

Electricity System Operator and  
all other interested parties



Making a positive difference  
for energy consumers

Email: [RegFinance@ofgem.gov.uk](mailto:RegFinance@ofgem.gov.uk)

Date: 24 August 2022

Dear colleague,

**Statutory consultation under section 11A of the Electricity Act 1989 on proposed modifications to Special Licence conditions 3 and 4 of the National Grid Electricity System Operator Limited's Electricity Transmission Licence**

We<sup>1</sup> are proposing changes to the electricity system operator special licence conditions that relate the ADJ, K correction and LSOEMRINC terms

We are proposing this licence modification to:

- a. revise the calculation of the ADJ term in the TNUOS Allowed Revenue calculation by including a new DISC term. It was not Ofgem's intention that the forecast risk for these variables would be borne by the electricity system operator (ESO). The reason for excluding these is to ensure that the differences between forecast and actual values do not impact the ADJ term. This change has the effect of excluding changes made in subsequent years of a discrete set of variables from the calculation of the ADJ term.
- b. revise the definition of TNR in the legacy K term (which only applies to the end of RIIO-1) so as to allow ESO to agree with Ofgem an alternate value for recovered revenue. The reason for this is to allow the return of some over-collection that is technically accruing the following year. In the RIIO-2 licence, there is currently no mechanism for the ESO to recover any revenue resulting from a restatement of RIIO-1 recovered revenue. The change has the result of allowing a mechanism whereby a restatement of RIIO-1 collected revenue will be reflected in Allowed Revenue in RIIO-2.
- c. revise the Legacy EMR incentive condition to allow for differences between the forecast incentive value and the actual value to be reflected in the ESO's Allowed Revenue internal costs. In the RIIO-2 licence, there is currently no mechanism for the ESO to recover any revenue resulting from a mis-forecasting of EMR incentives. The effect of this modification is to provide a mechanism whereby the over-forecasting of EMR incentive revenue by the ESO can be returned to consumers via a reduction in Allowed Revenue.

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<sup>1</sup> The terms 'Ofgem', 'we' and 'us' are used interchangeably in this letter. Ofgem is the office of the Gas and Electricity Markets Authority.

There are two annexes to this letter:

- Annex 1 to this letter sets out our Notice of a statutory consultation on a proposal to modify the ESO's licence
- Annex 2 to this letter sets out the proposed changes to the licence conditions.

Stakeholders have until 22 September 2022 to respond to this statutory consultation and can send views on the proposed changes to [regfinance@ofgem.gov.uk](mailto:regfinance@ofgem.gov.uk). If we decide to make the proposed modifications they will take effect not less than 56 days after the date on which the decision is published.

Yours sincerely,

**Jonathan Gorrie**  
**Chief Financial Advisor**  
**Duly authorised by the Authority**

## Annex 1 Notice of Statutory Consultation

To: National Grid Electricity System Operator Limited

### **Electricity Act 1989 Section 11A**

#### **Modification of Special Licence Condition 3.6 Adjustment term ( $ADJ_t$ ), Special Licence Condition 3.7 Correction Term $K_t$ , and Special Licence Condition 4.8.7 System Operator Legacy EMR Incentives Term $LSOEMRINC_t$ held by the above licensee**

