

NOTICE OF MODIFICATION OF THE SPECIAL CONDITIONS OF NATIONAL GRID GAS PLC'S GAS TRANSPORTER LICENCE IN RESPECT OF ITS NATIONAL TRANSMISSION SYSTEM UNDER SECTION 23 OF THE GAS ACT 1986

1. National Grid Gas plc (NGG) ("the Licensee") holds a gas transporter licence in respect of its National Transmission System (NTS) ("the NTS Licence") treated as granted pursuant to section 7 of the Gas Act 1986 ("the Act").
2. In accordance with section 23(3) and (4) of the Act, the Gas and Electricity Markets Authority ("the Authority") gives notice that it proposes to:
 - (i) modify Special Condition C8F and Special Condition C8G of the NTS Licence in accordance with Schedule 1 of this Notice; and
 - (ii) introduce new Special Condition C28 to the NTS Licence in accordance with Schedule 2 of this Notice.
3. The proposed licence modifications set out in Schedule 1 of this Notice are intended to implement proposals relating to the NTS System Operation External Cost Incentive Revenue Scheme from 1 April 2011. In summary, the effects of the proposed licence modifications are:
 - a) to implement an Operating Margins Incentive for the period 1 April 2011 to 1 April 2013; and
 - b) to implement a new Greenhouse Gas Incentive for the period 1 April 2011 to 1 April 2013.
4. The proposed licence modification set out in Schedule 2 of this Notice introduces a requirement on the Licensee to develop and undertake a Scheme of Work for the purposes of developing a long term external gas system operator incentive to reduce greenhouse gas emissions resulting from the operation of the transmission system by the licensee.
5. Subject to the outcome of this statutory consultation, consideration of respondents' views and the consent of the Licensee being given, it is the intention of the Authority that the proposed licence modification shall have effect on and from 06:00 hours on 1 April 2011.
6. Information in relation to the proposed licence modifications is contained in the following documents:

"Initial Proposals Consultation Document for Gas SO Incentives from April 2011", National Grid, 11 November 2010.
7. This document is available from the National Grid website at <http://www.nationalgrid.com/uk>.
8. The reasons why the Authority proposes to make the licence modifications were published by the Authority in the following document:

"National Grid Gas System Operator Incentives from April 2011: Final Proposals Consultation", Ofgem, 1 March 2011.
9. 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.

10. Any representations or objections to the proposed licence modifications may be made by 29 March 2011 and sent to:

Ian Marlee
Partner, GB Markets
Ofgem
9 Millbank
London SW1P 3GE

or by e-mail to soincentives@ofgem.gov.uk.

Ian Marlee
Partner, GB Markets
Duly authorised on behalf of the Gas and Electricity Markets Authority

1 March 2011

SCHEDULE 1

PROPOSED MODIFICATION OF THE SPECIAL CONDITIONS OF NATIONAL GRID GAS PLC'S GAS TRANSPORTER LICENCE IN RESPECT OF ITS NATIONAL TRANSMISSION SYSTEM UNDER SECTION 23 OF THE GAS ACT 1986

1. In Special Condition C8F (NTS System Operator external incentives, costs and revenues) substitute:

a. In paragraph (1)(a):

i. for

" $SOOIRC_t = SC_t + OMC_t + RBC_t + SIR_t + OMIR_t + RBIR_t + QIIR_t + EIR_t + UAGIR_t$ ",

substitute

" $SOOIRC_t = SC_t + OMC_t + RBC_t + SIR_t + OMIR_t + RBIR_t + QIIR_t + GHGIR_t + GHGC_t + UAGIR_t$ ";

ii. for

" OMC_t means the total costs incurred by the licensee in respect of formula year t in respect of the procurement of availability and utilisation of Operating Margins services that have been paid for the purposes of satisfying Operating Margins Requirements (having the meaning given to those terms in the network code) including all capacity fees, gas delivery service fees, standby fees and costs associated with reprofiling, withdrawing and injecting gas into and out of storage and costs that may arise as a result of the difference between the Operating Margins WACOG and Net Margins WACOG as calculated in accordance with Part 4 Section K of the UNC in the event of service utilisation multiplied by the relevant utilisation volume;"

