Transco's National Transmission System System Operator incentives 2004 – 2007

Further licence modifications and related issues

July 2004 184/04

Summary

Transco's National Transmission System (NTS) System Operator (SO) incentive scheme provides a number of incentives for Transco to carry out its role of operating the NTS in an economic and efficient manner.

Transco's SO incentive scheme has two components. The first component (referred to as 'deep' SO incentives) provides incentives to improve timely investment in the NTS by Transco in response to changing patterns of supply and demand. The second component (referred to as 'shallow' incentives) provides for improved incentives on Transco to carry out its role of operating the NTS on a day to day basis in an economic and efficient manner.

This paper concludes Ofgem's review of the components of Transco's SO incentives that were set in April 2002 for part of the 5 year period of the main price control. The paper proposes that:

- having reviewed the operation of incentives to date, the cap and collar of Transco's exit capacity investment incentive allowance be reduced to £ 1 million for each of the three remaining years of the current price control
- consistent with the April 2004 open letter issued by the Distribution Networks sales team, the obligation for Transco to introduce universal firm registration of NTS exit capacity shall be reviewed in the context of the interruption arrangements and offtake Regulatory Impact Assessment (RIA) consultation process, and
- Transco will undertake an annual review of its performance against the Operational Guidelines (OGs) and provide a single auditors' report covering both the OGs and the System Management Principles Statement (SMPS).

In addition, this paper considers five related issues that were discussed in the February 2004 consultation and concludes that:

- no changes should be made to the caps and collars of the internal SO costs incentive;
- a gas quality incentive should not be introduced at this time;

- the 20% hold back of system entry capacity to be offered for sale in short-term auctions should be retained;
- no changes should be made to the sharing factors for system reserve or to the cost targets for Operational Margins (OMs); and
- Transco should undertake specific proposed investment at Glenmavis LNG facility, as discussed with Ofgem, with the cost recovery of appropriate investment at LNG facilities to be considered at a later date.

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1. Introduction

Purpose of this document

1.1. This paper concludes Ofgem's review of the components of Transco's SO incentives that were set in April 2002 for part of the 5 year period of the main price control. The SO incentives provide long term signals and incentives for timely investment in the NTS by Transco, in response to customers' changing needs. In developing the SO incentive arrangements, Ofgem has set the parameters of the incentive schemes to provide Transco with an appropriate balance of risk and reward.

1.2. The document provides an explanatory note to accompany Ofgem's proposals to modify Transco's licence conditions in relation to its Operational Guidelines audit requirements and the re-setting of Transco's maximum exit capacity investment revenue allowance. It also concludes on a number of related issues that were discussed as part of the February 2004 proposals for the review of SO incentives.

Background

1.3. As part of Transco's April 2002 – 2007 price control, Ofgem introduced a number of incentive arrangements under Transco's Gas Transporter (GT) licence which were designed to facilitate the timely and efficient expansion of the NTS and the efficient, economic and coordinated operation of the NTS. A number of the SO incentives were set for a period of less than five years. This was due to uncertainties associated with the new system operation and investment incentive arrangements.

1.4. In general, Transco's incentives include targets for specific system operation functions (for example managing system constraints on a day-to-day basis – a shallow incentive, or making available for sale an agreed output of system capacity at each entry or exit point – a deep incentive). Transco is rewarded for below target costs and is penalised for above target costs for each function, subject to specified sharing factors.

Other relevant documents

1.5. In August 2003, Ofgem published an open letter, 'Review of Transco's SO Incentives' in which we set out the key parameters of Ofgem's review and sought views on the proposed scope of work.

1.6. In November 2003, Ofgem published a subsequent open letter, 'Review of Transco's SO Incentives', which outlined responses to the August letter and provided an initial view that no material changes were envisaged at the interim stage to the incentive arrangements.

1.7. In February 2004, Ofgem published its review of Transco's performance under its deep and shallow incentive arrangements and consulted upon its proposals to modify Transco's GT licence.

