

NOTICE UNDER SECTION 11(2) OF THE ELECTRICITY ACT 1989

The Gas and Electricity Markets Authority (“the Authority”) hereby gives notice pursuant to section 11(2) of the Electricity Act 1989 (“the Act”) as follows:

1. The Authority proposes to modify the special licence conditions of the transmission licence (“the Licence”) treated as granted to Scottish Hydro-Electric Transmission Ltd (“the Licensee”) under section 6(1)(b) of the Act by:
 - (a) amending special licence condition J (Restriction of Transmission Charges) by inserting a “RI” term in the transmission network revenue restriction formula so as to allow the Licensee’s maximum revenue allowance to be adjusted based on its performance against the Transmission Network Reliability Incentive (“RI”) Scheme;
 - (b) amending special licence condition J (Restriction of Transmission Charges) by inserting a definition of “RI” as a consequence of the proposed modification outlined in paragraph (a) above;
 - (c) inserting a new special licence condition Q (Adjustment to Transmission Network Revenue Restriction due to Transmission Network Reliability Incentive Scheme) which sets out how the RI component of the transmission network revenue restriction formula will be calculated in a relevant year;
 - (d) amending special licence condition I (Definitions) such that the definitions set out in this special licence condition apply to the new special licence condition Q;
 - (e) amending the definition of “charge restriction conditions” in special condition I (Definitions) such that the term includes the RI revenue adjustment;

- (f) amending special licence condition K (Restriction of transmission charges: Adjustments), special licence condition L (Information to be provided to the Authority in connection with charge restriction conditions) and special condition L1 (Price control review information) such that these special conditions refer to the RI revenue adjustment.
2. The proposed licence modifications are set out in Appendix 1 of this notice.
 3. The reasons why the Authority proposes to make these licence modifications are set out in Appendix 2 of this notice. The documents referred to in Appendix 2 of this notice are available free of charge from the Ofgem Research and Information Centre, 9 Millbank, London SW1P 3GE (0207 901 7003) or from the Ofgem website at www.ofgem.gov.uk.
 4. In summary the effect of the proposed licence modifications is to allow an adjustment to the Licensee's allowed revenue based upon its performance under the Transmission Network Reliability Incentive Scheme. The proposed licence modifications amend the transmission network revenue restriction formula in special condition J by including a new RI_r component. The details of how the RI_r component of this formula is to be calculated in any relevant year is set out in a new special condition Q. Consequential amendments are then made to special condition I, special condition J, special condition K, special condition L and special condition L1.
 5. Any representations or objections to the proposed licence modifications may be made on or before **20 January 2006** and sent to: Robert Hull, Director Transmission, Ofgem, 9 Millbank, London SW1P 3GE or by e-mail to mark.allen@ofgem.gov.uk



Robert Hull
Director, Transmission
Authorised on behalf of the Authority

16 December 2005

APPENDIX 1

NOTICE UNDER SECTION 11(2) OF THE ELECTRICITY ACT 1989

MODIFICATION OF EXISTING PROVISIONS OF THE TRANSMISSION LICENCE

- 1 Special Condition I: Definitions shall be amended by substituting “Special Conditions J to Q” for “Special Conditions J to P” in each place where it occurs.
- 2 The definition of “charge restriction conditions” in Special Condition I: Definitions shall be amended by substituting “Special Conditions I to Q” for “Special Conditions I to P”.
- 3 The formula in paragraph 1 of Special Condition J: Restriction of Transmission Charges shall be amended by inserting “+RI_t” at the end of the formula in the following manner:

$$\text{“TR}_t = R_t - KKT_t + LF_t + EI_t + BI_t + EC_t + CC_t + IAT_t + IAAC_t + TIRG_t + \mathbf{RI}_t \text{”}$$

- 4 Paragraph 1 of Special Condition J: Restriction of Transmission Charges shall be amended by inserting the following at the end of that paragraph immediately after the definition of “TIRG_t”:

“RI_t” means a revenue adjustment factor reflecting the licensee’s performance against a transmission network reliability incentive in the relevant incentive period relating to year t, and shall be calculated in accordance with Special Condition Q.

- 5 Special Condition K: Restriction of Transmission Charges: Adjustments shall be amended by substituting “Special Conditions I to Q” for “Special Conditions I to P” in each place where it occurs.
- 6 Special Condition L: Information to be provided to the Authority in connection with Charge Restriction Conditions shall be amended by substituting “Special Conditions I to Q” for “Special Conditions I to P” in each place where it occurs.

7 Special Condition L1: Price Control Review Information shall be amended by substituting “Special Conditions I to Q” for “Special Conditions I to P” in each place where it occurs.