substitute

" OMC_t means the total costs incurred by the licensee in respect of formula year t in respect of the procurement of availability and utilisation of Operating Margins services for the purposes of satisfying Operating Margins Requirements (having the meaning given to those terms in the network code) including all capacity fees, gas delivery service fees, standby fees and costs associated with reprofiling, withdrawing and injecting gas into and out of storage and costs that may arise as a result of the difference between the Operating Margins WACOG and Net Margins WACOG as calculated in accordance with Section K of the uniform network code in the event of service utilisation multiplied by the relevant utilisation volume;"

iii. for

"EIR_t means the Environmental Incentive Revenue in respect of formula year t which shall be calculated in accordance with paragraph 6 of this condition; and",

substitute

"GHGIR_t means the Greenhouse Gas Incentive Revenue in respect of formula year t which shall be calculated in accordance with paragraph 6(a) of this condition;",

iv. before the definition of UAGIR_t insert:

"GHGCT means the efficient Greenhouse Gas Emissions Project Costs in respect of formula year t which shall be calculated in accordance with paragraph 6(b) of this condition; and",

- b. For paragraph (3)(a) (Maximum operating margins incentive revenue) substitute:

"For the purposes of paragraph 1(a) of this condition, the maximum Operating Margins incentive revenue (in £) allowed to the licensee in respect of formula year t (OMIR_t) shall be derived from the following formula:

If $OMPC_t \leq OMIT_t$, then:

$$OMIR_t = \text{Min} [OMUSF_t \times (OMIT_t - OMOPC_t), OMCAP_t]$$

Otherwise:

$$OMIR_t = \text{Max} [OMDSF_t \times (OMIT_t - OMOPC_t), OMFLO_t]$$

where:

Min [x,y] is the value which is the lesser of x and y;

Max [x,y] is the value which is the greater of x and y;

OMIT_t means the operating margins incentive target (in £) in respect of formula year t and shall be derived using the following formula:

for formula year t=10

$$\text{OMIT}_t = \text{£}17,318,792 + \text{OMA}_t$$

where:

OMA_t means the operating margins incentive target adjustment (in £) in respect of formula year t whether of a positive or zero value in respect of the full recovery of the increase in costs efficiently incurred by the licensee as a result of booking deliverability at the Avonmouth LNG Storage facility. In the event the licensee incurs deliverability costs or a liability for deliverability costs at Avonmouth in formula year t=10, the licensee shall provide a statement to the Authority detailing the costs incurred or anticipated to be incurred and justification that these costs are efficient. This statement shall also detail the reduction in reprofiling and utilisation costs resulting from the licensee incurring deliverability costs. This statement shall be provided not later than 14 days of the licensee booking deliverability at the Avonmouth LNG Storage facility. Upon receipt of the statement, the Authority will determine the extent to which the licensee's costs are efficient and, if appropriate, shall issue a direction specifying the value of OMA_t . In formula year t=10 OMA_t shall take the value zero unless otherwise directed by the Authority.

for formula year t=11

$$\text{OMIT}_t = 0.95 \times \text{OMIT}_{t-1} + \text{OMLS}_t$$

where:

OMLS_t means the operating margins incentive target adjustment in formula year t (in £) whether of a positive or zero value in respect of the full recovery of the costs efficiently incurred by the licensee for locational -

Scotland operating margins. In the event the licensee will incur locational – Scotland operating margins costs or a liability for locational – Scotland operating margins costs in formula year $t=11$, the licensee shall within 14 days of booking locational – Scotland operating margins provide a statement to the Authority detailing these costs and justification that these costs are efficient. Upon receipt of the statement, the Authority will determine the extent to which the licensee’s costs are efficient and, if appropriate, shall issue a direction specifying the value of $OMLS_t$. In formula year $t=11$ $OMLS_t$ shall take the value zero unless otherwise directed by the Authority.

In the relevant formula year t , for formula year $t=10$ and formula year $t=11$ $OMIT_t$ shall take the value derived from the formula above unless the Authority directs that an alternative value (either higher or lower) shall apply. Such alternative value shall only be directed by the Authority to apply if the applicable prices specified in Special Condition C3 of the licensee’s transportation licence for the Avonmouth LNG Storage facility change from those specified in the Authority’s Notice of Modification under Section 23 of the Gas Act of 2 March 2011 (the “Notice”) such that the value of $OMIT_t$ would vary by an amount in excess of £100,000. The Authority shall direct a change to this value in line with any change to the prices set out in the Notice.

