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Gas transmission capacity - proposal to terminate Permit Arrangements and adjust the revenue earned from Permit Arrangements for the period 1 April 2013 – 31 March 2015

We¹ are consulting on proposed policy changes relating to National Grid Gas Transmission's (NGGT's) use of Permits to vary lead times for the provision of incremental gas transmission capacity.

These arrangements were put in place some time ago to allow NGGT to plan and manage the risks related to requests for new transmission capacity. They were extended on an interim basis while the industry considered proposals for new incremental capacity arrangements, called Planning and Advanced Reservation of Capacity Arrangements (henceforth referred to as PARCAs).²

If we were to approve PARCAs, we would terminate the Permit Arrangements. We seek your views on

- (i) adjusting the revenue earned from Permits for the period 1 April 2013 – 31 March 2015, and
- (ii) proposed changes to the gas transporter licence (the Licence), which may be required to implement these proposals.

We are including draft Licence text in Annex 1 to this letter to show the effect of these proposed changes and invite your comments on our amendments.

Your views on these changes will help us decide if the revenue earned from Permits should be amended. They will also help us draft the proposed Licence text for the statutory consultation processes that may follow later this year. Please send your responses to the questions in this letter to david.reilly@ofgem.gov.uk no later than 22 December 2014.

Permit Arrangements

The Permits in the Licence allow NGGT to vary the lead times for delivering new transmission capacity. They are linked to the arrangements for auctions and applications by network users. They have a cash value to provide incentives for NGGT to manage its

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably. Ofgem is the Office of the Gas and Electricity Markets Authority.

² <https://www.ofgem.gov.uk/publications-and-updates/proposed-licence-modification-special-licence-conditions-1a-2a-5f-5q-and-11c-national-grid-gas-transmission%E2%80%99s-licence-implement-planning-and-advanced-reservation-capacity-agreements>

risk efficiently. A detailed explanation of how the Permit Arrangements work in practice can be found in Annex 2 to this letter. The introduction of PARCAs will remove the need for Permits.

Why the Permit Arrangements were extended for the period of 1 April 2013 – 31 March 2015

In 2012, as part of its updated business plan for RIIO-T1, NGGT proposed new arrangements for the release of incremental capacity, known as PARCAs. However, as it became apparent that these changes were unlikely to be implemented in time for the start of the Price Control on 1 April 2013, we agreed to give NGGT a permit allowance of £19 million for the period 1 April 2013 – 31 March 2014. This allowance was granted on the basis that it would provide NGGT with some certainty and adequate protection for the risks it and consumers faced in the first year of the new price control. Any release of permits in the following three years of RIIO-T1 would be decided annually, based on NGGT being able to demonstrate the continued need for them.

When we announced this in our Final Proposals³, we did not expect NGGT to require permits beyond 31 March 2014. During 2013-14, it became clear due to outstanding concerns with the proposals, that PARCAs were unlikely to be in place before the July 2014 Exit (Flat) Capacity Annual Application Window and that there was uncertainty about whether they would be in place before the March 2015 Quarterly System Entry Capacity (QSEC) auction. As a contingency, after consultation we extended permits from 1 July 2014 – 31 March 2015 and granted an additional permits allowance of £13.39m.^{4 & 5}

The introduction of PARCAs

If we approve them, PARCAs will allow users to reserve incremental gas transmission capacity through a bilateral process with NGGT, rather than through the current capacity application windows. PARCAs have been developed by NGGT and industry since the start of the RIIO-T1 price control period. They will remove the sale of incremental capacity from the capacity allocation processes. Instead, national transmission system users who need incremental capacity will request it directly from NGGT. Once PARCAs are in place, the Permit Arrangements will no longer be required. We therefore intend to terminate them.

We published our consultation on changes to National Grid Gas Transmission's gas transporter licence needed to implement new arrangements for incremental gas transmission capacity (PARCAs) on 27 October 2014.

Timing

If PARCAs are introduced before the March 2015 QSEC auction, we intend to amend the revenue earned from Permits for 1 April 2013 – 31 March 2015. If PARCAs are not introduced before then, NGGT will need to manage lead times for projects associated with that auction. The simplest approach in that case would be to leave the arrangements, and allowances, for 1 April 2013 – 31 March 2015 as they are.

While we recognise that under this approach, NGGT could stand to gain financially if implementation of PARCAs is delayed for any reason, we do not have any reason to believe that NGGT would itself seek to delay implementation because of this. We note that under Special Condition (SC) 8A.3 of the Licence, NGGT has a duty to operate the pipeline system in an efficient, economic and co-ordinated manner. Subject to the outcome of the PARCAs consultation, we are working with NGGT and industry with a view to implementation in good time before the March 2015 auction.

