

To: National Grid Gas plc (Company number: 2006000)

**Gas Act 1986
Section 23(2)**

Notice of statutory consultation on a proposal to modify the Special Conditions of the gas transporter licence held by National Grid Gas plc in respect of the National Transmission System (NTS)

1. The Gas and Electricity Markets Authority ('the Authority')¹ proposes to modify the special conditions of the National Grid Gas plc (NTS) gas transporter licence held by NGG granted or treated as granted under section 7 of the Gas Act 1986 by amending special conditions:
 - 2B (Calculation of allowed pass-through items),
 - 10A (Undertaking from ultimate controller concerning non-discrimination between the NTS Transportation Owner Activity and the Distribution Network Transportation Activity),
 - 10B (Separation of NTS and Distribution Network Businesses), and
 - 10C (Appointment and duties of the business separation compliance officer),in the manner set out in Schedule A to this Notice.
2. We are proposing these modifications to the gas transporter held by National Grid Gas plc (NTS) because National Grid Gas plc is seeking to transfer its gas distribution assets and gas distribution gas transporter licence to a new legal entity ahead of selling a majority stake in its gas distribution business.
3. On 23 June 2016 we received a request from National Grid Gas plc seeking our consent to transfer its gas distribution gas transporter licence to National Grid Gas Distribution Limited. On 08 July 2016 we issued a consultation² on our minded to decision to consent to the transfer of the licence subject to certain modifications of the gas distribution gas transporter licence. As a result of the proposed sale, transfer and modifications of National Grid Gas plc' gas distribution gas transporter licence we are proposing to modify National Grid Gas plc's (NTS) gas transporter licence.
4. The effect of these proposed modifications is twofold:
 - modifying Special Condition 2B will ensure that it only applies to business rates applicable to the transmission business, and
 - modifying Special Conditions 10A, 10B and 10C will ensure the compliance officer and legal separation provisions of the licence apply to activities not solely within the same legal entity, but also between related entities.
5. A copy of the proposed modifications and other documents referred to in this Notice have been published on our website (www.ofgem.gov.uk). Alternatively they are available from our Research and Information Centre, 9 Millbank, London, SW1P 3GE (020 7901 7003).
6. Any representations with respect to the proposed licence modifications must be made on or before 9 September 2016 to: Rupika Madhura, Office of Gas and Electricity Markets, 9 Millbank, London, SW1P 3GE or by email to NGGD.Separation@ofgem.gov.uk.

¹ The terms "the Authority", "we" and "us" are used interchangeably in this document.

² <https://www.ofgem.gov.uk/publications-and-updates/national-grid-s-intended-sale-its-gas-distribution-networks-statutory-consultations-under-section-8aa-and-section-23-gas-act-1986>

7. We normally publish all responses on our website. However, if you do not wish your response to be made public then please clearly mark it as not for publication. We prefer to receive responses in an electronic form so they can be placed easily on our website.
8. If we decide to make the proposed modifications they will take effect not less than 56 days after the decision is published.

Signature of AP

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Ian Rowson
Duly authorised on behalf of the
Gas and Electricity Markets Authority

8 July 2016

Schedule A

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Special Condition 2B. Calculation of allowed pass-through items

Introduction

- 2B.1 The purpose of this condition is to provide for the calculation of the term PT_t (the allowed pass-through term) for the purposes of Part C of Special Condition 2A (Restriction of NTS Transportation Owner Revenue).
- 2B.2 The effect of the application of the PT_t term in Part C of Special Condition 2A is to ensure that the level of the Licensee's Maximum NTS Transportation Owner Revenue derived in accordance with that condition reflects certain costs that can be passed through to users.

Part A: Formula for calculation of allowed pass-through items (PT_t)

- 2B.3 For the purposes of Part C of Special Condition 2A, the PT_t term is derived in accordance with the following formula (in this condition, the "Principal Formula"):

$$PT_t = RB_t + LF_t + OPTC_t + ISA_t$$

- 2B.4 In the Principal Formula:

RB_t means the business rates adjustment in Formula Year t as derived in accordance with the formula set out in Part B of this condition.

