

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

**Gas Act 1986
Section 23(1)(a)**

Modification of the special conditions of the gas transporters licences held by the licensees listed above

1. Each of the gas transporter licensees listed above is the holder of a gas transporter licence ('the Licence') granted or treated as granted under section 7 of the Gas Act 1986 ('the Act').
2. Under section 23(2) of the Act the Gas and Electricity Markets Authority ('the Authority')¹ gave notice² on 21 September 2016 ('the Notice') that we propose to modify the following conditions of the Licence:
 - Special Condition 1I (The Network Innovation Competition)
 - Special Condition 1A (Restriction of revenue in respect of the Distribution Network Transportation Activity: definitions)

We stated that any representations to the modification proposal must be made on or before 25 October 2016.

3. A copy of the Notice was sent to the Secretary of State in accordance with section 23(4)(b) of the Act, and we have not received a direction that the change should not be made.
4. We received six responses to the Notice, which we carefully considered. We have placed all non-confidential responses on our website.² Our response to the comments made by the respondents is set out in our accompanying letter.³
5. It is necessary to make a number of minor alterations to the modifications set out in the Notice. These alterations are shown in yellow highlight in Schedule 1 below. The reasons for any differences between the modifications set out in the Notice and the modifications reflected in Schedule 1 are to correct an inconsistency between our policy position set out in the consultation document and the Licence drafting and to show consequential changes to paragraph numbers and referencing. Our reasons are set out in more detail in our accompanying letter.
6. The Funding Return Mechanism ('FRM'), set out in Special Condition 1I of the Licence, is the method by which the Authority can direct money associated with Network Innovation Competition ('NIC') projects to be returned to customers. We have made changes to widen the scope of the FRM.

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

² <https://www.ofgem.gov.uk/publications-and-updates/proposed-modification-funding-return-mechanism-network-innovation-competition-and-low-carbon-networks-fund-licence-condition>

³ <https://www.ofgem.gov.uk/publications-and-updates/decision-modify-funding-return-mechanism-network-innovation-competition-nic-and-low-carbon-networks-fund-lcnf-licence-conditions>

7. The reasons and effects for the modifications are set out below and in the accompanying letter.
8. We are making these licence changes because:

Reason 1: The FRM should be capable of returning money to customers during, or after the end of, the relevant project, if the Funding Licensee⁴ has acted in line with the Project Direction but has spent less than the sum provided for in the project budget. Our licence change will allow customers to benefit from these financial savings.

The default position will be that any revenues earned will be returned to customers and network licensees will need to justify any deviation from this. We consider there may 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 FRM, as currently set out in the NIC licence condition, does not make this clear. Therefore, the changes are intended to clarify this.

Reason 2: In recent NIC competitions, licensees have included innovative ways of generating money from relevant projects (that is not Intellectual Property) that will be returned to customers eg the City CNG⁵ and OSEAIT⁶ NIC projects.

The new Returned Project Revenues category covers the return of money generated by a Project, other than Intellectual Property, which this is already dealt with in the relevant licence conditions. 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 be recognised in the Project Direction. For existing projects, that have identified in their Full Submissions potential sources of revenue to be returned, we will amend the Project Directions to recognise this revenue source. The mechanism is not intended to be used to return revenue streams identified retrospectively.

9. The effect of the modifications will be 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 a Project, other than through Intellectual Property
 - allow the Authority to direct whether money can be retained by customers and/or the Funding Licensee.
10. Where an application for permission to appeal our decision is made to the Competition and Markets Authority ('CMA') under section 23B of the Act, Rule 5.7 of the CMA's Energy Licence Modification Appeals Rules⁷ requires that the appellant must send to any relevant licence holders who are not parties to the appeal a non-confidential notice setting out the matters required in Rule 5.2. The attached Schedule 2 provides a list of the relevant licence holders in relation to this modification. Section 23(10) of the Act sets out the meaning of 'relevant licence holder'.

⁴ Unless otherwise defined, capitalised terms have the meaning given to them in the NIC licence condition.

⁵ <https://www.ofgem.gov.uk/publications-and-updates/network-innovation-competition-2015-northern-gas-networks-decision-resubmission>

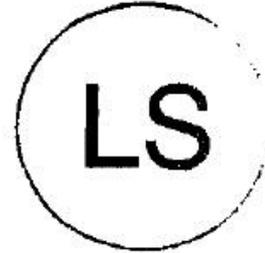
⁶ <https://www.ofgem.gov.uk/publications-and-updates/electricity-nic-submission-national-grid-electricity-transmission-oseait>

⁷ The rules were published by the Competition Commission in September 2012. On 1 April 2014, the Competition Commission was abolished and its functions transferred to the CMA.

Under the powers set out in section 23(1)(a) of the Act, we hereby modify special conditions 1A and 1I of the Licence of each of the licensees listed above in the manner specified in attached Schedule 1. This decision will take effect from 11 March 2017.

