

## **MODIFICATION OF SPECIAL CONDITION C8D OF NATIONAL GRID GAS PLC'S GAS TRANSPORTER LICENCE IN RESPECT OF ITS NATIONAL TRANSMISSION SYSTEM UNDER SECTION 23(1)(a) OF THE GAS ACT 1986**

### **NOTICE OF REASONS FOR THE DECISION TO MODIFY SPECIAL CONDITION C8D OF NATIONAL GRID GAS PLC'S GAS TRANSPORTER LICENCE UNDER SECTION 38A OF THE GAS ACT 1986**

Whereas –

1. National Grid Gas plc ("the Licence Holder") is the holder of a Gas Transporter Licence in respect of its National Transmission System ("the NTS") ("the Licence") granted or treated as granted under section 7 of the Gas Act 1986 ("the Act").
2. In accordance with section 23(3) of the Act the Gas and Electricity Markets Authority ("the Authority"):
  - i. gave notice ("the Notice") on 26 November 2009 that it proposed to make a modification to Special Condition C8D of the Licence setting out its effect;
  - ii. stated the reasons for the proposed modification; and
  - iii. served a copy of the Notice on the Licence Holder requiring any objections or representations to the modification to be made on or before 24 December 2009.
3. In accordance with section 23(4)(b) of the Act, the Authority gave notice of the proposed modification to the Secretary of State on 26 November 2009 and has not received a direction not to make the modification before the relevant time period specified in the Notice.
4. On 15 December 2009 the Licence Holder gave written consent to the proposed modification<sup>1</sup>.
5. Prior to the close of the relevant time period specified in the Notice, the Authority did not receive any responses which constituted formal objections. The Authority did not receive any further response in relation to the proposed modification, other than the consent from the Licence Holder. The Authority has carefully considered the consent received in relation to the proposed modification and considers that no further amendment is necessary to the Notice in relation to the consent received.
6. In accordance with 38A of the Act the Authority gives the following reasons for making the licence modification. The licence modification is necessary to:
  - reduce the entry capacity operational buy-back target cost to the estimated annual entry capacity operational buy-back costs to sharpen the incentives on the Licence Holder to contain the costs of entry capacity operational buy-back and therefore operate the NTS more economically. This should protect consumers from buy-back costs, whilst providing sufficient revenue on the Licence Holder to incentivise it to manage buy-back cost and without significantly disadvantaging the Licence Holder;
  - reduce the entry capacity operational buy-back upside cap to be consistent with the approach taken at the Fourth Transmission Price Control Review ("TPCR4"), which covered the period 2007-2012, such that the cap is not greater than the target; and
  - reduce the entry capacity operational buy-back downside collar to be consistent with the approach taken at TPCR4, such that the collar is not greater than the target and to deal with the asymmetric risk faced by the Licence Holder from potential extreme buy-back prices

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<sup>1</sup> The consent received, which was not confidential, is available free of charge from the Ofgem Research and Information Centre, 9 Millbank, London SW19 3GE or from the Ofgem website [www.ofgem.gov.uk](http://www.ofgem.gov.uk).

Further details of the reasons are published by the Authority in the following document:

"Notice under section 23(3) of the Gas Act – proposed modification of National Grid Gas Plc's National Transmission System Gas Transporter Licence with respect to entry capacity operational buy-back incentive and default incremental entry capacity lead time", with reference number 142/09, published on 26 November 2009.

This document is available free of charge from the Ofgem Research and Information Centre, 9 Millbank, London SW1P 3GE or from the Ofgem website at [www.ofgem.gov.uk](http://www.ofgem.gov.uk).

**THEREFORE**

In accordance with section 23(1)(a) of the Act, the Authority hereby modifies the Licence in the manner specified in attached Schedule A with effect on and from 1 January 2010.

This document constitutes a notice of reasons for the decision to modify the special conditions of the licence under section 38A of the Act.