1. The licensee to whom this direction is addressed ('the licensee') is the holder of an electricity transmission licence ('the licence') granted or treated as granted under section 6(1)(b) of the Electricity Act 1989 ('the Act').
2. In accordance with section 11A(2), (3) and (4) of the Act, the Gas and Electricity Markets Authority ('the Authority')<sup>2</sup> gives notice that it proposes to modify the licence granted or treated as granted under section 6(1)(b) of the Act by amending: Special Licence Condition 3 and Special Licence Condition 4.8 in the manner set out in the schedule attached to this notice and described in the consultation document accompanying this notice.
3. We are proposing this licence modification to:
  - a. revise the calculation of the ADJ term in the TNUOS Allowed Revenue calculation by including a new DISC term. It was not Ofgem's intention that the forecast risk for these variables would be borne by the electricity system operator (ESO). The reason for excluding these is to ensure that the differences between forecast and actual values do not impact the ADJ term. This change has the effect of excluding changes made in subsequent years of a discrete set of variables from the calculation of the ADJ term.
  - b. revise the definition of TNR in the legacy K term (which only applies to the end of RIIO-1) so as to allow ESO to agree with Ofgem an alternate value for recovered revenue. The reason for this is to allow the return of some over-collection that is technically accruing the following year. In the RIIO-2 licence, there is currently no mechanism for the ESO to recover any revenue resulting from a restatement of RIIO-1 recovered revenue. The change has the result of allowing a mechanism whereby a restatement of RIIO-1 collected revenue will be reflected in Allowed Revenue in RIIO-2.
  - c. revise the Legacy EMR incentive condition to allow for differences between the forecast incentive value and the actual value to be reflected in the licensee's Allowed Revenue internal costs. In the RIIO-2 licence, there is currently no mechanism for the ESO to recover any revenue resulting from a mis-forecasting of EMR incentives. The effect of this modification is to provide a mechanism whereby the over-forecasting of EMR incentive revenue by the ESO can be returned to consumers via a reduction in Allowed Revenue

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<sup>2</sup> The terms 'Ofgem', 'we' and 'us' are used interchangeably in this notice. Ofgem is the office of the Gas and Electricity Markets Authority.

4. A copy of this proposed modifications has been published on our website (<https://www.ofgem.gov.uk>). Alternatively, it is available from [foi@ofgem.gov.uk](mailto:foi@ofgem.gov.uk).
5. The reason for the proposed modifications is to more correct an error in the original licence drafting.
6. The proposed modifications are set out in Annex 2.
7. Any representations with respect to the proposed licence modification must be made on or before 22 September 2022 to: Andrew Ryan, Office of Gas and Electricity Markets, 10 South Colonnade, Canary Wharf, London, E14 4PU or by email to [RegFinance@ofgem.gov.uk](mailto:RegFinance@ofgem.gov.uk).
8. We normally publish all responses on our website. However, if you do not want 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.
9. Subject to responses to the statutory consultation, if we decide to make the proposed modification it will take effect not less than 56 days after the decision is published.

**Jonathan Gorrie**  
**Chief Financial Advisor**  
**Duly Authorised by the Authority**  
**24 August 2022**

## **Annex 2 - Proposed modifications to the Electricity System Operator Licence relating to Allowed Revenue**

The text of the proposed modifications to Special Licence Conditions 3.6, 3.7 and 4.8.7 are set out below with text to be inserted underlined and deleted text struck-through.

### **Special Condition 3.6 Adjustment term (ADJ<sub>t</sub>)**

#### **Introduction**

3.6.1. The purpose of this condition is to calculate the term ADJ<sub>t</sub> (the adjustment term), which in turn feeds into Maximum Revenue in Special Condition 3.1 (Transmission Network Revenue Restriction).

#### **Formula for calculating the adjustment term (ADJ<sub>t</sub>)**

3.6.2. For the Regulatory Year commencing on 1 April 2021, the value of ADJ<sub>t</sub> is zero.

3.6.3. For subsequent Regulatory Years, the value of ADJ<sub>t</sub> is derived in accordance with the following formula:

$$ADJ_t = (TO_{t-1} - TO^*_{t-1} - DISC_{t-1}) * (1 + I_{t-1} + 1.15\%)$$

where:

TO<sub>t</sub> means Maximum Revenue derived in accordance with Special Condition 3.1 (Transmission Network Revenue Restriction);

TO\*<sub>t</sub> means Maximum Revenue as forecast and published by the system operator by 1 April of Regulatory Year t; and

DISC<sub>t</sub> is derived in accordance with 3.6.4

I<sub>t</sub> means the average value of SONIA.