1.8. Ofgem published its explanatory note and direction to modify Transco's GT licence with reference to its shallow incentive arrangements in March 2004. The shallow incentive modifications considered amendments to the provisions of:

- ♦ special condition 17 'Operational guidelines for balancing'
- ♦ special condition 28A 'Revenue restriction definitions' (including 'NTS system operation revenue', 'Entry capacity buy-back incentive', 'NTS SO gas cost reference price' and the 'Residual gas balancing incentive), and
- ♦ special condition 33 'Information to be provided to the Authority in connection with the transportation system revenue restriction'.

1.9. These documents are located on Ofgem's website.

Structure of this document

1.10. This paper contains the following sections:

- ♦ chapter 2 sets out an explanation for Ofgem's proposed licence modifications to the following GT licence conditions:

    - Transco's maximum allowed revenue under its exit capacity investment incentive;
    - The status of Transco's universal firm exit capacity obligation; and
    - Transco's Operational Guidelines audit requirements;
- chapter 3 sets out Ofgem's conclusions on the following SO-related issues:
    - Internal SO costs incentive;
    - Proposed gas quality incentive;
    - 20 per cent entry capacity reservation for annual auctions;
    - Incentive parameters for system reserve; and
    - The treatment of Transco's LNG facilities at Isle of Grain and Glenmavis;
- Appendix 1 sets out Ofgem's statutory notice to modify Transco's GT licence; and
- Appendix 2 sets out the proposed amendments to:
    - special condition 17 (6) 'Operation Guidelines for balancing '; and
    - special condition 28B (6) 'Exit capacity investment incentive revenue'.

Views invited

1.11. Ofgem invites views on the proposed modifications set out in this document. Responses should be submitted by 6 September 2004 and should be addressed to:

Frances Warburton

Head of Gas Networks Regulation

Office of Gas and Electricity Markets

9 Millbank

London

SW1P 3GE

Electronic responses may be sent to lindie.kruger@ofgem.gov.uk.

1.12. All responses will normally be published on the Ofgem website and held electronically in the Research and Information Centre unless there are good reasons why they must remain confidential. Consultees should put any confidential material in appendices in their responses. Ofgem prefers to receive responses in an electronic form so that they can be placed easily on the Ofgem website. Any questions on this document can be discussed with Frances Warburton or Tolani Azeez by phone on 020 7901 7072 /7043 or by email to: frances.warburton@ofgem.gov.uk or tolani.azeez@ofgem.gov.uk.

Way forward

1.13. Following responses to this consultation, Ofgem will seek Transco's consent to modify its GT licence conditions under section 23 of the Gas Act. It is intended that the modifications will be effective from 1 April 2004.

2. Proposed licence modifications for Transco's deep SO incentives

Introduction

2.1. The objective of the deep SO incentive scheme is to provide incentives for timely and efficient investment in the NTS by Transco in response to changing patterns of supply and demand. The issues discussed in this chapter are:

- the exit capacity investment incentive;
- the obligation on Transco to introduce universal firm exit capacity rights; and
- audit requirements for operational guidelines.

Exit capacity investment incentive

2.2. The exit capacity investment incentive was designed to facilitate reform of the arrangements regarding the management of NTS exit capacity. The incentive involves arrangements for two stages of reform of the exit regime, a transitional stage which was intended to apply for two years from 1 April 2002 and a long-term stage which was intended to apply from 1 April 2004. The sharing factors, caps and collars for the transitional exit capacity incentive arrangement were set for an initial period of two years (2002/3 and 2003/4).

2.3. In addition, Ofgem placed a reasonable endeavours obligation on Transco to curtail its rights to offtake gas from the NTS and local distribution zones (LDZs) for more than 15 days per annum. This measure was considered as a transitional step towards the introduction of firm access rights.

2.4. It was Ofgem's intention that by 1 April 2004 Transco would have put in place arrangements for the firm registration of all NTS exit capacity and the transitional arrangements would have been replaced by long-term arrangements to provide incentives for Transco to contract efficiently for interruption with the holders of firm exit capacity. However, provision was made in the licence for the transitional arrangements to be extended should universal firm registration be delayed.