**The Official Seal of the Gas and Electricity Markets Authority here affixed is authenticated by the signature of**



.....  
**Stuart Cook**  
**Acting Senior Partner, Transmission & Governance**  
**Duly Authorised on behalf of the Authority**

**5 January 2010**

## Schedule A

### **Special Condition C8D NTS entry incentives, costs and revenues**

#### **Part A – The Gas Entry Revenue Restriction Calculations**

#### **Paragraph 3 Entry capacity operational buy-back incentive revenue**

### **3. Entry capacity operational buy-back incentive revenue**

- a) For the purposes of paragraph 1 of this condition, the maximum entry capacity operational buy-back incentive revenue in formula year t ( $EnCBBOIR_t$ ) shall be derived in accordance with the following formula:

$$EnCBBOIR_t = EnCOBBC_t + EnCOBBIR_t + EnCNOIR_t$$

where:

$EnCOBBC_t$  means the subset of the costs ( $EnCBBC_t$  as defined in paragraph 3(c) of this condition) incurred by the licensee in respect of formula year t in respect of entry capacity constraint management:

- (i) including (but not limited to) costs incurred by the licensee in respect of any payments made by the licensee to curtail the rights of relevant shippers to use firm entry capacity in formula year t (or any part thereof) which would otherwise be conferred on relevant shippers through the ownership of entry capacity rights; and
- (ii) excluding (subject to the provision of paragraph 3(n) of this condition) costs incurred by the licensee in this manner where the relevant shippers' ownership of entry capacity rights relates to:
  - (aa) funded incremental obligated entry capacity first released for sale by the licensee after 31 March 2007 (as included within the term  $EnCIBBC_t$  (as defined in paragraph 5(a) of this condition) until such time as that entry capacity has been delivered to relevant shippers; and
  - (bb) funded incremental obligated entry capacity in respect of the Milford Haven NTS Entry Point released for sale

during the allocation held between September 2004 and December 2004 (inclusive), for use at the Milford Haven NTS Entry Point from 1 October 2007 (as included within the term  $EnCBBMHBC_t$  as defined in paragraph 4(a) of this condition), until such time as that capacity has been delivered to relevant shippers;

$EnCNOIR_t$  has the meaning given in paragraph 3(b) of this condition;

$EnCOBBIR_t$  shall (except that in the circumstances specified in paragraph 3(j) of this condition when it shall take the value 0) be calculated in accordance with the following formula:

i) If  $EnCOBBIP_t \leq (EnCOBBTC \times PIT_t)$ , then:

$$EnCOBBIR_t = \text{MIN}\{EnCOBBSF \times ((EnCOBBTC \times PIT_t) - EnCOBBIP_t), (EnCOBBUC \times PIT_t)\}$$

ii) If  $EnCOBBIP_t > (EnCOBBTC \times PIT_t)$ , then

$$EnCOBBIR_t = \text{MAX}\{EnCOBBSF \times ((EnCOBBTC \times PIT_t) - EnCOBBIP_t), -(EnCOBBDC \times PIT_t)\}$$

where:

$EnCOBBIP_t$  means the entry capacity operational buy-back performance measure in respect of formula year  $t$  and shall be defined in accordance with paragraph 3(b) of this condition;

$EnCOBBTC$  means the entry capacity operational buy-back target cost and shall take the value of £18,000,000 for the period between 1 April 2007 and 31 March 2008, £ 20,250,000 for the period between 1 April 2008 and 31 March 2009, £19,125,000 for the period between 1 April 2009 and 31 March 2010 and £13,500,000 for each formula year commencing on or after 1 April 2010;

EnCOBBSF means the entry capacity operational buy-back sharing factor and shall take the value of 50%;

EnCOBBUC means the entry capacity operational buy-back upside cap and shall take a value of £18,000,000 for the period between 1 April 2007 and 31 March 2009, £16,875,000 for the period between 1 April 2009 and 31 March 2010 and £13,500,000 for each formula year commencing on or after 1 April 2010; and

EnCOBBDC means the entry capacity operational buy-back downside collar and shall take the value of £18,000,000 for the period between 1 April 2007 and 31 March 2009, £16,000,000 for the period between 1 April 2009 and 31 March 2010 and £10,000,000 for each formula year commencing on or after 1 April 2010.