$OMUSF_t$ means the operating margins upside sharing factor in respect of formula year t and in formula year $t=10$ and formula year $t=11$ shall take the value 0.2;

$OMDSF_t$ means the operating margins downside sharing factor in respect of formula year t and in formula year $t=10$ and formula year $t=11$ shall take the value 0.2;

$OMCAP_t$ means the operating margins incentive cap in respect of formula year t and in formula year $t=10$ and formula year $t=11$ shall take the value £1,000,000;

OMFLO_t means the operating margins incentive collar in respect of formula year t and in formula year t=10 and formula year t=11 shall take the value -£1,000,000;

OMOPC_t means the operating margins overall performance cost measure (in £) in respect of formula year t and in formula year t=10 and formula year t=11 shall be derived using the following formula:

$$\text{OMOPC}_t = \text{OMAPC}_t + \text{OMUPC}_t$$

where:

OMAPC_t means the operating margins availability performance cost measure (in £) in respect of formula year t and is equal to the total costs incurred by the licensee in respect of formula year t in respect of the procurement of availability of Operating Margins services for the purposes of satisfying Operating Margins Requirements (having the meaning given to those terms in the network code) including all capacity fees, gas delivery service fees, standby fees and costs associated with re-profiling, withdrawing and injecting gas into and out of storage;

OMUPC_t means the operating margins utilisation performance cost measure (in £) in respect of formula year t and shall be derived using the following formula:

if: $\text{OMUV}_t \leq \text{OMUVC}_t$, then:

$$\text{OMUPC}_t = \text{OMAUC}_t$$

if: $\text{OMUV}_t > \text{OMUVC}_t$, then:

$$\text{OMUPC}_t = \text{OMAUC}_t \times \left[\frac{\text{OMUVC}_t}{\text{OMUV}_t} \right]$$

where:

- OMUV_t means the total volume (in GWh) of utilisation of operating margins (as defined in accordance with Section K paragraph 1.1.2 (c) of the uniform network code as at 1 March 2011) in formula year t;
- OMUVC_t means the operating margins utilisation volume cap (in GWh) in respect of formula year t and in formula year t=10 and in formula year t=11 shall take the value 78.1GWh; and
- OMAUC_t means the operating margins actual utilisation cost (in £) in respect of formula year t and shall be equal to the total costs incurred by the licensee in respect of formula year t as a result of the utilisation of Operating Margins as defined in accordance with of Section K paragraph 1.1.2 (c) of the uniform network code as at 1 March 2011. Such costs including costs incurred as a result of the withdrawal of gas from an Operating Margins Facility (as such facility defined in the network code), the cost of the Operating Margins WACOG as calculated in accordance with Section K of the uniform network code multiplied by the relevant utilisation volume and costs incurred as a result of re-profiling required as a result of the utilisation of Operating Margins including capacity fees, gas delivery service fees and costs associated with the injection of gas into an Operating Margins Facility. For the avoidance of doubt, costs reported under OMAUC_t will not also be reported under OMAPC_t and vice versa.”

- c. For paragraph (6) (Environmental Incentive) substitute:

“(6)Greenhouse Gas Emissions Incentive

(a) Greenhouse Gas Incentive Revenue

For the purposes of paragraph 1(a) of this condition, the greenhouse gas emissions incentive revenue (in £) allowed to the licensee in respect of formula year t (GHGIR_t) shall depend on the value of VIPM_t and shall be derived from Table L below:

Table L

VIPM_t	GHGIR_t
VIPM _t < VITL _t	(VITL _t - VIPM _t) x VIRP _t
VITL _t ≤ VIPM _t ≤ VITU _t	0
VIPM _t > VITU _t	(VITU _t - VIPM _t) x VIRP _t

where:

VIPM_t means the venting incentive performance measure (tonnes of natural gas) in respect of formula year t which shall be the aggregate amount of natural gas released to the atmosphere by venting from all relevant compressors;

VITL_t means the venting incentive target volume lower limit (in tonnes of natural gas) in respect of formula year t and in formula year t=10 shall take the value 2857 and in formula year t=11 shall take the value 2857;

VITU_t means the venting incentive target volume upper limit (in tonnes of natural gas) in respect of formula year t and in formula year t=10 shall take the value 3157 and in formula year t=11 shall take the value 3157;