2.5. It was intended that the 15 day interruptible incentive would be replaced by a universal firm regime with contractual arrangements for system interruption that would allow shippers to signal their demand for firm exit capacity rights on a long or short-term basis.

2.6. Ofgem considered that in light of the transitional incentive arrangements and ongoing developments for NTS exit capacity arrangements, it would be necessary to review the exit capacity investment revenue caps and collars.

Respondents' view

2.7. All respondents to the February 2004 paper who commented on this issue (except for Transco) stated that it was appropriate to minimise the exit capacity investment incentive cap and collar while the exit arrangements are under review. Transco did not consider that Ofgem had made a case for reducing the caps and collars and indicated a preference for a phased reduction.

Ofgem's proposals

2.8. Because of the ongoing consideration of reforms to exit arrangements, it is appropriate that the transitional incentive arrangements should remain in place. Ofgem has considered the most appropriate levels of caps, collars and sharing factors for rolling forward the current structure of the incentive for 2004/5-2006/7. Having reviewed the operation of the exit capacity investment incentive to date, it is proposed to reduce both the cap and the collar that apply to the exit capacity investment incentive to £1 million for each of the three final years of the control (2004/5, 2005/6 and 2006/7). No changes are proposed to the sharing factors.

Universal firm exit capacity rights

2.9. As discussed above, it was Ofgem's intention that by 1 April 2004, Transco would have put in place arrangements for the registration of all NTS exit capacity as firm. Transco's GT licence contains an obligation on Transco to introduce universal firm NTS exit registration on a reasonable endeavours basis by April 2004 or as soon as reasonably practicable thereafter.

2.10. In a March 2003 letter, 'Universal firm registration of NTS exit capacity: update', Ofgem stated that it considered that the scope of the ongoing exit reform should be expanded to include LDZ interruption. At that time Ofgem stated that if the scope of exit reforms were to be expanded to include LDZs, it would not seem appropriate to enforce the universal firm obligation from 1 April 2004. However, Ofgem noted that despite this decision, Transco retained a reasonable endeavours requirement to ensure universal firm registration of NTS exit capacity as soon as is reasonably practicable after 1 April 2004.

2.11. In the February 2004 SO incentives document, Ofgem proposed that in the light of the Distribution Networks (DN) sales consultation process and work on the reform of the exit arrangements, it would consider removing the requirement from Transco's licence for it to introduce universal firm NTS exit registration on a reasonable endeavours basis by April 2004 or as soon as reasonably practicable thereafter.

2.12. Ofgem published an open letter in April 2004 'Way forward on options for exit capacity reform' outlining its approach to the reform of the exit capacity regime and the treatment of universal firm registration obligation in the context of the DN sales consultation process. In that letter, Ofgem explained that it would no longer be appropriate to remove the present universal firm obligation from Transco's GT licence.

Respondents' views

2.13. All respondents to the February 2004 document supported the proposal to remove the requirement from the licence for Transco to introduce universal firm exit registration on a reasonable endeavours basis by 1 April 2004.

Ofgem's proposals

2.14. Having given careful consideration to the ongoing work required to review the exit arrangements at NTS and LDZ level, Ofgem does not consider that it would be appropriate to remove the universal firm obligation from Transco's GT licence at this point in time.

2.15. As set out in the April open letter, Ofgem considers that it would be consistent with its obligations under the amended Utilities Act (as amended by the Sustainable Energy Act 2003), to consult on a Regulatory Impact Assessment (RIA) setting out the full range of exit reform options (including that of retaining the present exit arrangements and potentially removing the universal firm registration obligation) before proposing an appropriate way forward with respect to universal firm exit capacity. Ofgem published its RIA on interruption arrangements on 30 June 2004.