³ <https://www.ofgem.gov.uk/ofgem-publications/53599/1riio1fpoverviewdec12.pdf>

⁴ <https://www.ofgem.gov.uk/ofgem-publications/86584/140317riioy2permitscoverletter.pdf>

⁵ <https://www.ofgem.gov.uk/ofgem-publications/87455/140415permitscoverformoddirfinal.pdf>

Adjusting the revenue earned from Permit Arrangements for the period 1 April 2013 – 31 March 2015

In our consultation of 17 March 2014 to extend permits to 31 March 2015, we said: "If and when new commercial arrangements are introduced we will consider what an appropriate and fair treatment of NGG's permit allowance is". We confirmed this in our letter of 28 April 2014, when we announced our decision to extend permits to 31 March 2015.

Assuming that PARCAs are introduced before the March 2015 QSEC auction, it would be appropriate and fair to reduce the revenue earned from Permits for 1 April 2013 – 31 March 2015 because otherwise we think this would result in a financial gain to NGGT that is not related to a risk faced by it. This reflects the fact that the allocation of permits was based on a full year and anticipated permits being available to NGGT for both the July 2014 Exit application window and the entry auction in the following March.

One approach could have been to take away all unused permits from the additional allowance given for 1 July 2014 – 31 March 2015 because it was part of a contingency arrangement, introduced due to the uncertainty over the implementation of PARCAs. We think that this approach may result in a reduction in revenue that is disproportionate to the reduction in risk facing NGGT so we have not considered this further.

We think it is right to reflect the reduction in NGGT's prospective risk; that is, the fact that once PARCAs are implemented, incremental capacity requests can be managed without the need for Permits.

We have considered options from three broad criteria to reduce the £32.39m 1 April 2013 – 31 March 2015 allowance. These are -

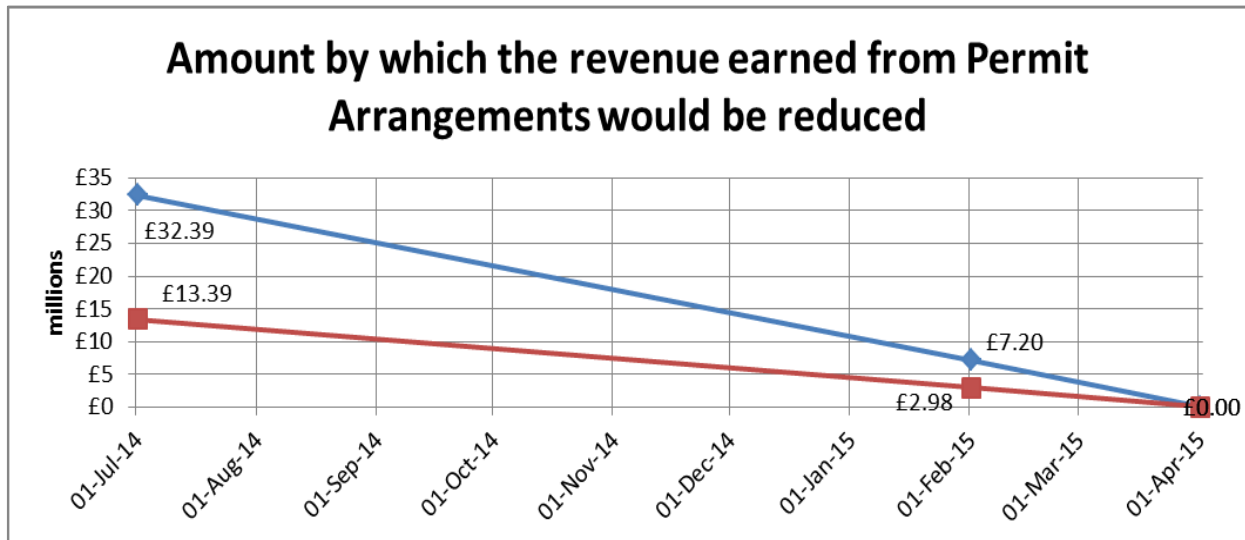
1. Time-related adjustment
2. Adjustment related to whether permits were allocated for entry or exit capacity
3. Adjustment related to permits committed for use

These are discussed below.

1. Time-related adjustment

This could be achieved by pro-rating the unused permits based on the date that PARCAs are introduced. Several options based on this criterion could be considered. Two examples are shown in the chart below. In one option, we consider that the permits allowance of £32.39m was introduced in July 2014 and would be in place for the nine months until April 2015. If the PARCA arrangements were introduced on 1 February 2015, then we would lower the revenue earned by £7.2m. The other option assumes that only the additional allowance of £13.39m is prorated, to lower the revenue earned by £2.98m.

These options and time-related derivatives are illustrated below. They have the benefit of simplicity but we consider them to be somewhat artificial, as NGGT's potential requirement to use permits is not time linear but more related to a specific application window and auction period.