8 After Special Condition P: Information to be provided to the Authority in connection with Transmission Investment for Renewable Generation there shall be inserted the following new condition:

Special Condition Q: Adjustment to Restriction of Transmission Charges due to Transmission Network Reliability Incentive

1. For the purpose of paragraph 1 of Special Condition J, the term RI_t shall be derived from the following formula:

$$RI_t = R_t \cdot RAF_y$$

Save that:

- (a) in the relevant year commencing on 1 April 2006 RI_t shall relate to the licensee’s performance against the transmission network reliability incentive during incentive period y commencing on 1 January 2006 and ending on 31 March 2007; and
- (b) in all other relevant years RI_t shall have a value equal to zero.

where:

R_t shall be calculated in accordance with the formula specified in paragraph 1 of Special Condition J.

RAF_y is the revenue adjustment factor based on the licensee’s performance against the transmission network reliability incentive during incentive period y , and is derived from the following formula:

If $RIP_y < RILT_y$:

$$RAF_y = RIUPA_y \left[\frac{RILT_y - RIP_y}{RILT_y} \right]$$

If $RIP_y > RIUT_y$:

$$RAF_y = \max \left(RIDPA_y, RIDPA_y \left[\frac{RIP_y - RIUT_y}{RICOL_y - RIUT_y} \right] \right)$$

Otherwise:

$$RAF_y = 0$$

where:

$RILT_y$ is the lower incentivised loss of supply event target in respect of incentive period y, which is the number of events specified in the following table:

Incentive Period y	1 January 2006 – 31 March 2007
$RILT_y$	14

$RIUT_y$ is the upper incentivised loss of supply event target in respect of incentive period y, which is the number of events specified in the following table:

Incentive Period y	1 January 2006 – 31 March 2007
$RIUT_y$	16

$RIUPA_y$ is the maximum upside percentage adjustment in respect of incentive period y , which has the value as specified in the following table:

Incentive Period y	1 January 2006 – 31 March 2007
$RIUPA_y$	0.5%

$RIDPA_y$ is the maximum downside percentage adjustment in respect of incentive period y , which has the value as specified in the following table:

Incentive Period y	1 January 2006 – 31 March 2007
$RIDPA_y$	-0.75%

$RICOL_y$ is the incentivised loss of supply collar in respect of incentive period y which is the number of events specified in the following table:

Incentive Period y	1 January 2006 – 31 March 2007
$RICOL_y$	37

RIP_y is the number of incentivised loss of supply events in incentive period y .

$\max(A,B)$ means the value equal to the greater of A and B.

2. For the purposes of this Special Condition, “incentivised loss of supply event” shall mean any event on the licensee’s transmission system that causes electricity not to be supplied to a customer subject to the following exclusions:
 - (a) any such event that causes electricity to not be supplied to 3 or less directly connected parties;
 - (b) any unsupplied energy resulting from a shortage of available generation;
 - (c) any unsupplied energy resulting from a user’s request for disconnection in accordance with the Grid Code;
 - (d) any unsupplied energy resulting from emergency de-energisation of part of the licensee's transmission system, either as a consequence of a user's request for emergency de-energisation of its equipment or the user carrying out an emergency de-energisation of its equipment;
 - (e) any unsupplied energy resulting from a planned outage as defined in the Grid Code;
 - (f) any unsupplied energy resulting from a de-energisation or disconnection of a user’s equipment necessary to ensure compliance with an instruction by the system operator to the licensee pursuant to the STC; and
 - (g) any unsupplied energy resulting from an emergency de-energisation or disconnection of a user’s equipment necessary to ensure compliance with the Electricity Safety, Quality and Continuity Regulations 2002, as amended from time to time, or to otherwise ensure public safety.

3. For the purpose of paragraph 2, a “directly connected party” is any party with a direct connection to the licensee’s transmission system with the exception of any connection to a distribution system.

4. Where:

(a) the licensee considers that any event on the licensee’s transmission system that causes electricity not to be supplied to a customer has been wholly or partially caused by an exceptional event;

(b) the licensee has notified the Authority of such event within 14 days of its occurrence;

(c) the licensee has provided details of the exceptional event and such further information, if any, as the Authority may require in relation to such an exceptional event; and

(d) the Authority is satisfied that the event notified to it under subparagraph (b) is an exceptional event,

the Authority may, by notice to the licensee, direct that the number of incentivised loss of supply events in incentive period y shall be adjusted as specified in that direction.

5. For the purpose of paragraph 4, the adjustment directed by the Authority shall be based on the extent to which the Authority is satisfied that the licensee had taken reasonable steps to prevent the event having the effect of interrupting supply and to mitigate its effect (both in anticipation and subsequently).