Audit requirements for Operational Guidelines

2.16. As set out in the February 2004 SO incentive review document, Transco is required to produce a System Management Principles statement (SMPS)[1], in order to provide transparency in its role as system operator. In addition Transco has an ongoing licence obligation to produce Operational Guidelines (OGs)[2].

2.17. The March 2004 draft licence modifications proposed the removal of the requirement for Transco to provide separate auditor's statements for OGs and SMPS.

Respondents' views

2.18. All respondents to the February 2004 consultation supported Transco's proposal to maintain the OGs but to remove the separate audit requirements for OGs.

Ofgem's proposals

2.19. Ofgem now proposes a further amendment to special condition 17 (6) in order to clarify Ofgem's intention for Transco to continue to provide an audited report for the OGs but for Transco to incorporate this report as an identifiable and separate section within the SMPS audit statement (which Transco is obliged to produce under special condition 27 of its GT licence). The proposed modification to special condition 17, as set out in Appendix 1 to this document, will provide for an annual review of Transco's performance against the OGs at

[1] Special condition 27: Licensee's procurement and use of system management services
[2] Special condition 17: Operational Guidelines for Balancing

the end of the formula year and it will also provide for this information to be set out within one auditor's statement covering both the SMPS and the OGs.

3. Conclusions on related issues

Introduction

3.1. In the February 2004 consultation, Ofgem discussed a number of related issues which interact with both the deep and shallow SO incentive arrangements that did not require any licence modifications. This chapter provides Ofgem's conclusions in relation to:

- Transco's internal SO costs incentive;
- the proposed gas quality incentive;
- Transco's obligation to reserve 20% of entry capacity for short term auctions;
- Transco's system reserve costs; and
- the treatment of the Isle of Grain and Glenmavis LNG facilities.

Internal SO costs incentive

3.2. Transco's internal incentive scheme covers SO internal costs over which Transco has direct control. These internal costs comprise:

- operating expenditure;
- capital expenditure; and
- a return on the SO regulatory value (RV).

3.3. In order to maintain consistency across the NTS SO incentive schemes, Ofgem applied sharing factors to the NTS SO internal costs equal to the average sharing factors of the day-to-day external cost schemes (excluding the entry capacity buy-back scheme[3]). Any changes to the parameters of the external cost scheme

[3] This was considered in detail and modified under the Authority's March 2004 Notice.

would require an adjustment to the internal cost sharing factors to keep them aligned with the proposed external cost incentive sharing factors.

3.4. In the February 2004 document, Ofgem noted Transco's request for the alignment of the internal SO cost incentive with the internal TO incentives as well as external SO incentives. The initial reason for aligning the SO internal costs with the external SO costs was that this would allow Transco to make efficient trade offs, for example it could increase its internal costs if this would improve its performance under SO external costs.

Respondents' views

3.5. As stated in the March 2004 document, respondents who commented on the internal costs incentive in general supported Ofgem's proposed approach. A number of respondents highlighted the need for Ofgem to address the differences between the internal SO and TO schemes, as the arrangements are further developed.

Ofgem's views

3.6. Since Ofgem has concluded that the SO incentive sharing factors will not change, Ofgem is not proposing to make any changes to the internal SO costs incentive.

Proposed gas quality incentive

3.7. In the December 2001 document[4], Ofgem stated its intention to further extend the SO incentives to include gas quality services. For parties wanting to enter gas onto Transco's system, such services could include blending or otherwise changing the quality of gas that falls outside set specifications.

3.8. Transco only accepts gas outside of the network specification[5] if it can accommodate the gas without detrimentally affecting the total quality of gas within its network. HSE has granted consent for a pipeline from one entry point

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[4] 'Transco's National Transmission System operator incentives 2002-7, Final proposals', Ofgem, December 2001.

[5] This specification would be as set out under the Gas Safety (Management) Regulations (GS(M)R).

to be exempt from the requirement to convey compliant gas. In addition to conveying non-compliant gas through pipelines which are exempt from HSE regulations, Transco offers different gas quality specifications (within HSE regulations) at different terminals. Ofgem is concerned that there is a lack of transparency in the way Transco allows gas of different gas quality specifications into its transmission system and that Transco could be acting in a discriminatory manner.