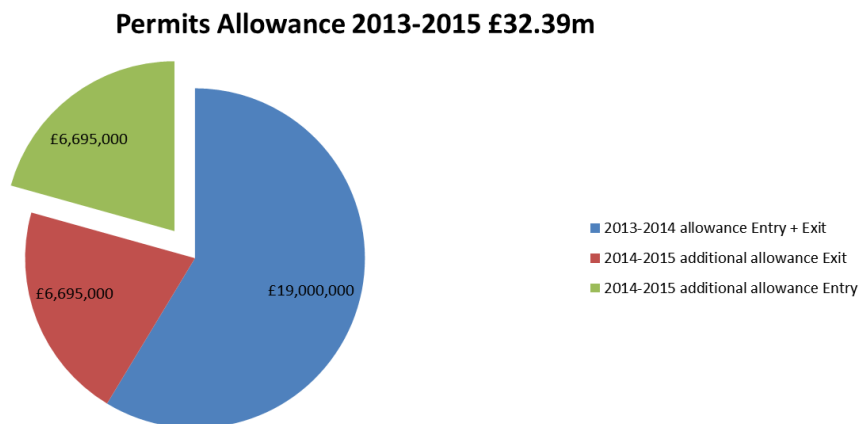


Both options 2 and 3 take account, in different ways, of the fact that NGGT will not need to plan or manage the risk associated with the March 2015 entry capacity auction if PARCAs are introduced before the start of the auction process.

2. Adjustment related to whether permits were allocated for entry or exit capacity

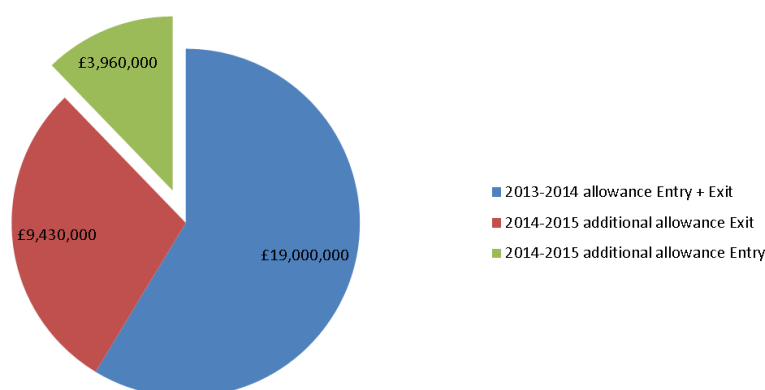
Permits are not allocated for either entry or exit capacity but as a total envelope. We set the allowances for the period 1 April 2013 – 31 March 2014 and the extended period 1 July 2014 – 31 March 2015 based on projected rather than actual data submitted by NGGT regarding specific potential entry and exit projects. We then made a subjective assessment as to the level of permits that would be required. We note that the entry and exit information was provided by NGGT on a confidential basis. Nevertheless, there are options for determining the split between entry and exit capacity, for example:

- a. It could be done on an arbitrary split. A 50/50 split between entry and exit is shown on the pie chart below.



- b. it is possible to split the entry and exit according to the subjective assessment that we made at that time. This would lower the revenue earned from Permit Arrangements by £3.96m.

Permits Allowance 2013-2015 £32.39m



This option is based on our subjective assessment of a historic forecast. This assessment was not intended to tie allowances to particular entry or exit projects but to provide an envelope within which NGGT could manage its risk.

However, basing the revenue earned from Permits on projected data provided by NGGT (which has not proven to be accurate thus far), or the subjective assessment of it that we made in setting the allowances, might not necessarily be an appropriate reflection of NGGT's reduced risk following the introduction of PARCAs.