3.6.4 DISC<sub>t</sub> means the difference between the values of Term<sub>t</sub>, TSP<sub>t</sub>, TSH<sub>t</sub>, TNGET<sub>t</sub>, TOFTO<sub>t</sub>, OFET<sub>t</sub>, TICF<sub>t</sub>, TICP<sub>t</sub> as included in TO\*<sub>t</sub> and TO<sub>t</sub> and is derived in accordance with the following formula:

$$\text{DISC}_t = (\text{Term}_t + \text{TSP}_t + \text{TSH}_t + \text{TNGET}_t + \text{TOFTO}_t + \text{OFET}_t + \text{TICF}_t + \text{TICP}_t) - (\text{Term}^*_t + \text{TSP}^*_t + \text{TSH}^*_t + \text{TNGET}^*_t + \text{TOFTO}^*_t + \text{OFET}^*_t + \text{TICF}^*_t + \text{TICP}^*_t)$$

where:

Term\*<sub>t</sub> + TSP\*<sub>t</sub> + TSH\*<sub>t</sub> + TNGET\*<sub>t</sub> + TOFTO\*<sub>t</sub> + OFET\*<sub>t</sub> + TICF\*<sub>t</sub> + TICP\*<sub>t</sub> means the values included in the Maximum Revenue as forecast and published by the system operator by 1 April of the Regulatory Year t.

## Special Condition 3.7 Correction Term ( $K_t$ )

### Introduction

3.7.1 The purpose of this condition is to calculate the term  $K_t$  (the correction term), which in turn feeds into Maximum Revenue in Special Condition 3.1 (Transmission Network Revenue Restriction).

### Part A: Formula for calculating the adjustment term ( $K_t$ )

3.7.2 For the Regulatory Year commencing on or after 1 April 2022, the value of  $K_t$  is zero.

3.7.3 For Regulatory Year commencing 1 April 2021, the value of  $K_t$  is derived in accordance with the following formula:

$$K_t = (TO_{t-1} - TNR_{t-1})(1 + I_{t-1} + 1.15\% + PRP_{t-1}PRA_{t-1})$$

where:

$TO_t$  has the value of  $TO_t$  as determined in accordance with Part A of Special Condition 3A (Restriction of Transmission Network Revenue) of this licence as in force on 31 March 2021;

$TNR_t$  has the value of  $TNR_t$  as determined in accordance with Part A of Special Condition 3A (Restriction of Transmission Network Revenue) of this licence as in force on 31 March 2021 or as agreed with the Authority;

$I_t$  means the average value of SONIA;

$PRP_t$  means the penal rate proportion and has the value of 1, unless the Authority directs otherwise in accordance with paragraph 3.7.5; and

$PRA_t$  means the penal rate adjustment, derived in accordance with paragraph 3.7.4.

3.7.4 The value of  $PRA_t$  is derived in accordance with the following formula:

$$PRA_t = \begin{cases} 1.15\% & \text{if } TNR_t/TO_t \geq 1.055 \\ -1.15\% & \text{if } TNR_t/TO_t \leq 0.945 \\ 0, & \text{otherwise} \end{cases}$$

where:

$TO_t$  is derived in accordance with Part A; and

$TNR_t$  is derived in accordance with Part A.

3.7.5 The Authority will direct a value for  $PRP_t$  which is not less than zero and not more than 1, if it is satisfied that differences between Recovered Revenue and Allowed Revenue were for reasons outside the reasonable control of the licensee.



## Special Condition 4.8 System Operator Legacy Adjustments (SOLAR<sub>t</sub>)

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### Part D: The formula for calculating the System Operator legacy EMR incentives term (LSOEMRINC<sub>t</sub>)

4.8.7 For the two Regulatory Years commencing on 1 April 2021 ~~to~~ and 1 April 2022, the value of LSOEMRINC<sub>t</sub> is derived in accordance with the following formula:

$$LSOEMRINC_t = SOEMRINC_t * RPIF_t$$

where:

SOEMRINC<sub>t</sub> has the value of SOEMRINC<sub>t</sub> as determined in accordance with Part C of Special Condition 4L (Financial Incentives on EMR) of this licence as in force on 31 March 2021; and

RPIF<sub>t</sub> has the value of RPIF<sub>t</sub> as determined in accordance with paragraph 3A.7 of Part C of Special Condition 3A (Restriction of Transmission Network Revenue) of this licence as in force on 31 March 2021 as amended by sections 7.14 and 7.15 of the Price Control Financial Handbook; and

for Regulatory Year commencing 1 April 2023 is negative £2.725m; and

for Regulatory Years commencing on or after 1 April ~~2023~~ 2024 is zero.