### **Entry capacity operational buy-back performance measure**

- b) For the purposes of paragraph 3(a) of this condition, the entry capacity operational buy-back performance measure in respect of formula year t (EnCOBBIP<sub>t</sub>) shall be derived from the following formula:

$$\text{EnCOBBIP}_t = \text{EnCOBBC}_t - \text{AOEnCRD}_t - \text{REVIC}_t - (\text{ANOEnCR}_t - \text{EnCNOIR}_t) - \text{RCOR}_t - \text{RLOC}_t - \text{RADD}_t$$

where:

EnCOBBC<sub>t</sub> shall have the meaning given to that term in paragraph 3(a) of this condition;

AOEnCRD<sub>t</sub> means revenue derived by the licensee in respect of formula year t from on the day sales of obligated entry capacity and shall be calculated in accordance with paragraph 8(f) of this condition;

REVIC<sub>t</sub> shall have the meaning given to that term in paragraph 6(a) of this condition;

- ANOEnCR<sub>t</sub> means the revenue derived by the licensee in respect of formula year t from sales of non-obligated entry capacity and shall be calculated in accordance with paragraph 8(c) of this condition;
- EnCNOIR<sub>t</sub> means  $\sum_{\forall i} (\text{EnCNOIR}_{i,t})$  where EnCNOIR<sub>i,t</sub> (the revenues from the accelerated release of incremental obligated entry capacity) is defined in accordance with paragraph 3(f) of this condition;
- RCOR<sub>t</sub> shall have the meaning given to that term in paragraph 3(d)(i) of Special Condition C8C (NTS System Operation Activity Revenue Restriction);
- RLOC<sub>t</sub> shall have the meaning given to that term in paragraph 3(d)(i) of Special Condition C8C (NTS System Operation Activity Revenue Restriction); and
- RADD<sub>t</sub> means any further revenues derived by the licensee in respect of formula year t that the Authority has directed to include in the formula for the entry capacity operational buy-back performance measure (EnCOBBIP<sub>t</sub>).

#### **Entry capacity constraint management costs**

- c) For the purposes of paragraph 3(d) of this condition, the entry capacity constraint management costs incurred by the licensee in respect of formula year t (EnCBBC<sub>t</sub>) shall be derived from the following formula:

$$\text{EnCBBC}_t = \sum_{d|y(d)=t} \text{BBC}_{d,t} + \sum_{d|y(d)=t} \text{ECCC}_{d,t}$$

where:

- BBC<sub>d,t</sub> means the costs incurred by the licensee in the curtailment of capacity rights to put gas into the transportation system (less any revenues received from DN operators in respect of the curtailment of capacity rights to put gas into their transportation system) in respect of day d of formula year t (including costs incurred in respect of any acquisitions from gas shippers of capacity rights); and
- ECCC<sub>d,t</sub> means the costs incurred by the licensee in respect of any payments made by the licensee to gas shippers in exchange for agreeing to

offtake gas from the NTS at the licensee's request on day d in respect of formula year t and in respect of any costs incurred by the licensee undertaking any other commercial or physical action to manage entry capacity excluding those covered by  $BBC_{d,t}$  including any locational buy actions.

- d) The entry capacity constraint management costs incurred by the licensee in respect of formula year t ( $EnCBBC_t$ ) shall be attributed between the following terms:
- i) the entry capacity operational buy-back cost term ( $EnCOBBC_t$ ) in paragraph 3(a) of this condition;
  - ii) the Milford Haven entry capacity specific incentive cost term ( $EnCBBMHBBC_t$ ) in paragraph 4(a) of this condition; and
  - iii) the entry capacity incremental buy-back cost term ( $EnCIBBC_t$ ) in paragraph 5(a) of this condition;

such that:

$$EnCBBC_t = EnCOBBC_t + EnCBBMHBBC_t + EnCIBBC_t$$

- e) In the process of attributing entry capacity constraint management costs ( $EnCBBC_t$ ) in accordance with paragraph 3(d) of this condition, the licensee shall ensure that:
- i) it attributes costs in accordance with the cost allocation rules set out in paragraph 3(n) of this condition; and
  - ii) that while applying those cost allocation rules, it shall not attribute the same costs to more than one term for the purposes of paragraph 3(d).