LF_t means the licence fee adjustment in Formula Year t as derived in accordance with the formula set out in Part C of this condition.

$OPTC_t$ means the policing cost adjustment in Formula Year t in respect of the additional costs of complying with any requirement arising under sections 85 to 90 of the Counter-Terrorism Act 2008 in respect of the provision of policing services in or around a gas facility, as derived in accordance with the formula set out in Part D of this condition.

ISA_t means the Independent Systems adjustment in Formula Year t, in respect of the recovery of costs incurred pursuant to arrangements associated with the conveyance of gas to Independent Systems, as derived in accordance with Part E of this condition.

Part B: Calculation of the business rates adjustment term (RB_t)

2B.5 For the purposes of the Principal Formula, subject to paragraph 2B.7 and 2B.8, RB_t is derived in accordance with the following formula:

$$RB_t = \left(\frac{RBA_{t-2}}{RPIA_{t-2}} - RBE_{t-2} \right) \times PVF_{t-2} \times PVF_{t-1} \times RPIF_t$$

2B.6 In the above formula for RB_t:

RBA_{t-2} means the amount NTS prescribed rates, in Formula Year t-2, of the charge incurred in respect and has the value of 39.4 per cent, or such other value as agreed in writing by the Authority, of the prescribed rates (or any equivalent tax or duty replacing them) levied on the Licensee in Formula Year t-2 in relation to its NTS Transportation Owner Activity and Distribution Network Transportation Activity.

RBE_{t-2} means the NTS prescribed rates amount of the allowance in respect of the prescribed rates (or any equivalent tax or duty replacing them) in Formula Year t-2 in relation to the NTS Transportation Owner Activity, and is represented by the amount set out in Appendix 1 of this condition.

RPIA_{t-2} has the value given to it by Part D of Special Condition 2A.

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.

2B.7 In the Formula Years 2013/14 and 2014/15 RB_t will have the value zero.

2B.8 In respect of any Formula Year t-2 in which the revaluation by The Valuation Office Agency (in England and Wales) or the Scottish Assessors Association (in Scotland) of the assets used by the Licensee in respect of its NTS Transportation Owner Activity for the purposes of setting prescribed rates came into effect, RB_t will have the value of zero in Formula Year t and in each subsequent Formula Year, unless the Authority has satisfied itself that the Licensee has used reasonable endeavours to minimise the amount of the prescribed rates. If the Authority has so satisfied itself, it will direct that the formula set out in this Part B is to apply for the purposes of calculating the RB_t term in the specific Formula Year and in each of the subsequent Formula Years.

Part C: Calculation of the licence fee adjustment term (LF_t)

2B.9 For the purposes of the Principal Formula, subject to paragraph 2B.11 of this condition, LF_t is derived in accordance with the following formula:

$$LF_t = \left(\frac{LFA_{t-2}}{RPIA_{t-2}} - LFE_{t-2} \right) \times PVF_{t-2} \times PVF_{t-1} \times RPIF_t$$

2B.10 In the above formula for LF_t:

LFA_{t-2} means the amount of the payments, in Formula Year t-2, made by the Licensee in respect of the NTS Transportation Owner Activity under Standard Condition 3 (Payments by the Licensee to the Authority).

LFE_{t-2} means the amount of the licence fee allowance in Formula Year t-2, and is represented by the amount set out in Appendix 2 of this condition.

RPIA_{t-2} has the value given to it by Part D of Special Condition 2A.

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.

2B.11 In the Formula Years 2013/14 and 2014/15 LF_t will have the value zero.

Part D: Calculation of the policing cost adjustment term (OPTC_t)

2B.12 For the purposes of the Principal Formula, subject to paragraph 2B.14 of this condition, OPTC_t is derived in accordance with the following formula:

$$OPTC_t = \left(\frac{OPTA_{t-2}}{RPIA_{t-2}} - OPTE_{t-2} \right) \times PVF_{t-2} \times PVF_{t-1} \times RPIF_t$$

2B.13 In the above formula for OPTC_t:

OPTA_{t-2} means the amount of the payments, in Formula Year t-2, made by the Licensee to the Secretary of State in respect of provision of policing services.