3.9. It may be appropriate for gas quality services to be offered to all users on a transparent and non-discriminatory basis. For instance, if a shipper wanted to enter non-specification gas onto the NTS, it would need to purchase a gas quality service that would allow it to do so. This could be achieved by either:

- requiring that shippers purchase gas quality services only from Transco which, in turn, provides the services in the most economic way possible (e.g. by investing or contracting with third-parties); or

- allowing shippers to contract directly with anyone able to offer gas quality services (including Transco, other shippers, producers and third parties).

3.10. The way forward should depend on the potential for the competitive provision of such gas quality services.

Respondents' views

3.11. Of the five respondents who commented on this issue, all were in agreement with Ofgem's proposal not to produce a gas quality incentive at this time in light of the review currently being undertaken by DTI (with input from Ofgem).

Ofgem's views

3.12. As stated in the February 2004 document, DTI, Ofgem and the HSE recently began a study on gas quality issues in the GB market. As part of that review, Ofgem will give due consideration to the definition of gas quality issues, identification of gas quality services offered in other markets and the costs associated with providing gas quality services.

3.13. Ofgem will be issuing an open letter on gas quality shortly setting out the issues in more detail and suggesting potential ways forward. In light of this ongoing review and the forthcoming letter, we are not proposing to introduce a gas quality incentive within Transco's GT licence at this time.

The obligation to reserve 20 per cent entry capacity for short term auctions

3.14. Under the SO incentive arrangements, Transco is obliged to offer for sale a minimum of 90 per cent of the TO baseline entry capacity (known as initial SO baseline entry capacity). No more than 80 per cent of the initial SO baseline entry capacity at each terminal can be offered for sale more than one year in advance (through long term auctions) with the remaining 20 per cent must be reserved for sale in short-term auctions (together with any remaining long-term baseline entry capacity). Ofgem introduced the 20 per cent holdback of entry capacity to address concerns that selling all available entry capacity in the long-term auctions could create a barrier to entry into the gas market.

3.15. Ofgem indicated during the April 2002 price control review that the reservation requirement should be removed once a liquid secondary market in entry capacity had been developed. This would provide shippers (and new entrants) with an additional market in which to buy system entry capacity outside of the long-term auctions timetable. Ofgem stated in April 2002 that it intended to review the liquidity of the secondary market after two years.

Respondents' views

3.16. The majority of respondents to the February 2004 document supported Ofgem's proposal to retain a 20 per cent reservation of entry capacity for annual auctions. Respondents who supported the proposal agreed with Ofgem's analysis that suggested that there was a need for greater liquidity in the secondary market before this reservation should be removed. Ofgem noted the views of one respondent who considered that the 20 per cent reservation created an artificial cap and that the development of secondary markets would continue to be constrained while this restriction remained.

Ofgem's views

3.17. Ofgem concluded the secondary market liquidity review in the February 2004 document. Ofgem stated that considering the ratio of secondary market traded volume to the volume of original product sold at St Fergus terminal, there was still a need for further evidence of secondary market liquidity. Ofgem now considers that it would be appropriate for the 20 per cent entry capacity reservation provision to remain in place until a secondary market in trading for capacity has been fully developed or until the next price control review.

System reserve

3.18. The SO system reserve function embraces two elements: Operating Margins (OMs) and storage top-up. At the time of setting the initial SO incentive arrangements, Ofgem considered that the arrangements in relation to storage top-up should remain in Transco's network code. As such, the initial system reserve incentive scheme relates solely to the costs of OMs.

3.19. Transco is required, under the terms of its safety case[6], to access gas reserves (typically as gas in storage) to deal with changes in supply or demand forecasts, offshore supply failures, transportation plant failures, and to cover the orderly rundown of the transmission system in the event of a network emergency. In each case, the requirement is driven by the need to provide within-day support to maintain pressures within safe tolerance levels while other action is taken to address the specific problem. The securing of gas in storage, which allows Transco to ensure the supply of gas is maintained in the event of a network emergency, is referred to as OM gas.