This document is notice of the reasons for the decision to modify the gas distribution licence held by the licensees listed above as required by section 38A of the Act.

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



.....
Geoffrey Randall
Head of RIIO Electricity Transmission
Duly authorised on behalf of the
Gas and Electricity Markets Authority

13 January 2017

SCHEDULE 1

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.

11.13 ~~11.11~~ 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 ~~11.12~~ The Licensee must comply with any direction that is issued by the Authority under paragraph ~~11.11~~13 of this condition.

Part D: Determination of the amount of the NIC term

11.15 ~~11.13~~ The NIC term is the net amount of NIC Funding less any Funding Return for the Formula Year t that is to be paid to the Licensee by the NTS Operator, or vice versa, in compliance with the determination made for that purpose in a direction issued by the Authority pursuant to the provisions of Part D of Special Condition 2F (The Network Innovation Competition) in the gas transporter licence held by the NTS Operator.

11.16 ~~11.14~~ The NIC Funding to which paragraph 11.4 of this condition refers is the proportion (if any) of total NIC Funding raised by the NTS Operator from its NTS Transportation Owner Charges in accordance with the NIC Funding Mechanism that the Authority determines is to be allocated to the Licensee in respect of its Eligible NIC Projects, as adjusted by the amount of any Funding Return (as to which, see Part C above).

11.17 ~~11.15~~ In each Formula Year t, as provided for by the NIC Governance Document and in accordance with the appropriate provisions of the NTS Operator's licence the Authority will calculate and then, by direction given to the Licensee and other Gas Transporter Licensees, will specify, in accordance with the appropriate provisions set out in the NIC Governance Document:

- (a) the net amount of the NIC term;
- (b) how the amount of that term has been calculated, taking account of any Funding Return; and
- (c) the manner in which and the timescale over which the NTS Operator is required to transfer that amount to the Licensee or vice versa.

Part E: The NIC Governance Document

11.18 ~~11.16~~ The Authority will issue, and may from time to time revise, a document, to be known as the NIC Governance Document, for purposes connected with the regulation, governance, and administration of the NIC.

11.19 ~~11.17~~ The NIC Governance Document may, without limitation, make appropriate provision about or impose requirements in respect of:

- (a) the eligibility criteria to be applied by, and information to be provided to, the Authority in relation to the assessment and approval of proposed NIC Projects;
- (b) the evaluation criteria against which the funding of such projects will be assessed and approved (where necessary);
- (c) the process and procedures that will be in place for the assessment, approval, and financing of such projects' funding (where necessary);

- (d) arrangements to ensure that relevant matters the Licensee learned from the implementation of Eligible NIC Projects can be captured and disseminated by the Licensee to other Gas Transporter Licensees;
- (e) the nature of the reporting obligations in respect of such projects (which may include reporting in respect of the funding and the completion of such projects, as well as reporting on compliance with this condition and the provisions of the NIC Governance Document);
- (f) arrangements relating to the treatment of intellectual property rights including Returned Royalty Income in respect of Eligible NIC Projects; and
- (g) any other matters relating to the regulation, governance, or administration of the NIC.

11.20 **11.18** Where provisions of the NIC Governance Document require the compliance of the Licensee, the Licensee must comply with those provisions as if the NIC Governance Document were part of this condition.

Part F: Procedure for issuing and revising the NIC Governance Document

11.21 **11.19** Before issuing the NIC Governance Document under this condition, the Authority, by notice given to the Licensee and all other Gas Transporter Licensees with a condition of similar effect to this condition in their licence, will:

- (a) state that it proposes to issue the NIC Governance Document, and specify the date on which it proposes that the document should take effect;
- (b) set out the text of the NIC Governance Document and the Authority's reasons for proposing to issue it; and
- (c) specify the date (which will not be less than a period of 28 days from the date of the notice) within which representations with respect to the proposed NIC Governance Document may be made.

11.22 **11.20** The Authority will consider any representations that are duly made and not withdrawn.

11.23 **11.21** The requirements of paragraphs 11.**19 21** and 11.**20 22** of this condition may be satisfied by action taken before, as well as by action taken after, the commencement of this condition.

11.24 **11.22** In paragraph 11.**19 21** of this condition, "issuing and revising the NIC Governance Document" includes issuing any revision of the document, and the procedure provided for under that paragraph will apply to any such revision.

Part G: Interpretation

11.25 **11.23** Defined terms used in this condition are to be read and given effect subject to any further clarification that might be set out in the NIC Governance Document in relation to such terms.

**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 1I (The Network Innovation Competition);

SCHEDULE 2

LIST OF RELEVANT LICENCE HOLDERS⁸

National Grid Gas Distribution Limited
Northern Gas Networks Limited
Scotland Gas Networks Plc
Southern Gas Networks Plc
Wales & West Utilities Limited

⁸ Gas licence holders are listed at: <https://www.ofgem.gov.uk/publications-and-updates/all-gas-licensees-registered-addresses>