OPTE_{t-2} means the amount of the policing cost allowance in Formula Year t-2, and has the value of £13.5 million.

RPIA_{t-2} has the value given to it by Part D of Special Condition 2A.

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.

2B.14 In the Formula Years 2013/14 and 2014/15 OPTC_t will have the value zero.

Part E: Calculation of the Independent Systems adjustment term (ISA_t)

2B.15 For the purposes of the Principal Formula, ISA_t is derived in accordance with the following formula:

$$ISA_t = IS_t - (ISE_t \times RPIF_t)$$

2B.16 In the above formula for ISA_t:

IS_t means the amount paid in Formula Year t, in respect of the recovery of costs incurred pursuant to arrangements associated with the conveyance of gas to Independent Systems and as derived in accordance with Special Condition 11F (Gas Conveyed to Independent Systems).

ISE_t means the Independent Systems allowance in Formula Year t, and is represented by the amount set out in Appendix 3 of this condition.

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

Special Condition 10A. Undertaking from ultimate controller concerning non-discrimination between the NTS Transportation Owner Activity and the Distribution Network Transportation Activity.

1. Consistently with the undertaking to be procured under paragraph 2 below, where the licensee:
 - (a) procures services from a DN operator, ~~the licence for which~~ has an ultimate controller which is also an ultimate controller of ~~is held in the same legal entity as the licensee;~~ and/or
 - (b) provides services to such DN operator,

~~notwithstanding the fact that these licences are held in the same legal entity,~~ the licensee shall enter into and comply with written arrangements for the provision and/or procurement of services between the licensee and such DN operator. Such arrangements are to be entered into on arm's-length commercial terms having the same effect as, and not being unduly different from, those which would apply;

- ~~(i) if the licensee entered into a contract with a relevant gas transporter to provide and/or procure the same services (regardless of whether such contract exists or not); and~~
- ~~(ii) if the licensee and such DN operator were in fact held in separate and unrelated legal entities.~~

2. The licensee shall procure from each company or other person which is at any time an ultimate controller of the licensee and also an ultimate controller of a DN Operator, a legally enforceable undertaking in favour of the licensee in the form specified by the Authority that the ultimate controller will instruct, direct and procure that the licensee shall:

- (a) conduct its transportation business in a manner best calculated to secure that the businesses of DN operators, ~~the licences for which~~ have an ultimate controller which is also an ultimate controller of the licensee ~~are held by the holder of this licence in the same legal entity,~~ do not obtain any unfair commercial advantage (including any such advantage from a preferential or discriminatory arrangement); and

(b) enter into and comply with written arrangements, which if the businesses of such DN operators did not have an ultimate controller which is also an ultimate controller of the licensee~~were not held within the same legal entity~~, would be a contract on arm's-length commercial terms.

3. The licensee shall:

(a) deliver to the Authority evidence (including a copy of each such undertaking) that the licensee has complied with its obligation to procure undertakings pursuant to paragraph 2;

(b) inform the Authority immediately in writing if the directors of the licensee become aware that any such undertaking has ceased to be legally enforceable or that its terms have been breached; and

(c) comply with any direction from the Authority to enforce any such undertaking;

and shall not, save with the consent in writing of the Authority, enter (directly or indirectly) into any agreement or arrangement with any ultimate controller of the licensee or any of the subsidiaries of any such corporate ultimate controller (other than the subsidiaries of the licensee) at a time when -

(i) an undertaking complying with paragraph 2 is not in place in relation to that ultimate controller; or

(ii) there is an unremedied breach of such undertaking; or

(iii) the licensee is in breach of the terms of any direction issued by the Authority under paragraph 3 of this condition.

4. In this condition, "relevant gas transporter" shall have the meaning given in Standard Special Condition A3 (Definitions and Interpretation) save that it shall exclude ~~Transeo~~
~~ple both in its capacity as the licensee and in its capacity as a DN operator~~ which has an ultimate controller which is also an ultimate controller of the licensee.