VIRP_t means the venting incentive reference price (in £/tonne of natural gas vented) in respect of formula year t and shall be derived using the following formula:

$$VIRP_t = NTCP_t \times VF_t$$

where

NTCP_t means the Non Traded Carbon Price (in £/tCO₂e) in respect of formula year t and shall be derived using the following formula:

$$NTCP_t = \frac{\sum_{m=1}^{12} NTMCP_{m,t,y} \times IF_{m,t,y}}{12}$$

where:

$NTMCP_{m,t,y}$ means the latest Non Traded Central Carbon Price (£/tCO₂e) for month m in formula year t as published in advance of month m by the Department of Energy and Climate Change (or any other government department from time to time) in year y prices;

$\sum_{m=1}^{12} X_{m,t}$ means the sum of $x_{m,t}$ for months m=1 to m=12 where m=1 is the first month of formula year t and m=12 is the last month of formula year t;

$IF_{m,t,y}$ means the inflation factor from year y to month m in formula year t as derived using the following formula:

$$IF_{m,t,y} = \frac{AI_t}{AI_y}$$

where:

AI_t means the annual inflation index for formula year t and is equal to the arithmetic average of the retail prices index numbers published or determined with

respect to each of the six months from July to December (both inclusive) in formula year t-1;

AI_y means the annual inflation index for year y and is equal to the arithmetic average of the retail prices index numbers published or determined with respect to each of the six months from July to December (both inclusive) in year y-1;

and

VF_t means the venting equivalent factor that represents the number of tonnes of CO₂ equivalent of each tonne of natural gas vented in respect of formula year t and in formula year t=10 shall take the value 20.84 and in formula year t=11 shall take the value 20.86.

“relevant compressor” means gas and electrically powered gas compression equipment forming part of the pipe-line system to which this licence relates that is used by the licensee to increase the pressure of gas in part of that pipe-line system; and

“venting” means the release of natural gas from a relevant compressor as a result of:

(a) starting a compressor;

- (b) purging a compressor;
- (c) depressurising a compressor; or
- (d) the leakage of gas through a seal around the shaft of a compressor.

(b) Greenhouse Gas Emissions Project Costs

For the purposes of paragraph 1(a) of this condition, the greenhouse gas emissions project costs (in £) allowed to the licensee in respect of formula year t (GHGC_t) shall be of a positive or zero value as directed by the Authority for the purposes of paragraph 7 of Special Condition C28 (Requirement to develop and undertake a Scheme of Work to facilitate the establishment of a long term external gas system operator incentive to reduce targeted greenhouse gases). In the event the licensee incurs costs under Special Condition C28 (Requirement to develop and undertake a Scheme of Work to facilitate the establishment of a long term external gas system operator incentive to reduce targeted greenhouse gases) that it considers should be recovered via GHGC_t , the licensee shall by 31 July in the formula year t following the formula year in which those costs are incurred provide a statement to the Authority detailing the costs incurred in formula year $t-1$ and justification that these costs were efficiently incurred. Upon receipt of the statement, the Authority will determine the extent to which the licensee's costs were efficiently incurred and, if appropriate, shall issue a direction specifying the value of GHGC_t . The value of GHGC_t in formula year $t=10$, formula year $t=11$ and formula year $t=12$ shall be zero or as directed by the Authority."

In Special Condition C8G (NTS System Operator internal incentives, costs and revenues) substitute:

d. In paragraph (1)(b):

i. for

" IOC_t means the operating costs incurred in respect of formula year t attributable to the provision of NTS SO activity in accordance with Special Condition C9 (Allocation of revenues and costs for calculations under the price control in respect of the NTS transportation owner activity and NTS system operation

activity) other than $ExCC_t$, $EnCBBC_t$, $ExCBBICP_t$, SC_t , OMC_t , $OMPC_t$, RBC_t , Pension Costs and charges levied on the licensee by the agency (as defined in Standard Special Condition A15 (Agency)).”,

substitute

“ IOC_t means the operating costs incurred in respect of formula year t attributable to the provision of NTS SO activity in accordance with Special Condition C9 (Allocation of revenues and costs for calculations under the price control in respect of the NTS transportation owner activity and NTS system operation activity) other than $ExCC_t$, $EnCBBC_t$, $ExCBBICP_t$, SC_t , OMC_t , $OMPC_t$, RBC_t , non recoverable costs (as such term is defined in Special Condition C28 (Requirement to develop and undertake a Scheme of Work to facilitate the establishment of a long term external greenhouse gas system operator incentive to reduce targeted greenhouse gases), Pension Costs and charges levied on the licensee by the agency (as defined in Standard Special Condition A15 (Agency)).”