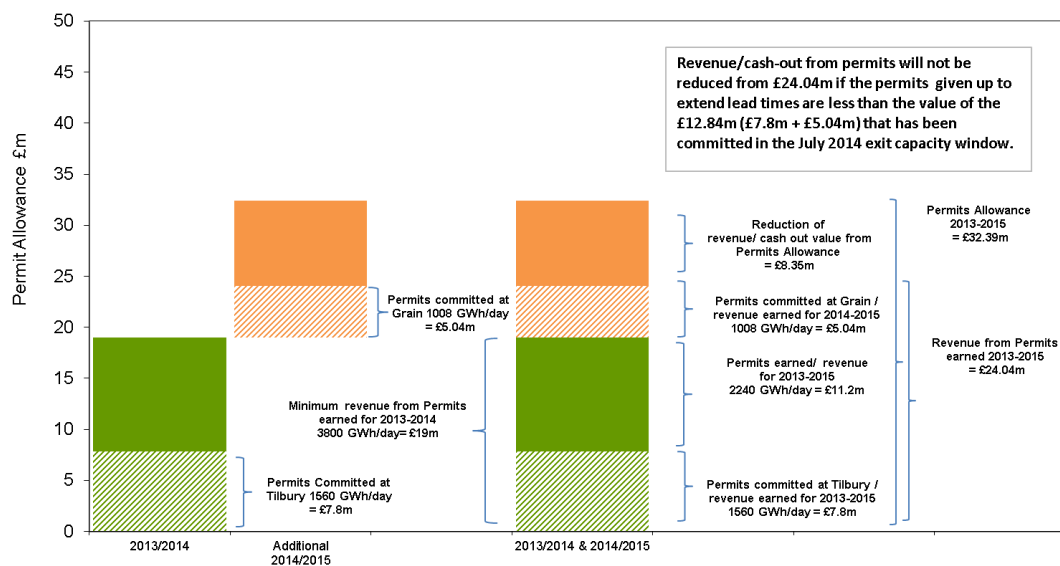
3. Permits committed for use

The entry/exit split of the allowance could alternatively be determined as follows:

- The allowance for the period 1 April 2013 – 31 March 2014 was £19m, and the additional allowance we set from July 2014 is £13.39m. The full allowance for the period 1 April 2013 – 31 March 2015 is £32.39m.
- For the July 2013 Exit capacity release window, NGGT only proposed to vary the lead times at Tilbury Power Station.
- For the July 2014 Exit capacity release window, NGGT proposed to vary the lead times at Tilbury Power Station (committing £7.8m worth of Permits) and at Grain Power Station (committing £5.04m worth of Permits)
- We take the view that the permits committed for Tilbury in the July 2014 Exit capacity release window (£7.8m) were carried forward from the allowance for the period 1 April 2013 – 31 March 2014, and that those committed for Grain (£5.04m) are from the additional allowance for the period to 31 March 2015.
- It follows that the exit proportion of the additional permits allowance is equal to the commitment made on Grain; and the entry proportion is the remainder.
- On this basis, we would propose to exclude this remainder, £8.35m, from the revenue earned from Permit Arrangements for the period 1 April 2013 – 31 March 2015.
- We think that the Permits Allowance excluding this £8.35m is adequate to allow NGGT to manage any ad-hoc applications.

Using this approach, we would propose to reduce the revenue earned from Permits from the allowance of £32.39m by £8.35m. We would not propose to reduce further the cash out value if the amount of any permits that are given up to extend lead times is less than the £12.84m (£7.8m + £5.04m) value of permits committed in the July 2014 Exit capacity release window. The revenue earned from Permits would therefore be £24.04m. This cash-out value consists of £19m for the period 1 April 2013 – 31 March 2014 (including £7.8m committed to Tilbury in the 2013 and 2014 Exit capacity release window) + £5.04m from the additional allowance for the period to 31 March 2015.

Permits Allowance



These figures are based on NGGT's most recent balanced assessment of risk and the fact that the main future risks for NGGT, those arising from the March QSEC auction, will not need to be managed with Permits. This could strike the right balance between protecting the interests of consumers from unnecessary costs and providing NGGT with an adequate permits allowance to manage the remaining future risk of receiving incremental capacity signals.

Both options 2 and 3 are intended to reflect NGGT's ability to manage future risk without Permits, once PARCAs are introduced. There may be other ways to calculate a reduction that reflects this change in NGGT's risk, and we would be happy to consider alternatives if you wish to suggest these.

Question 1: What is your preferred approach to adjust the revenue earned from Permits? If you have an alternative, please explain how it would work.

Proposed Licence Changes

The proposed modifications to SC 1A, SC 2D, SC 5F and SC 5G are provided in Annex 1 to this letter. These changes include the removal of text relating to the use of Permits and the variation of lead times following the introduction of PARCAs. They also show the changes to the revenues earned from Permit Arrangements if we decide to adjust the revenue earned from Permits.

Question 2: What are your views on our Licence change proposals?

Responding

If you have views on these issues, please email david.reilly@ofgem.gov.uk by 22 December 2014. You can also speak to David on 0203 263 9648 if you need more information. We will consider and publish a summary of all responses after the consultation closes. Please mark your response as confidential if you don't want it published on our website.

Yours faithfully,

Andy Burgess

Associate Partner, Transmission and Distribution Policy

ANNEX 1 to Gas transmission capacity - proposal to terminate Permits Arrangements and adjust the revenue earned from Permit Arrangements for the period 1 April 2013 – 31 March 2015

Special Condition 1A. Definitions

The change indicated below is in addition to those proposed changes to SC 1A in our consultation on changes needed to implement PARCAs on 27 October 2014.

