with the baseline. It includes both load related capex and non-related capex.

#### British Electricity Trading and Transmission Arrangements (BETTA)

BETTA introduced a single GB-wide set of arrangements for trading energy and for access to and use of the transmission system which came fully into effect at BETTA go-live (1 April 2005).

### C

#### Capital Expenditure (Capex)

Expenditure on investment in long-lived transmission assets, such as gas pipelines or electricity overhead lines.

#### Compound Annual Reduction (CAR)

Also known as Compound Annual Growth Reduction (CAGR). The cumulative year on year rate applied to an investment or other part of a company's activities over a multiple-year period.

**D**[Distribution Price Control Review \(DPCR\)](#)

The price control review for the electricity distribution network operators conducted in 2003 & 2004. The resulting price control covers the years 2005 to 2010.

[Distribution Network Operators \(DNOs\)](#)

Holders of electricity distribution licences. Licences are granted for specified geographical areas. Currently in Great Britain there are seven companies who own the fourteen licensed distribution areas.

**E**[Early Retirement Deficit Costs \(ERDC\)](#)

ERDCs are the costs of providing the additional pension benefits payable to a scheme member who retires before normal retirement date as a result of re-organisation or redundancy, over and above the benefits to which such a member would be entitled if he retired voluntarily at the same date. The rules of both the ESPS and the LGPS provide for the automatic enhancement of benefits to which a member becomes entitled on taking early retirement as a result of re-organisation or redundancy. Principal employer companies have often in the past used a pension fund surplus to cover part or all of these additional costs, subject to agreement with the trustees of the scheme. In the absence of agreement by the trustees, the employer must make additional contributions to the pension fund to cover the additional liability.

[Electricity Supply Pension Scheme \(ESPS\)](#)

A Retirement Benefit Scheme based upon benefits paid as a proportion of final salary. The Scheme is an exempt approved scheme (ICTA'88) and is subject to a trust document. The "Group" has many principal employers and is organised and defined by a set of rules, trustees and produces accounts annually and actuarial valuations at least every 3 years (triennially). The scheme is principally for people working in the Electrical Utility Industries. This scheme is one of the 26 separate tranches each actuarially independent.

**F**[Final Sums Liability \(FSL\)](#)

The level of financial security a generator seeking connection to the network is required to post to cover the costs of works completed to connect them.

[Front Office Management Services Agreed \(FOMSAs\)](#)

An agreement between the gas distribution business retained by National Grid Gas plc and the IDNs with regards to the provision of certain IT services.

#### [Forecast Business Plan Questionnaire \(FBPQ\)](#)

Expenditure information requested by Ofgem from the licensees relating to the period from 2005/06 to 2011/12.

### **G**

#### [Gas Distribution Networks \(GDNs\)](#)

Gas Distribution Networks, of which there are eight, four of which are owned by National Grid Gas plc, and four of which were sold by Transco plc (now National Grid Gas plc) to third party owners on 1 June 2005.

#### [Gas Distribution Price Control Review \(GDPCR\)](#)

The review of the price control applying to gas distribution networks. The review will extend the existing price control for the year 2007-08 and reset the control for the period commencing 1 April 2008.

#### [Gas Transmission Charging Methodology Forum \(GTCMF\)](#)

A dedicated forum, established in January 2006, to allow National Grid NTS to provide information to the gas industry on its ongoing review of its Transportation Charging Methodology and other relevant charging methodologies and issues, and to provide an opportunity for users' views to be represented and discussed.

#### [Great Britain System Operator \(GBSO\)](#)

See SO.

### **H**

#### [Historical Business Plan Questionnaire \(HBPQ\)](#)

Expenditure information requested by Ofgem from the licensees relating to the period from the year before their most recent five-year full price control until 2004/05.

### **I**

#### [Independent Distribution Networks \(IDNs\)](#)

Gas Distribution Networks which were sold to third party owners by Transco plc (now National Grid Gas plc) on 1 June 2005. There are four such network companies, which are: Northern Gas Networks Ltd, Scotland Gas Networks plc, Southern Gas Networks plc and Wales & West Utilities Ltd.

#### Information Quality Incentive Mechanism

A form of incentive design adopted by Ofgem as part of the DPCR which provided companies with the potential for greater rewards if they chose more challenging cost targets.

#### Innovation Funding Initiative (IFI)

A mechanism to remunerate research & development expenditure by DNOs.