3.20. Transco's allowed revenue under the current SO price control includes the costs of storage services. The costs of purchasing and selling gas in storage are not funded under the current SO price control, but are instead dealt with through network code arrangements (the so-called "neutrality" arrangements). Initially

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[6] Transco's operations are covered by a Safety Case which has been agreed with the Health and Safety Executive (HSE). The HSE must approve any material changes to the safety case.

Ofgem considered that these costs should continue to be recovered in this manner for the two-year duration of the initial incentive scheme. Consequently, the OM allowance in the system reserve target related only to storage costs. The target costs for 2002/3 and 2003/4 were set at £16.8m and £16.6m respectively.

3.21. In setting the initial caps and collars and sharing factors, Ofgem recognised that Transco procures a large part (by cost) of its system reserve storage requirements from Transco LNG storage, a business unit within Transco. As Transco has indicated that it is likely to continue to rely on LNG and that the potential to use other service providers (or demand side measures) is limited, Ofgem indicated in the February 2004 paper that it would be inappropriate to apply either caps and collars or sharing factors of less than 100 per cent to these costs. If these were to be applied, Transco could have an incentive to increase the costs it incurs for booking such system reserve, as it would earn all of the revenue (through its LNG subsidiary) but incur only a proportion of the costs through the SO incentive. It was therefore considered appropriate for Transco to be exposed to 100% of the variation in system reserve costs from the incentive target.

Respondents' views

3.22. Of those respondents who commented on this issue, the majority of respondents considered that it was appropriate to maintain the existing structure of incentive caps, collars and sharing factors while Transco's ownership of the LNG facilities continues. Transco expressed disappointment that its anticipated increase in OM costs over the next three years had not been reflected in the system reserve targets.

Ofgem's views

3.23. Ofgem does not propose to make any changes to the sharing factors for system reserve. Ofgem put in place 100 per cent sharing factors for the initial two year period due to Transco's ownership of the LNG facilities. Ofgem has stated[7] that, should new storage facilities or more flexible demand management arrangements emerge, or Transco's proposals to restructure the ownership result

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[7] 'Transco's National Transmission System system operator incentives 2002-7, Final proposals', Ofgem, December 2001.

in a more arms-length, transparent and non-discriminatory tender process, Ofgem would consider reviewing the 100 per cent sharing factors.

3.24. Ofgem notes that Transco retains ownership of the LNG facilities and still uses these facilities for booking a significant proportion of its OM storage capacity. No significant new storage facilities have begun operation in the last two years (although a number are in advanced planning stages) and that demand management arrangements remain largely unchanged. In the light of these factors, it is proposed not to change the target currently allowed for the purchase of OMs at this time.

Treatment of Isle of Grain LNG facility

3.25. In May 2003 Transco put forward to Ofgem a proposal to transfer its Isle of Grain Liquefied Natural Gas (LNG) facility to a non-regulated company within the NGT Group and to convert the facility into a LNG import terminal. Ofgem approved the transfer in its July 2003 decision document[8].

3.26. Transco proposed modifications (639[9] and 647[10]) to the network code to change the status of the Isle of Grain from an LNG storage facility to an importation terminal. Modification 647 sought to put in place arrangements from January 2005 when Isle of Grain terminal would cease to offer storage services. Ofgem approved modification 647 on 26 February 2004.

3.27. Modification 639 proposes that Isle of Grain be removed from the list of Transco LNG storage facilities and from the list of constrained storage facilities (as per the network code). Ofgem is still considering this proposal.

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[8] *National Grid Transco's proposal to transfer its Liquefied Natural Gas facility at Isle of Grain to a separate NGT group company*, A decision document, Ofgem July 2003.
[9] Mod 639 - Isle of Grain: Change of Status from LNG Storage Facility to Importation Terminal.
[10] Mod 647 - Transitional Arrangements to facilitate the change of status of the Isle of Grain facility to a LNG Importation Terminal.

