

**To: National Grid Gas Plc
Northern Gas Networks Limited
Scotland Gas Networks Plc
Southern Gas Networks Plc
Wales & West Utilities Limited**

**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 the gas transporter licensees

1. The Gas and Electricity Markets Authority ('the Authority')¹ proposes to modify the special conditions of the gas transporter licence held by the gas transporter licensees granted or treated as granted under Section 7 of the Gas Act 1986 by amending
 - Special Condition 1I (The Network Innovation Competition) (NIC)
 - Special Condition 1A (Restriction of revenue in respect of the Distribution Network Transportation Activity: definitions).
2. The Funding Return Mechanism (FRM) set out in the NIC licence condition is the method by which the Authority can direct money associated with a project to be returned to customers. We propose to make changes to the NIC licence condition to widen the scope of the FRM. To do this, we propose to introduce a new category called 'Returned Project Revenues'. The proposed changes formalise practices that are already taking place and provide clarity on the arrangements for new projects.
3. There are two main reasons for the proposed modification to the NIC licence condition which are further set out in the accompanying cover letter. In summary:

Reason 1: The FRM should be capable of returning money to customers during, or after the end of, the relevant project, if the Funding Licensee² has acted in line with the Project Direction but has spent less than the sum provided for in the project budget. The proposed licence change would allow customers to benefit from these financial savings.

There could be occasions where the Authority considers it appropriate for a proportion of any underspent project budget to be retained by Funding Licensees (who may then redistribute it amongst parties involved in the Eligible NIC Project as appropriate).

The Funding Return Mechanism, as currently set out in the NIC licence condition, does not make this clear. Therefore, the change is intended to clarify this.

Reason 2: In recent NIC competitions, licensees have included innovative ways of generating money from the relevant projects (that is not Intellectual Property) that will be returned to customers eg City CNG³ and OSEAIT⁴.

We propose that the new Returned Project Revenues category also covers the return of money generated by the Project, other than by Intellectual Property (this is already covered in the licences). The default position is for money to be returned to customers. It

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

² Unless otherwise defined, capitalised terms have the meaning given to them in the NIC licence condition.

³ <https://www.ofgem.gov.uk/publications-and-updates/network-innovation-competition-2015-northern-gas-networks-decision-resubmission>

⁴ <https://www.ofgem.gov.uk/publications-and-updates/electricity-nic-submission-national-grid-electricity-transmission-oseait>

may however be appropriate to return some of the money generated by the relevant project to the Funding Licensee (who may then decide to redistribute it amongst parties involved in the Eligible NIC Project as appropriate). For new NIC projects it is for the licensee, in their Full Submission, to identify any revenues that could be earned from their Project that should be subject to return. This will then be recognised in the Project Direction. For projects already in force, that have identified in their Full Submissions potential sources of revenue to be returned, we will need to amend the Project Directions to recognise this revenue source. The mechanism is not intended to be used to return revenue streams identified retrospectively.

- 4. The effect of the proposed modifications is to:
 - enable the return of NIC funding during or at the end of a project, where the project has underspent its budget but where the Funding Licensee has acted in line with the Project Direction, to customers
 - allow the return of revenue generated by the project, other than through Intellectual Property
 - allow the Authority to direct whether money can be retained by customers and/or the Funding Licensee.

- 5. This Notice and associated documents⁵ 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 25 October 2016 to: Stacy Feldmann, Office of Gas and Electricity Markets, 9 Millbank, London, SW1P 3GE or by email to stacy.feldmann@ofgem.gov.uk.

- 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 it will take effect not less than 56 days after the decision is published.

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Geoffrey Randall
Head of RIIO, Electricity Transmission
Duly authorised on behalf of the
Gas and Electricity Markets Authority 21 September 2016

⁵ These are:
- our cover letter to this statutory consultation which contains our response to stakeholders who responded to our March 2016 informal consultation on this issue,
Notices to other network companies that have the NIC licence condition in force, to make similar changes.

Special Condition 1I: The Network Innovation Competition

Part C: The Funding Return Mechanism

- 1I.5 The Funding Return Mechanism relates to payments to be made by the Licensee to the NTS Operator, in each case to such extent (if any) as may be relevant, of:
- (a) Halted Project Revenues;
 - (b) Disallowed Expenditure; ~~and~~
 - (c) Returned Royalty Income; and
 - (d) Returned Project Revenues.
- 1I.6 The Funding Return is the total amount, in respect of the Licensee, of any amounts arising under paragraph 1I.5 of this condition.
- 1I.7 Halted Project Revenues are any revenues received by the Licensee from the NTS Operator under the NIC Funding Mechanism in respect of an Eligible NIC Project which have not yet been spent, or otherwise committed, at the time that the Authority requires that project to be halted in accordance with the applicable provisions of the NIC Governance Document or the terms of the relevant Project Direction.
- 1I.8 Disallowed Expenditure is any revenue received by the Licensee from the NTS Operator under the NIC Funding Mechanism that the Authority determines has not been spent in accordance with the applicable provisions of the NIC Governance Document or the terms of the relevant Project Direction.
- 1I.9 Returned Royalty Income is revenue earned from intellectual property generated through Eligible NIC Projects undertaken by the Licensee, less Directly Attributable Costs, and that is payable to customers under the NIC Funding Mechanism, as calculated in accordance with the provisions of the NIC Governance Document.
- 1I.10 For the purposes of paragraph 1I.9 of this condition, Directly Attributable Costs are costs relating to the maintenance and management of intellectual property generated through Eligible NIC Projects undertaken by the Licensee that have not been otherwise remunerated by Distribution Network Transportation Charges, Excluded Services, or the NIC Funding Mechanism.
- 1I.11 Returned Project Revenues are:
- (a) revenues received by the Licensee from the NTS Operator under the NIC Funding Mechanism in respect of an Eligible NIC Project that the Authority determines have not been spent, and where the Project has been carried out in accordance with the applicable provisions of the NIC Governance Document and/or the terms of the relevant Project Direction; or
 - (b) revenues earned from Eligible NIC Projects by the Licensee other than Returned Royalty Income, that the Authority determines are payable to the customers.
- 1I.12 The Authority may direct how the relevant revenues under paragraphs (a) and (b) above should be paid to customers through the Funding Return Mechanism, or where the Authority considers it to be appropriate, how they should be retained by the licensee, or distributed by the licensee to other parties involved in the Eligible NIC Project.
- 1I.13 In each Formula Year t , in accordance with the appropriate provisions of the NIC Governance Document, the Authority will calculate and then, by direction given to the Licensee, will specify:

- (a) the amount of any Funding Return that the Licensee must pay to the NTS Operator;
and
- (b) the manner in which and the timescale over which that amount is to be paid.

11.14 The Licensee must comply with any direction that is issued by the Authority under paragraph ~~11.14~~13 of this condition.

**Special Condition 1A. Restriction of revenue in respect of the Distribution Network
Transportation Activity: definitions**

[We only show the new or modified definitions to be inserted in alphabetical order within this condition]

Returned Project Revenues has the meaning given to that term in Part C of Special Condition 11 (The Network Innovation Competition);