## L

#### Lattice Group Pension Scheme (LGPS)

A Retirement Benefit Scheme based upon benefits paid as a proportion of final salary or for newer members contributions paid to the scheme. The Scheme is an exempt approved scheme (ICTA'88) and is subject to a trust document. The Scheme is organised and defined by a set of rules, trustees and produces accounts annually and actuarial valuations at least every 3 years (triennially). The Pension Scheme is principally for people working in the Gas Utility Industries.

#### Liquefied Natural Gas (LNG)

LNG consists mainly of methane gas liquefied at around -260 degrees Fahrenheit. Cooling and liquefying the gas reduces its volume by 600 times such that a tonne of LNG corresponds to about 1,400 cubic metres of methane in its gaseous state. LNG may be stored or transported by special tanker.

#### Load Related Capex

The installation of new assets to accommodate changes in the level or pattern of electricity or gas supply and demand.

## M

#### Monopolies and Mergers Commission (MMC)

The Competition Commission replaced the MMC on 1 April 1999. It is an independent public body. The CC conducts in-depth inquiries into mergers, markets and the regulation of the major regulated industries.

## N

### National Grid Gas (NGG NTS)

The licensed gas transporter responsible for the gas transmission system, and four of the regional gas distribution companies.

### National Grid Electricity Transmission (NGET)

The electricity transmission licensee in England & Wales.

### National Transmission System (NTS)

The high pressure gas transmission system in Great Britain.

### Non-Load Related Capex

The replacement or refurbishment of assets which are either at the end of their useful life due to their age or condition, or need to be replaced on safety or environmental grounds.

## O

### One in Twenty Obligation

A licence obligation imposed by Standard Special Condition A9 (Pipe-Line System Security Standards) upon both NGG NTS and the GDNs.

### Operating Expenditure (Opex)

The costs of the day to day operation of the network such as staff costs, repairs and maintenance expenditures, and overhead.

### Operating Margin (OM)

In relation to gas the OM is gas in storage which is reserved by the NTS to ensure the supply of gas is maintained in the event of a network emergency.

## P

### Public Electricity Suppliers (PESs)

The fourteen successor companies to which were transferred the electricity distribution and supply undertakings of the former area boards at privatisation. Each PES was required to provide distribution services and connections, and to provide a supply to consumers, in the geographical area (the 'authorised area') formerly served by the area board to which it was the successor. The duty to supply was progressively removed as competition was introduced, and was eliminated entirely

by the Utilities Act 2000 which converted each PES licence into separate distribution and supply licences. The duty to provide distribution services and connections within its authorised area remains an obligation of the EDNO which, in each of the fourteen areas, is the present successor to the relevant PES.

#### Pipeline Maintenance Centre (PMC)

Internal NG group providing specialised maintenance and emergency services for high pressure gas pipelines.

#### Plugs Model

A method used by NGET to classify network assets (for the purposes of charging) as either general infrastructure assets or connection assets. The plugs model identifies connection assets as excluding any assets which are shared or sharable by another user. The cost of connection assets are used to derive connection charges, while the cost of infrastructure assets is used to derive use of system charges. See Transmission Network Use of System charges.

## R

#### Real Unit Operating Expenditure (RUOE)

A measure of operating performance calculated by dividing the real operating expenditure in a year by an appropriate output measure.

#### Registered Power Zones (RPZ)

A mechanism to encourage the DNOs to develop and demonstrate new and more cost-efficient ways of connecting and operating generators on their systems.

#### Regulatory Asset Value (RAV)

The value ascribed by Ofgem to the capital employed in the licensee's regulated transmission or (as the case may be) distribution business (the 'regulated asset base'). The RAV is calculated by summing an estimate of the initial market value of each licensee's regulated asset base at privatisation and all subsequent allowed additions to it at historical cost, and deducting annual depreciation amounts calculated in accordance with established regulatory methods. These vary between classes of licensee. A deduction is also made in certain cases to reflect the value realised from the disposal of assets comprised in the regulatory asset base. The RAV is indexed to RPI in order to allow for the effects of inflation on the licensee's capital stock. The revenues licensees are allowed to earn under their price controls include allowances for the regulatory depreciation and also for the return investors are estimated to require to provide the capital.