Permit Arrangements	means the arrangements for varying the Contractual Delivery Date compared to the Entry Lead Time and Exit Lead Time and is subject to the arrangements set out in Part A of Special Condition 2D (Permit Arrangements for the provision of Incremental Capacity).
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Special Condition 2D. Permit Arrangements for the provision of incremental capacity

Introduction

- 2D.1 ~~The purpose of this condition is to provide arrangements that allow the Licensee to obtain revenues from Permit Arrangements (from 1 April 2013 – 31 March 2015).~~ The purpose of this condition is to provide arrangements for the use of permits by the Licensee in relation to the provision of Incremental Obligated Entry Capacity and Incremental Obligated Exit Capacity (together ‘incremental obligated capacity’), including the maximum value of permits available for the Formula Year commencing on 1 April 2013 of £19m (2009/10 prices) and the maximum value of permits available for the Formula Year commencing on 1 April 2014 of £32.39m (2009/10 prices), which would be an addition of £13.39m.
- 2D.2 ~~NOT USED~~ The effect of the application of the Permit Arrangements under this condition is to allow the Licensee:
- (a) ~~to vary the date on which the Licensee is contractually obliged to provide incremental obligated capacity; and~~
 - (b) ~~to obtain additional revenue for permits remaining at 31 May 2013 from the Legacy Permit Arrangements.~~
- 2D.3 ~~NOT USED~~ The Licensee can use a permit to defer the delivery of one GWh per Day of incremental obligated capacity for a month or earn a permit for every one GWh per Day of incremental obligated capacity it delivers early by a month.
- 2D.4 ~~NOT USED~~ The Licensee can use or earn multiple permits to defer or for delivery of any amount of incremental obligated capacity for a number of months subject to the provisions of this condition.

- 2D.5 ~~NOT USED~~ Permits held by the Licensee at the end of the Formula Year commencing on 1 April 2013 will be usable by the Licensee in the Formula Year commencing on 1 April 2014.
- 2D.6 ~~NOT USED~~ Permits held by the Licensee in the Formula Year commencing on 1 April 2014 will be implemented in accordance with Part C and will only be usable from the 1 July 2014.
- 2D.7 ~~NOT USED~~ Part A sets out the provisions under which permits may be used and earned.
- 2D.8 ~~NOT USED~~ Part B sets out the level of permits applicable for use in the Formula Year commencing on 1 April 2013.
- 2D.9 ~~NOT USED~~ Part C sets out the level of permits applicable for use in the Formula Year commencing on 1 April 2014.
- 2D.10 Part D sets out the revenue earned by the Licensee for the Permit Arrangements commencing on 1 April 2013 and 1 April 2014.
- 2D.11 ~~NOT USED~~ Part E sets out arrangements to allow the Licensee to obtain additional revenue for any permits under the Legacy Permit Arrangements remaining on 31 May 2013.

Part A: ~~NOT USED~~ Provisions for using and earning permits

- 2D.12 ~~NOT USED~~ The Permit Arrangements will apply, unless otherwise directed by the Authority in writing, for the Formula Years commencing on 1 April 2013 and 1 April 2014.
- 2D.13 ~~NOT USED~~ Subject to paragraph 2D.14, the Licensee may, with the consent of the Authority, vary the Entry Lead Time for any individual NTS Entry Point or vary the Exit Lead Time for any individual NTS Exit Point.
- 2D.14 ~~NOT USED~~ Consent will be deemed to have been granted by the Authority under paragraph 2D.13 if:
- (a) — the Licensee is proposing to reduce the Entry Lead Time in relation to NTS Entry Points or the Exit Lead Time in relation to NTS Exit Points; or
 - (b) — the volume of capacity being deferred (in units of GWh per Day for each one month period) is, at Day n , less than the Licensee's permit entitlement PE_n defined in paragraph 2D.19 (within the Formula Year commencing 1 April 2013) and defined in paragraph 2D. 21 (within the Formula Year commencing 1 April 2014) of this condition.
- 2D.15 ~~NOT USED~~ The Licensee must not vary the Entry Lead Time or Exit Lead Time by more than 24 months at any NTS Entry Point or NTS Exit Point in relation to a single variation event without seeking written consent to do so from the Authority (such consent must be sought in a timely manner).
- 2D.16 ~~NOT USED~~ In relation to NTS Entry Points, the Licensee must seek written consent not later than 105 days before the start of the Annual Invitation Period.

2D.17 ~~NOT USED~~In relation to NTS Exit Points either:

- (a) — for applications for Incremental Obligated Exit Capacity under the Annual Application Window, the Licensee must seek written consent not later than 90 days before the start of the Annual Application Window; or
- (b) — for applications for Incremental Obligated Exit Capacity made outside the Annual Application Window consistent with the obligations under Special Conditions 9A (Entry Capacity and Exit Capacity Obligations and Methodology Statements) and 9B (Methodology to determine the release of Entry Capacity and Exit Capacity volumes), the Licensee must use reasonable endeavours to seek written consent not later than 90 days in advance of the application.