### **Accelerated release of incremental obligated entry capacity**

- f) The revenues from the accelerated release of incremental obligated entry capacity ( $EnCNOIR_{i,t}$ ) shall be the revenues received by the licensee from the sale of non-obligated entry capacity at NTS Entry Point i for use on all days g of formula year t and shall be derived from the following formula:

$$EnCNOIR_{i,t} = \sum_{g/y(g)=t} EnCNOIR_{i,g}$$

where:

$EnCNOIR_{i,g}$  means the revenues received by the licensee from the sale of non-obligated entry capacity at NTS Entry Point i for use on day g in circumstances where:

- i) day g is less than 6 months prior to the day on which the licensee's obligation to contractually deliver incremental obligated entry capacity for use at NTS Entry Point i first arises as a result of the implementation of a proposal made under paragraph 9(f) of this condition;
- ii) the allocation of the capacity occurred on a day at least 18 months prior to the day on which the licensee's obligation to contractually deliver incremental obligated entry capacity for use at NTS Entry Point i first arises as a result of the implementation of a proposal made under paragraph 9(f) of this condition;
- iii) the day on which the licensee's obligation to contractually deliver incremental obligated entry capacity for use at NTS Entry Point i that arises as a result of the implementation of a proposal made under paragraph 9(f) of this condition has not been extended by the licensee beyond the default of timescale of 42 months; and
- iv) the amount of non-obligated entry capacity released is, on day g, not greater than the difference between the level of incremental obligated entry capacity at NTS entry point i 6 months after day g and the level of incremental obligated entry capacity at point i on day g.

#### **Incremental capacity delivery incentive payment**

- g) The licensee may, with the consent of the Authority, vary the lead time for the contractual delivery of incremental obligated entry capacity at an individual NTS entry point from the default of 42 months from the 1<sup>st</sup> day of the month following the end of the Annual Invitation Period (as defined in the network code). Consent shall be deemed to have been granted if:
  - i) the licensee is proposing to reduce the lead time for the contractual delivery to a period of less than 42 months; or
  - ii) the volume of firm entry capacity being deferred (in units of GWh per day for each one month period) is, at day n, less than the licensee's "entry lead time deferment volume entitlement"  $LTDVEn_n$  defined in paragraph 3(i) of this condition.



- h) The licensee shall notify the Authority in writing and in a timely manner of each instance where it varies the lead time for the contractual delivery of incremental obligated entry capacity from the default of 42 months specifying:
- i) the NTS Entry Point affected;
  - ii) the volume of capacity (in units of GWh per day for each one month period ) for which the contractual delivery date is being brought forward; or
  - iii) the volume of capacity (in units of GWh per day for each one month period) for which the contractual delivery date is being put back.
- i) The licensee's entry lead time deferment volume entitlement on day n ( $LTDVE_{n_n}$ ) (in units of GWh per day for each one month period) shall be calculated in accordance with the following formula:

$$LTDVE_{n_n} = 7200 + \sum_{v, n-1} DLTDVE_{n_v}$$

where:

$DLTDVE_{n_v}$  means the change in the lead time for contractual delivery (in units of GWh per day for each one month period) that arises from the variation event v as notified to the Authority pursuant to paragraph 3(h) of this condition. For the avoidance of doubt, where  $v=0$   $DLTDVE_{n_0}$  shall take the value zero; and

subscript v means the relevant variation event, where  $v=1$  shall mean the first variation event notified to the Authority pursuant to paragraph 3(h) of this condition.

### **Review of entry capacity operational buy-back scheme**

- j) The licensee may issue a notice to the Authority providing that the value of the  $EnCOBBIR_t$  shall take a value of 0 (zero) in respect of any period or periods of time specified in said notice, provided the provisions of paragraphs 3(k) to 3(l) of this condition have been met.
- k) A notice provided by the licensee to the Authority under paragraph 3(j) shall:
- i) be in writing addressed to the Authority;

- ii) state the period or periods referred to in paragraph 3(j) of this condition to which it will apply;
  - iii) not be in respect of any period or periods commencing prior to 1<sup>st</sup> April 2009; and
  - iv) be submitted on a date after 31<sup>st</sup> December 2008.
- l) The licensee may withdraw the notice referred to in paragraph 3(j) of this condition at any time.
- m) The notice shall have no effect if the Authority has made a reference to the Competition Commission under section 24 of the Act relating to the modification of paragraph 3 of this condition before the date of the first period on which such a notice would take effect.

**Buy-back cost allocation rules**

- n) For the purpose of attributing the entry capacity constraint management costs referred to in paragraph 3(d) of this condition the licensee shall apply the rules set out in its statement of entry capacity constraint management cost allocation rules prepared pursuant to paragraph 13 of this condition.