6. A direction under paragraph 4 shall not have effect unless, before it is made, the Authority has given notice to the licensee:

- (a) setting out the terms of the proposed direction;
- (b) stating the reasons why it proposes to issue the direction; and
- (c) specifying the period (not being less than 14 days from the date of the notice) within which the licensee may make representations or objections

and the Authority has considered such representations or objections and given reasons for its decision.

7. For the purpose of paragraph 4, an “exceptional event” means an event or circumstance that is beyond the reasonable control of the licensee and which results in or causes electricity not to be supplied to a customer and includes an act of the public enemy, war declared or undeclared, threat of war, terrorist act, revolution, riot, insurrection, civil commotion, public demonstration, sabotage, act of vandalism, fire (not related to weather), any severe weather event resulting in more than 4 faults being recorded by the licensee on the licensee’s transmission system in any 24 hour period, governmental restraint, Act of Parliament, other legislation, bye law or directive (not being any order, regulation or direction under section 32, 33, 34 and 35 of the Electricity Act 1989) provided that lack of funds shall not be interpreted as a cause beyond the reasonable control of the licensee.
8. Within 28 days of the end of the incentive period y, or such later date as the Authority may direct, the licensee shall provide a report to the Authority in a form approved by the Authority. The report shall contain the following information:
 - (a) the number of incentivised loss of supply events occurring during the incentive period y;

- (b) the details of any excluded events referred to in paragraph 2 with reference to such relevant supporting information that in the Authority's opinion is necessary for it to determine whether an excluded event has occurred; and
 - (c) the details of any adjustments made to the number of incentivised loss of supply events in incentive period y for exceptional events in accordance with paragraph 4.
9. Unless the Authority otherwise directs within 28 days of receipt of the report, the number of incentivised loss of supply events in incentive period y specified in the report shall be deemed to be final.

APPENDIX 2

NOTICE UNDER SECTION 11(2) OF THE ELECTRICITY ACT 1989

REASONS FOR PROPOSED MODIFICATIONS OF THE TRANSMISSION LICENCE

Introduction

- 1.1. Ofgem is proposing modifications to the transmission licences of both Scottish Power Transmission Ltd (SPTL) and Scottish Hydro-Electric Transmission Ltd (SHETL). The purpose of these modifications is to introduce a scheme to reward system reliability and penalise system unreliability, thereby further promoting the efficient development and management of the respective transmission networks.
- 1.2. It is intended that the proposed reliability incentive scheme for SPTL and SHETL (“the Scottish reliability incentive scheme”) mirrors, as far as practicable, the reliability incentive scheme which has already been introduced for National Grid Electricity Transmission (“NGET”).
- 1.3. Ofgem outlined the reasons for introducing a reliability incentive scheme for NGET in consultation documents that were issued in October 2004¹ and December 2004². The reasoning underpinning the reliability incentive scheme proposals for NGET applies equally to the proposed Scottish reliability incentive scheme, in particular Ofgem’s view that the interests of consumers can be better protected if transmission licensees are subject to more focused financial incentives to establish and maintain efficient management and operational process to maintain system reliability.
- 1.4. In this appendix we will outline the differences, and the reasons for those differences, between NGET’s reliability incentive scheme and the proposed Scottish reliability incentive scheme.
- 1.5. Ofgem wishes to emphasise that the proposed Scottish reliability incentive scheme is intended only to operate as an interim measure. Ofgem will be

¹ Electricity transmission network reliability incentive schemes: Initial proposals, Ofgem, October 2004, 240/04

² Electricity transmission network reliability incentive schemes: Final proposals, Ofgem, December 2004

reviewing all incentive arrangements as part of the Transmission Price Control Review (TPCR) with any new arrangements resulting from the TPCR project to commence from 1 April 2007. This could include changes to the financial incentives associated with system reliability, and system performance more generally.

Background

- 1.6. On 28 August 2003 there was a loss of supply event in London which was followed by a loss of supply event in Birmingham on 5 September 2003. Ofgem launched an investigation into both these events, with the results of the investigation being published on 25 June 2005³. As a result of the investigation Ofgem concluded that the introduction of a reliability incentive scheme for transmission licensees would enhance the existing regulatory and legislative framework.
- 1.7. Following consultation NGET's licence was amended to include a reliability incentive scheme. The scheme commenced operation on 1 January 2005.
- 1.8. The reliability incentive scheme for NGET operates by rewarding or penalising NGET based on the difference between the actual level of unsupplied electricity per annum and a target level of unsupplied electricity per annum which is set out in NGET's licence. When calculating the actual level of unsupplied electricity only those events where 4 or more customers are affected are taken into account.
- 1.9. For 2006/07 the target level of unsupplied electricity for NGET is 248 MWh to 274 MWh. If the actual level of unsupplied electricity is below 248 MWh then the revenue of NGET will increase by up to 1 percent. If the actual level of unsupplied energy increases above 274MWh then the revenue of NGET will decrease by up to 1.5 percent. NGET will lose 1.5 percent of revenue if the actual level of unsupplied energy is in excess of 653 MWh.