2D.18 ~~NOT USED~~The Licensee shall notify the Authority in writing and in a timely manner of each instance where it varies the Entry Lead Time or Exit Lead Time for incremental obligated capacity specifying:

- (a) — the NTS Entry Point or NTS Exit Point affected;
- (b) — the volume of capacity (in units of GWh per Day) for which the Entry Lead Time or Exit Lead Time is being shortened; or
- (c) — the volume of capacity (in units of GWh per Day) for which the Entry Lead Time or Exit Lead Time is being lengthened.

Part B: ~~NOT USED~~ Level of Permits Arrangements (1 April 2013 – 31 March 2014)

2D.19 ~~NOT USED~~The Licensee's permit entitlement on Day n (PE_n) (in units of GWh per Day for each one month period) for the Formula Year commencing on 1 April 2013 will be calculated in accordance with the following formula:

$$PE_n = 3800 + \sum_{v, n-1} DLT DVE_v$$

where:

$DLT DVE_v$ means the change in the Entry Lead Time or Exit Lead Time (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 2D.13 of this condition.

v means the relevant variation event, where v=1 shall mean the first variation event notified to the Authority pursuant to paragraph 2D.13 of this condition.

2D.20 ~~NOT USED~~For the avoidance of doubt:

- (a) — where there have been no variations to the Entry Lead Time or Exit Lead Time ($v=0$), $DLT DVE_v$ will have the value zero (0); and
- (b) — the Licensee's Permit Entitlement (PE_n) in the Formula Year commencing on 1 April 2013 shall be adjusted by variation events notified to the Authority pursuant to paragraph 2D.13 within the Formula Year commencing on 1 April 2013.

Part C: ~~NOT USED~~ Level of Permits Arrangements (1 July 2014 – 31 March 2015)

2D.21 ~~NOT USED~~ The Licensee's permit entitlement on Day n (PE_n) (in units of GWh per Day for each one month period) for the Formula Year commencing on 1 April 2014 will be calculated in accordance with the following formula from the 1 July 2014:

$$PE_n = 6478 + \sum_{v,n-1} DLTDE_{v,n}$$

where:

$DLTDE_{v,n}$ means the change in the Entry Lead Time or Exit Lead Time (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 2D.13 of this condition.

v means the relevant variation event, where $v=1$ shall mean the first variation event notified to the Authority pursuant to paragraph 2D.13 of this condition.

2D.22 ~~NOT USED~~ For the avoidance of doubt:

(a) — where there have been no variations to the Entry Lead Time or Exit Lead Time ($v=0$), $DLTDE_{v,n}$ will have the value zero (0) and;

the Licensee's permit entitlement (PE_n) in the Formula Year commencing on 1 April 2014 shall be adjusted by variation events notified to the Authority pursuant to paragraph 2D.13 within the Formula Years commencing on 1 April 2013 and 1 April 2014.

Part D: Revenue earned from Permit Arrangements (1 April 2013 – 31 March 2015)

2D.23 For the purposes of Part E of Special Condition 2A (Restriction of NTS Transportation Owner Revenue) the term PA_t shall be calculated in the Formula Year commencing 1 April 2016 as follows:

$$PA_t = \min[(PE_{end} \times \pounds 5,000), \pounds 32,390,000] \times \text{Adjusted revenue amount following consultation} \times PVF_{t-2} \times PVF_{t-1} \times RPIF_t$$

where:

PE_{end} means the value of PE_n (in GWh per Day for each one month period) where Day n is 31 May 2015.

PVF_t has the value given to it by Part D of Special Condition 2A.

$RPIF_t$ has the value given to it by Part D of Special Condition 2A.

2D.24 PA_t will have the value zero other than in the Formula Year commencing on 1 April 2016.

Part E: Legacy Permit Arrangements

2D.25 For the purposes of Part C of Special Condition 3A (Restriction of NTS System Operation Revenue) the $DELINC_t$ term is derived in accordance with the following formula:

$$DELINC_t = RLTDVEN_{t-1} + RLTDVEX_{t-1}$$

where:

$RLTDVEN_{t-1}$ means the value of the entry permits held by the licensee on 31 May 2013 from the arrangements set out in Special Condition C8C (NTS System Operation Activity Revenue Restriction) paragraph 3(a) as it was in force in this licence as at 31 March 2013.

$RLTDVEX_{t-1}$ means the value of the exit permits held by the licensee on 31 May 2013 from the arrangements set out in Special Condition C8C paragraph 3(a) as it was in force in this licence as at 31 March 2013.

2D.26 $DELINC_t$ will have the value zero except in the Formula Year commencing 1 April 2013 when it will be calculated in accordance with the formula in 2D.25.