Special Condition 10B. Separation of NTS and Distribution Network Businesses

1. The licensee, in carrying out its gas transportation business in respect of the NTS, shall forthwith put in place and at all times maintain such managerial and operational systems which are necessary to ensure that the licensee complies with the obligations contained in Standard Special Condition A6 (Conduct of the Transportation Business) and Standard Special Condition A35 (Prohibition of Cross-Subsidies).
2. Unless otherwise directed by the Authority, the licensee shall by no later than 1 May 2005 have in place a statement (“**the statement**”), approved by the Authority, describing the practices, procedures and systems which the licensee has adopted (or intends to adopt) to secure compliance with paragraph 1.
3. Where the Authority does not indicate otherwise within 60 days of receipt of the statement, the statement shall be deemed to be approved by the Authority.
4. The statement shall in particular (but without prejudice to the generality of paragraph 1) set out how the licensee shall:
 - (a) maintain appropriate managerial and operational independence of the transportation business in respect of the NTS from any associated gas transporter business;
 - (b) secure that no breach of the requirements of paragraph 1 shall occur as a result of any arrangements for access by any associated gas transporter business or by any person engaged in, or in respect of, the associated gas transporter business with respect to:
 - (i) premises or parts of premises occupied by persons engaged in, or engaged in respect of, the management or operation of the transportation business in respect of the NTS;
 - (ii) systems for the recording, processing or storage of data to which persons engaged in, or engaged in respect of, the management or operation of the transportation business in respect of the NTS have access;
 - (iii) equipment, facilities or property employed for the management or operation of the transportation business in respect of the NTS; or

- (iv) the services of persons who are (whether or not as their principal occupation) engaged in, or in respect of, the management or operation of the transportation business in respect of the NTS; and
- (c) manage the transfer of employees from the transportation business in respect of the NTS to any associated gas transporter business.

~~5. The managerial and operational independence referred to in paragraph 4(a) above shall include the establishment of separate managerial boards for each of:~~

- ~~(a) the transportation business in respect of the NTS; and~~
- ~~(b) the associated gas transporter businesses, taken as a whole, as defined in this condition.~~

~~Such managerial boards shall be bodies consisting of at least two members, two of whom shall be directors of Transco plc. These managerial boards shall be responsible for directing the affairs and taking all substantial decisions relating to the business in respect of which they have been established. Each member of such managerial boards who is also a director of Transco plc shall fulfil their role in relation to the taking of such decisions as if he or she were a director of a legally incorporated company whose sole business is the business in respect of which the managerial board he or she is a member of has been established.~~

~~65.~~ The licensee shall revise the statement prepared in accordance with paragraph 2 when circumstances change so that the statement prepared in accordance with paragraph 2 no longer secures compliance with paragraph 1. Such revision of the statement shall only become effective once the Authority has approved the revised statement in accordance with paragraphs 2 or 3.

~~76.~~ The licensee shall use its best endeavours to ensure compliance with the terms of the statement as from time to time revised and approved by the Authority.

~~87.~~ The licensee shall publish a copy of the approved statement prepared in accordance with paragraph 2 (or the latest approved revision) on its company website within five working days of its approval by the Authority.

98. In this condition “**associated gas transporter business**” means ~~an affiliate, related undertaking, or business unit of the licensee which is a DN operator~~ which has an ultimate controller which is also an ultimate controller of the licensee.

Special Condition 10C. Appointment and duties of the business separation compliance officer