#### Renewables Obligation Certificates (ROCs)

A mechanism implemented by the Government to promote generation by renewable energy sources. Generators are given certificates depending on the volume they generate and suppliers are required to source a per cent of their energy from renewable sources or pay a buyout price.

#### Repex

In this consultation this term describes the use of an operating allowance to fund each year's expected non load related capital expenditure.

#### RPI-X

The form of price control currently applied to network monopolies. Each company is given a revenue allowance in the first year of each control period. The price control then specifies that in each subsequent year the allowance will move by 'X' per cent in real terms.

#### Re-openers

A process undertaken by Ofgem to re-set the revenue allowances (or the parameters that give rise to revenue allowances) under a price control before the scheduled next formal review date for the relevant price control.

#### Revenue Driver

A means of linking revenue allowances under a price control to specific measurable events which are considered to influence costs. An example might be to allow a specified additional revenue allowance for each MW of new generation connecting to the network. Revenue drivers are used by Ofgem to increase the accuracy of the revenue allowances.

#### Rolling Incentives

A measure which ensures licensees are able to retain the rewards of efficiency savings for a period of five years (consistent with the duration of the price control) irrespective of when the efficiency saving is made.

## S

#### Security and Quality of Supply Standard (SQSS)

As referred to in the electricity Transmission Licence Standard Conditions C17 and D3, this is the standard in accordance with which the electricity transmission licensees shall plan, develop and operate the transmission system.

#### Scottish Hydro-Electric Transmission Limited (SHETL)

The electricity transmission licensee in northern Scotland.

### Scottish Power Transmission Limited (SPTL)

The electricity transmission licensee in southern Scotland.

### Sliding scale

This term is used generically to describe incentive schemes which involve profit (and loss) sharing around a fixed target costs, such as the current form of SO incentives in gas and electricity.

### System Operator (SO)

The system operator has responsibility to construct, maintain and operate the NTS and associated equipment in an economic, efficient and co-ordinated manner. In its role as SO, NGG NTS is responsible for ensuring the day-to-day operation of the transmission system.

## T

### Theoretical Maximum Physical Capacity

An approach to determining the level of baselines which can be characterised as the maximum amount of gas that can be taken through a particular entry or offtake point by reducing supplies at other nodes in order to balance the network but not taking into account interactions with flows elsewhere on the network.

### Transmission Connected Customer (TCC)

A customer directly connected to the gas or electricity transmission system.

### Transmission Entry Capacity (TEC)

Defines a generator's maximum allowed export capacity onto the transmission system. The holder of the TEC has the right to export the specified number of megawatts onto the transmission system at any one time, and is eligible for compensation if NGET cannot accommodate this export on the network.

### Transmission Investment for Renewable Generation (TIRG)

In the context of this document, this means the regulatory mechanisms developed before the start of the next main price control in 2007, to fund a number of specific network enhancement projects required to provide transmission capacity for new renewable generation plants.

### Transmission Owners (TO)

Companies which hold transmission owner licenses. Currently there are three electricity TOs; NGET, SPTL and SHETL. NGG NTS is the gas TO.

#### [Transmission Price Control Review \(TPCR\)](#)

The TPCR will establish the price controls for the transmission licensees which will take effect in April 2007 for a 5-year period. The review applies to the three electricity transmission licensees, NGET, SPTL, SHETL and to the licensed gas transporter responsible for the gas transmission system, NGG NTS

#### [Transmission Use of System Charges \(TNUoS\)](#)

Charges levied by NGET on users of the GB electricity transmission network to recover the costs of providing and maintaining the general network infrastructure assets. TNUoS charges vary by location, and are different for generators and for suppliers.

### **U**

#### [Unit Cost Allowance \(UCA\)](#)

A parameter of the current revenue restriction for NGG NTS. A UCA is set for each entry point, and is intended to reflect the cost of providing additional capacity at that point on the network. The actual additional revenue entitlement for NGG NTS if it releases such additional capacity at a particular entry point is a function of the UCA for that entry point. NGG NTS also uses the UCAs as reserve prices in its auctions of entry capacity.

#### [Uniform Network Code \(UNC\)](#)

As of 1 May 2005, the UNC replaced NGG NTS's network code as the contractual framework for the NTS, GDNs and system users.

### **V**

#### [Vesting Assets](#)

Assets included in the RAV at the vesting date.

#### [Vesting](#)

The date at which the regulated gas and electricity transmission and distribution companies were privatised.

## Appendix 4 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

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