SCHEDULE 2

PROPOSED MODIFICATION OF THE SPECIAL CONDITIONS OF NATIONAL GRID GAS PLC'S GAS TRANSPORTER LICENCE IN RESEPECT OF ITS NATIONAL TRANSMISSION SYSTEM UNDER SECTION 23 OF THE GAS ACT 1986

Add the following Special Condition:

Special Condition C28: Requirement to develop and undertake a Scheme of Work to facilitate the establishment of a long term external gas system operator incentive to reduce targeted greenhouse gases

1. The licensee shall develop a draft of the Scheme of Work by 28 April 2011 or such other date as agreed by the Authority.
2. The licensee shall cooperate with the Authority and any Consultants appointed pursuant to paragraph 5 in the conduct of the Review by or around 24 May 2011 or such other date as the Authority may reasonably direct.
3. The licensee shall make any consequential amendments to the draft Scheme of Work arising from the Review as may reasonably be directed by the Authority by 6 June 2011 or such date as the Authority may reasonably direct.
4. The licensee shall undertake the activities set out in the Scheme of Work within the timescales outlined in the Scheme of Work or such other timescales as the Authority may reasonably direct.
5. The licensee shall cooperate with and assist the Authority in selecting and appointing Consultants to conduct the Review. The scope and content of any contract in respect of work to be undertaken during the Review by any Consultants shall be:
 - a) proposed by the Authority;
 - b) reviewed by the licensee;
 - c) approved by the Authority, subject to any modification as it may reasonably require, having taken into account any representations by the licensee.
6. Any contract entered into pursuant to paragraph 5 between the Authority, the licensee and any Consultants shall make provision for payment of the Consultants by the licensee. Where Consultants are to be appointed for the purposes of this condition, the licensee's performance of its obligations to cooperate with the Consultants shall be conditional on the Consultants having entered into an agreement with the licensee to maintain confidentiality and preserve the intellectual property of the licensee on reasonable terms.
7. The Authority may direct the recovery of up to 60% of the non recoverable costs up to a maximum of £300,000 pursuant to GHGC_t specified in Special Condition C8F (NTS System Operator external incentives, costs and revenues).
8. The licensee shall comply with all the requirements of this condition in a timely fashion and in good faith.
9. For the purposes of this condition:

"Consultants" means any persons appointed jointly by the Authority and the licensee for the purpose of conducting the Review in accordance with this condition;

"Greenhouse Gas Emissions Incentive" means any Greenhouse Gas Emissions Incentive equivalent to that specified in paragraph 6 of Special Condition C8F (NTS System Operator external incentives, costs and revenues) and any incentivisation for the reduction of the licensee's Greenhouse Gas Emissions to be applicable to the licensee from 1 April 2013;

"Scheme of Work" means a specification of work for the purposes of developing a long term Greenhouse Gas Emissions Incentive to reduce Greenhouse Gas Emissions resulting from the operation of the pipeline system to which this licence relates by the licensee. The Scheme of Work should include:

- (i) an approach, estimated costs (where the estimated non recoverable costs shall not exceed £500,000) and timetable;
- (ii) the development of a methodology for the quantification of the licensee's Greenhouse Gas Emissions arising from venting of natural gas from the pipeline system to which this licence relates which is designed to improve the information available to the Authority when the Authority is developing its proposals for a Greenhouse Gas Emissions Incentive;
- (iii) projects relating to alternatives to venting natural gas;

"Greenhouse Gas Emissions" means:

- (a) the release of natural gas; and
- (b) other emissions as a result of activities of the licensee as an alternative to the release of natural gas from the pipeline system to which this licence relates as a result of operation, maintenance or decommissioning of that system (or any part of it);

"non recoverable costs" means any costs incurred by the licensee in undertaking the activities set out in the Scheme of Work that are not recoverable by the licensee through mechanisms other than those referred to in paragraph 7 of this condition. Such costs shall not include the costs of developing the draft of the Scheme of Work or the costs of the Consultants;

"Review" means any work undertaken by the Authority and any Consultants appointed pursuant to paragraph 5 in the examination of the draft of the Scheme of Work developed by the licensee to determine its appropriateness (having regard to the scope and likely costs of undertaking the activities set out in the draft of the Scheme of Work) for the development of a long term Greenhouse Gas Emissions Incentive.