2D.27 $RLTDVEN_{t-1}$ shall be calculated in accordance with the following formula:

$$RLTDVEN_{t-1} = \min[(LTDVEN_{end} \times \text{£}5,000), \text{£}8,256,960] \times RPIF_t$$

where:

$LTDVEN_{end}$ means the value of $LTDVEN_n$ (in GWh per Day for each one month period) where Day n is 31 May 2013 and is derived with the following formula:

$$LTDVEN_n = 1440 + \sum_{v,n-1} DLTDVEN_v$$

$DLTDVEN_v$ means the change in the Entry Lead Time (in units of GWh per Day for each one month period) that arises from the variation event v as notified to the Authority by 1 May 2013.

2D.28 $RLTDVEX_{t-1}$ shall be calculated in accordance with the following formula:

$$RLTDVEX_{t-1} = \min[(LTDVEX_{end} \times \text{£}274), \text{£}688,149] \times RPIF_t$$

where:

$LTDVEX_{end}$ means the value of $LTDVEX_n$ (in GWh per Day) where Day n is 31 May 2013 and is derived with the following formula:

$$LTDVEX_n = 2190 + \sum_{v,n-1} DLTDVEX_v$$

$DLTDVEX_v$ means the change in the Exit Lead Time (in units of GWh per Day) that arises from the variation event v as notified to the Authority by 1 April 2013.

Special Condition 5F. Determination of Incremental Obligated Entry Capacity volumes and the appropriate revenue drivers to apply

The change indicated below is in addition to those proposed changes to SC 5F in our consultation on changes needed to implement PARCAs on 27 October 2014. The change is

the deletion of SC 5F 6 (h), renumbered as SC 5F 10 (h) by the proposed changes in our consultation on PARCAs.

- 5F.6 The Entry Capacity notice must include the following information, in sufficient detail to enable the Authority to determine (in accordance with paragraph 5F.9 of this condition) whether the Licensee must implement the proposal:
- (a) the results of applying the capacity release methodology statements for the time being in force pursuant to Special Condition 9B and the rationale and justification for why the Licensee considers that the volume of Firm Entry Capacity should be released;
 - (b) how the capacity release methodology statements for the time being in force pursuant to Special Condition 9B have been applied (including the provision of all relevant input data) by the Licensee to determine the amount of Firm Entry Capacity that it proposes to treat as Incremental Obligated Entry Capacity;
 - (c) the NTS Entry Point or NTS Entry Points to which the proposal relates;
 - (d) the volume of Incremental Obligated Entry Capacity that the Licensee proposes to treat as:
 - (i) Funded Incremental Obligated Entry Capacity and the associated revenue driver allowance for each relevant Formula Year t $EnCl_t$ calculated in accordance with Part B of this condition and/or associated variation to the Constraint Management target for each relevant Formula Year t $CMOpDT_t$ for the purposes of Part I of Special Condition 3B (Entry Capacity and Exit Capacity Constraint Management); and
 - (ii) Non-incremental Obligated Entry Capacity substituted to that NTS Entry Point in accordance with the Entry Capacity Substitution methodology for the time being in force pursuant to Special Condition 9A to which the proposal relates;
 - (e) the volume of unsold Non-incremental Obligated Entry Capacity that has been substituted from one or more other NTS Entry Points, in accordance with the Entry Capacity Substitution methodology for the time being in force pursuant to Special Condition 9A;
 - (f) the first month in which the volume of Incremental Obligated Entry Capacity referred to in paragraph 5F.6(d) of this condition would be provided at the relevant NTS Entry Point or in which the volume of Non-incremental Obligated Entry Capacity referred to in paragraph 5F.6(e) of this condition would cease to be provided at the relevant NTS Entry Points (for the avoidance of doubt, the capacity will be deemed to be used from the first Day of the month in question);
 - (g) the date in respect of which the Licensee's obligations to offer for sale the volume of Incremental Obligated Entry Capacity referred to in paragraph 5F.6(d) of this condition would commence and the date on which the Licensee's obligations to offer for sale that volume of Non-incremental Obligated Entry Capacity substituted away from those NTS Entry Points referred to in paragraph 5F.6(e) of this condition would cease; and
 - (h) ~~details of any Permit Arrangements made under the provisions of Special Condition 2D (Permit Arrangements for the provision of incremental capacity).~~

Special Condition 5G. Determination of Incremental Obligated Exit Capacity volumes and the appropriate revenue drivers to apply

The change indicated below is in addition to those proposed changes to SC 5G in our consultation on changes needed to implement PARCAs on 27 October 2014. The change is the deletion of SC 5G 6 (h), renumbered as SC 5G 10 (h) by the proposed changes in our consultation on PARCAs.