1. The licensee shall ensure, following consultation with the Authority that a competent person (who shall be known as the “business separation compliance officer”) shall be appointed for the purpose of facilitating compliance by the licensee with Standard Special Condition A6 (Conduct of Transportation Business), Special Condition 10B (Separation of NTS and Distribution Network Businesses), Special Condition 10A (Undertaking from ultimate controller concerning non-discrimination between the NTS transportation activity and the Distribution Network Transportation Activity) and Standard Special Condition A35 (Prohibition of Cross Subsidies) (together, the “**relevant duties**”). The business separation compliance officer may be the same person as is appointed as compliance officer under Standard Special Condition A34 (Appointment of Compliance Officer).
2. The licensee shall at all times ensure that the business separation compliance officer is engaged for the performance of such duties and tasks as are appropriate for the purpose specified in paragraph 1, which duties and tasks shall include those set out at paragraph 6.
3. The licensee shall establish a compliance committee (being a sub-committee of the board of directors of the licensee) for the purpose of overseeing and ensuring the performance of the duties and tasks of the business separation compliance officer set out in paragraph 2 and the compliance of the licensee with its relevant duties. Such compliance committee shall report to the audit committee of the ultimate controller and shall include among its members such person in the licensee’s business as is responsible for the management of regulatory issues relating to the licensee.
4. The licensee shall procure that the business separation compliance officer:
 - (a) is provided with such staff, premises, equipment, facilities and other resources; and
 - (b) has such access to the licensee’s premises, systems, information and documentationas, in each case, he might reasonably expect to require for the fulfilment of the duties and tasks assigned to him.
5. The licensee shall make available to the business separation compliance officer a copy of any complaint or representation received by it from any person in respect of a matter arising under or by virtue of the relevant duties.
6. The duties and tasks assigned to the compliance officer shall include:
 - (a) providing advice and information to the licensee (including individual directors of the licensee) and the compliance committee established under paragraph 3 of this condition for the purpose of ensuring the licensee’s compliance with the relevant duties;
 - (b) (monitoring the effectiveness of the practices, procedures and systems adopted by the licensee in accordance with the statement referred to at paragraph 2 of Special Condition 10B (Separation of NTS and Distribution Network Businesses);
 - (c) advising whether, to the extent that the implementation of such practices, procedures and systems require the co-operation of any other person, they are designed so as reasonably to admit the required co-operation;

- (d) investigating any complaint or representation made available to him in accordance with paragraph 5;
 - (e) recommending and advising upon the remedial action which any such investigation has demonstrated to be necessary or desirable;
 - (f) providing relevant advice and information to the licensee (including individual directors of the licensee) and the compliance committee established under paragraph 3 of this condition, for the purpose of ensuring its implementation of;
 - (i) the practices, procedures and systems adopted in accordance with the statement referred to at paragraph 2 of Special Condition 10B (Separation of NTS and Distribution Network Businesses); and
 - (ii) any remedial action recommended in accordance with sub-paragraph (e);
and
 - ~~(g) reporting to the compliance committee any instances which come to his attention, relating to a member of either of the management boards established under paragraph 5 of Special Condition 10B (Separation of NTS and Distribution Network Businesses), taking into account the interests of a business other than that in respect of which the managerial board of which he is a member of has been established. All such reports shall be copied to the members of the audit committee of the ultimate controller; and~~
 - ~~(h)~~(g) reporting annually to the compliance committee established under paragraph 3 of this condition, in respect of each year after this condition comes into force, as to his activities during the period covered by the report, including the fulfilment of the other duties and tasks assigned to him by the licensee.
7. As soon as is reasonably practicable following each annual report of the business separation compliance officer, the licensee shall produce a report:
- (a) as to its compliance during the relevant year with the relevant duties; and
 - (b) as to its implementation of the practices, procedures and systems adopted in accordance with the statement referred to at paragraph 2 of Special Condition 10B (Separation of NTS and Distribution Network Businesses).
8. The report produced in accordance with paragraph 7 shall in particular:
- (a) detail the activities of the business separation compliance officer during the relevant year;
 - (b) refer to such other matters as are or may be appropriate in relation to the implementation of the practices, procedures and systems adopted in accordance with the statement at paragraph 2 of Special Condition 10B (Separation of NTS and Distribution Network Businesses); and
 - (c) set out the details of any investigations conducted by the business separation compliance officer, including:
 - (i) the number, type and source of the complaints or representations on which such were based;
 - (ii) the outcome of such investigations; and
 - (iii) any remedial action taken by the licensee following such investigations.

9. The licensee shall, as soon as reasonably practicable, submit to the Authority a copy of the report produced in accordance with paragraph 7 of this condition, and shall publish the report on its website.