Respondents' views

3.28. A number of respondents supported Ofgem's proposal for the inclusion of the Isle of Grain as an operating margin facility. Respondents were also supportive of maintaining the current incentive parameters and sharing factors at this point in time. One respondent did not consider that it was necessary for Ofgem to conduct a review of the incentives placed upon Transco to substitute its use of LNG at this time.

3.29. Transco has suggested that the costs of OMs would increase from 2005 due to the Isle of Grain offering an LNG importation service. Transco considered that the system reserve sharing factors should be reduced to reflect that a significant proportion of OM spend will flow to third parties.

Ofgem's views

3.30. Following its approval of modification 647, Ofgem modified special condition 28B (8)(c) of Transco's GT licence to reflect the inclusion of costs incurred in respect of LNG importation capacity under the definition of the System Reserve Performance Measure (SRCP) in March 2004. No changes are proposed to auction reserve prices (as set out in Section 9D prices) at this point in time. Ofgem will give further consideration to the effects of Isle of Grain LNG on OM costs at a future date.

Treatment of Glenmavis LNG facility

3.31. The Glenmavis LNG facility is one of the LNG facilities which may be utilised by Transco to provide an OM service. In addition, under the terms of its GT licence, Transco is obliged to transport natural gas to the Scottish Independent Networks (SINs). Road tankers appear to be the least cost means of meeting this obligation. The Glenmavis facility was selected and developed further to supply LNG to road tankers because of its geographical position.

3.32. Transco LNG initiated a review of the options for maintaining the required level of service provided by the Glenmavis facility. Transco LNG concluded that the most economic and efficient approach involves full replacement of the Glenmavis Phase 2 cold box and associated refrigerating plant.

Respondents' views

3.33. Transco commented that it looked forward to contributing to discussions with Ofgem in order to determine an appropriate means of revenue recovery in relation to its proposed investment at Glenmavis.

Ofgem's views

3.34. Ofgem considers that such investment seems warranted and discussions are continuing with Transco on an appropriate means of revenue recovery for investment costs which it considers to have been economically and efficiently incurred. As such, while no changes to Transco's SO system reserve incentive target are proposed in this document, Ofgem may consider it appropriate to review the targets at a future date.

Appendix 1 Notice under section 23 (3) of the Gas Act 1986

The Gas and Electricity Markets Authority (the Authority) hereby gives notice pursuant to section 23 (3) of the Gas Act 1986 (the Act) as follows:

1.1 The Authority proposes to modify Special Condition 17 (6) and Special Condition 28 B Part 2 (6) (a) in Transco plc's Gas Transporter Licence granted under section 7 of the Act to implement proposed changes to Transco's NTS System Operation arrangements. The proposed changes have been emboldened, shaded and italicised.

1.2 The reasons for making these proposed modifications and the effects of making these proposed modifications are set out in the explanatory note accompanying this Notice. The effects of the proposed modifications are set out in Annex 1 to this Notice. Further details of the proposed modifications were published by the Authority in the following documents:

a) Transco's National Transmission System Review of System Operator incentives 2002-7: Scope of review – Open letter, August 2003

b) Transco's National Transmission System Review of System Operator incentives 2002-7: Proposals Document, February 2004.

1.3 The proposed modifications can be found in Annex 1 to this Notice.

1.4 Copies of the documents referred to in paragraph 1.2 are available from the Ofgem library, 9 Millbank, London SW1P 3GE (020 7901 7003) or on the Ofgem website (www.ofgem.gov.uk).

1.5 Any representations in relation to the proposed modifications should be received on or before 6 September 2004 and should be addressed to Frances Warburton, Head of Gas Networks Regulation, Ofgem, 9 Millbank, London SWIP 3GE, (or by email to lindie.kruger@ofgem.gov.uk).

NOTICE UNDER SECTION 23 (3) OF THE GAS ACT 1986

Signed by

………………………………………….