- 5G.6 The Exit Capacity notice must include the following information, in sufficient detail to enable the Authority to determine (in accordance with paragraph 5G.9 of this condition) whether the Licensee must implement the proposal:
- (a) the results of applying the capacity release methodology statements for the time being in force pursuant to Special Condition 9B and the rationale and justification for why the Licensee considers that the volume of Firm Exit Capacity should be released;
 - (b) how the capacity release methodology statements for the time being in force pursuant to Special Condition 9B have been applied (including the provision of all relevant input data) by the Licensee to determine the amount of volume of Firm Exit Capacity that it proposes to treat as Incremental Obligated Exit Capacity;
 - (c) the NTS Exit Point or NTS Exit Points to which the proposal relates;
 - (d) the volume of Incremental Obligated Exit Capacity that the Licensee proposes to treat as:
 - (i) Funded Incremental Obligated Exit Capacity and the associated revenue driver allowance for each relevant Formula Year t $ExCI_t$, calculated in accordance with Part B of this condition and/or associated variation to the Constraint Management target for each relevant Formula Year t $CMOpDT_t$ for the purposes of Part I of Special Condition 3B (Entry Capacity and Exit Capacity Constraint Management); and
 - (ii) Non-incremental Obligated Exit Capacity substituted to that NTS Exit Point in accordance with the Exit Capacity Substitution methodology for the time being in force pursuant to Special Condition 9A to which the proposal relates;
 - (e) the volume of unsold Non-incremental Obligated Exit Capacity that has been substituted from one or more other NTS Exit Points, in accordance with the Exit Capacity Substitution methodology for the time being in force pursuant to Special Condition 9A;
 - (f) the first month in which the volume of Incremental Obligated Exit Capacity referred to in paragraph 5G.6(d) of this condition would be provided at the relevant NTS Exit Point or in which the volume of Non-incremental Obligated Exit Capacity referred to in paragraph 5G.6(e) of this condition would cease to be used at the relevant NTS Exit Points (for the avoidance of doubt, the capacity will be deemed to be used from the first Day of the month in question);
 - (g) the date in respect of which the Licensee's obligations to offer for sale the volume of Incremental Exit Capacity referred to in paragraph 5G.6(d) of this

condition would commence and the date on which the Licensee's obligations to offer for sale that volume of Non-incremental Obligated Exit Capacity substituted away from those NTS Exit Points referred to in paragraph 5G.6(e) of this condition would cease; and

- (h) ~~details of any Permits Arrangements applied under the provisions of Special Condition 2D (Permit Arrangements for the provision of incremental capacity).~~

ANNEX 2 to Gas transmission capacity - proposal to terminate Permits Arrangements and adjust the revenue earned from Permit Arrangements for the period 1 April 2013 – 31 March 2015

How the permits arrangements work in practice

NGGT is responsible for allocating capacity to enable users to put gas onto ('entry') or take gas off ('exit') the National Transmission System (NTS). It has a Licence obligation to provide a certain level of 'firm' capacity (the 'obligated capacity'). It also has a Licence obligation in particular circumstances to provide firm capacity in excess of the obligated capacity, within specified timescales. Such excess capacity is referred to as 'incremental capacity' and the specified timescales are referred to as 'default lead times'.

Under Transmission Price Control Review (TPCR) 3⁶, NGGT was able to request consent from the Authority to vary lead times for individual entry and exit sites from the default lead times on a case-by-case basis. TPCR4 introduced a system of permits to allow NGGT to vary these lead times.

The permit arrangement system provides NGGT with an allowance of permits (in units of GWh/day for each one month period) for deferring delivery of incremental capacity beyond the default lead times. The permits also have a monetary value, which enable NGGT to receive revenue from its permit allowance that have been earned but not used up. It can earn additional permits, and therefore increase its allowance, if it decreases lead times below the default lead time. There is no limit on the number of permits NGGT can earn by decreasing lead times. However, it gives up permits, and therefore uses up its allowance, if it increases lead times beyond the default lead time, and can only increase lead times by the number of permits it has in its allowance at that time.

These permits are committed in advance (in the annual invitation letters to the entry capacity auction and the exit capacity application window) of long term allocations of capacity indicating the change in lead times for set volumes of incremental capacity at specific entry or exit points. This provides Users with sufficient information with which to request incremental capacity. For entry capacity, this is done through the invitation to the annual Quarterly System Entry Capacity (QSEC) auction. For exit capacity, this is done either through the invitation to the Annual Application Window or by the submission of an ad-hoc application for incremental exit capacity.

Permits are deemed to have been earned or given up if incremental entry or exit capacity is subsequently released and only varies the lead times for release of that volume of incremental capacity at the relevant entry or exit point. The allowance is updated each time permits are earned or given up.

⁶ TPCR3 set out price controls that applied to Transco's (NGGT's predecessor) activities relating to the NTS from April 2002 to March 2007. TPCR4 set revised price controls that applied from April 2007 to March 2012 but was "rolled-over" with some amendments until the introduction of the current price control RIIIO-T1 that applied from April 2013.