Andrew Walker

Director, Transmission Networks Regulation

Duly authorised on behalf of the Authority 30 July 2004

END.

Appendix 2 Annex 1 to Notice under section 23 (3) of the Gas Act 1986

Proposed amendments to existing provisions of Transco plc's Gas Transporter Licence

AMENDMENT TO SPECIAL CONDITION 17 Operational Guidelines for Gas Balancing

A proposed amendment to insert the following:

6. (b) ***a statement, by a person eligible for appointment as company auditors (within the meaning of Part II of the Companies Act 1989) approved by the Authority from time to time, who has carried out an investigation in accordance with the scope and objectives established by the licensee and approved by the Authority, as to whether, in his opinion, the licensee has, in carrying out the balancing measures, done so in all material respects in accordance with the guidelines and if not, in what respect, the licensee has failed to do so. This statement shall be incorporated under, but set out as a separate section within, the licensee's annual auditor's statement under special condition 27(7) (b) and shall be prepared in accordance with special condition 27 (7) (b).***

AMENDMENT TO SPECIAL CONDITION 28 B Part 2 (6) Exit Capacity Investment Incentive Revenue

(a) Principal formula

For the purposes of paragraph 14(2) of Part 2 of this Special Condition, the maximum exit capacity investment incentive revenue allowed to the licensee in respect of formula year t ($EXCIIR_t$) shall be derived from the following formula:

If $ExIT_{t-} - ExCIT_t \geq ExCPt - ExCC_t$, then:

$ExCIIR_t =$

$$MIN\ ((ExUSF_t \times ((ExIT_t - EXCP_t) - (ExCIT_t - ExCC_t))), EXCAP_t) = (ExCIT_t - EXCC_t)$$

Otherwise:

$ExCIIR_t =$

$$MAX\ ((ExDSF_t \times ((ExIT_t - ExCP_t) - (ExCITt - ExCC_t))), ExCOL_t) = (EXCIT_t - ExCC_t)$$

Where:

$ExIT_t$	means the exit incentive target in respect of formula year t and shall be derived in accordance with paragraph 14(6)(d) of Part 2 of this Special Condition;
$ExCIT_t$	means the incentive target for costs incurred by the licensee in respect of formula year t in respect of its use of constrained storage facilities to avoid transportation constraints (all having the meanings given to those in the licensee's Network Code) as set out in the following table:

	Formula year				
Variable	**t = 1**	**t = 2**	**t = 3**	**t = 4**	**t≥5**
$ExCIT_t$ £ million	5.9	6.2	6.6	6.6	6.6

$ExCP_t$ means the exit performance measure in respect of formula year t, and shall be derived in accordance with paragraph 14(6)(h) of Part 2 of this Special Condition;

$ExCC_t$ means the payments made by the licensee in respect of costs incurred by the licensee in respect of formula year t in respect of its use of constrained storage facilities to avoid transportation constraints (all having the meanings given to those terms in the licensee's Network Code);

MIN (x,y) means the value equal to the lesser of x and y;

$ExUSF_t$ means the exit upside sharing factor on respect of formula year t as set out in the following table:

	Formula year	
Variable	**t = 1**	**t≥2**
$ExUSF_t$ £ million	50%	50%

$ExDSF_t$ means the exit downside sharing factor in respect of formula year t as set out in the following table:

	Formula year	
Variable	t = 1	t≥2
$ExDSF_t$	25%	25%

$ExCAP_t$ means the maximum exit capacity investment revenue in respect of formula year t as set out in the following table:

	Formula year		
Variable	t = 1	t = 2	*t≥3*
ExCAPt………………… £million	10	10	***1***

MAX (x,y) means the value equal to the greater of x and y; and

$ExCOL_t$ means the minimum exit capacity investment revenue in respect of formula year t as set out in the following table:

	Formula year		
Variable	t = 1	*t≥2*	*t≥3*
$ExCOL_t$ £million	-2.5	-2.5	***-1***