³ Statement by the Gas and Electricity Markets Authority, following an investigation into compliance by National Grid Company plc with its obligations under section 9(2)(a) of the Electricity Act 1989 and Special Licence Condition AA4.1 of its Electricity Transmission Licence in relation to a transmission failure in London and in relation to a transmission failure in Birmingham, 25 June 2004, 144/04

- 1.10. In the October 2004 Initial Proposals document⁴ Ofgem indicated that it would consider how incentive arrangements could apply to the Scottish transmission licensees so that consumers across Great Britain can benefit from a reliability incentive scheme.
- 1.11. Ofgem has now considered how a reliability incentive scheme could apply in Scotland. Ofgem considers that the NGET reliability incentive scheme framework of penalties and rewards linked to a measure of system reliability, benchmarked against past performance, is also appropriate on an interim basis for SPTL and SHETL and represents an enhancement to the overall regulatory regime. As noted above, the issue of financial incentives linked to system reliability and system performance will be examined as part of the TPCR, and changes may be made to the regime for all three transmission licensees with effect from 1 April 2007.

The Scottish Reliability Incentive Scheme

- 1.12. As stated above, it is intended that the proposed Scottish reliability incentive scheme mirrors, as far as practicable, NGET's reliability incentive scheme. A summary of the changes that have been made to the NGET reliability incentive scheme in applying the framework to SPTL and SHETL are set out below.

Reliability Target

- 1.13. The Scottish reliability incentive scheme will be based on the number of "incentivised loss of supply events". An "incentivised loss of supply event" is "any event on the licensee's transmission system that causes electricity not to be supplied to a customer" subject to certain exemptions.
- 1.14. This differs from the NGET reliability incentive scheme which is based on the total level of megawatt hours that are unsupplied in "incentivised loss of supply events".
- 1.15. The different metric has been chosen for the Scottish reliability incentive scheme because SPTL and SHETL are Transmission Owners (TOs) while NGET is the Great Britain System Operator (GBSO) and TO. The number of events (rather than the volume of energy lost through such events) is more closely related to

⁴ Electricity transmission network reliability incentive schemes: Initial proposals, Ofgem, October 2004, 240/04

the actions of TOs, while the volume of energy lost is dependent in part on the actions of the GBSO.

Duration

- 1.16. The Scottish reliability incentive scheme will cover the period 1 January 2006 until 31 March 2007.
- 1.17. The Scottish reliability incentive scheme could be based on two separate incentive periods reflecting the way in which the licensee's allowed revenue is calculated during the price control period. However, if this were the case this would result in one incentive period only lasting three months, with the incentivised loss of supply event target for SPTL being two events during this period and the incentivised loss of supply event target for SHETL being three events during this period. This would result in an incentive scheme which has an all or nothing effect. For example, if there were no incentivised loss of supply events then SPTL's revenue would be increased by the full 0.5%, whereas if there was one incentivised loss of supply event then there would be no change to SPTL's revenue. This is not considered to be a desirable outcome for an incentive regime trying to improve management processes.
- 1.18. Therefore, it is proposed to only have one reliability incentive period from 1 January 2006 until 31 March 2007, a period of 15 months. This will overcome the problem of a low target level leading to an all or nothing incentive. It also aligns with the transmission price control review process currently being undertaken by Ofgem.
- 1.19. The same approach was adopted for the first year of the NGET reliability incentive scheme which covered the period from 1 January 2005 to 31 March 2006.

Maximum Revenue Adjustment

- 1.20. NGET have a maximum reward for out-performance of 1 percent of allowed revenue and a maximum penalty for underperformance of 1.5 percent of allowed revenue. However, it is proposed to limit the changes in revenue for SPTL and SHETL to 0.5 percent of allowed revenue for out-performance and 0.75 percent of allowed revenue for underperformance.

1.21. The proposed difference in the maximum revenue adjustments is due to the fact that there is only one incentive period under the Scottish reliability incentive scheme. If there were more than one incentive period then any unusual reliability performance by SPTL or SHETL during a particular incentive period would be balanced out by more typical performances in other incentive periods so that in the long run the licensee's performance against the reliability incentive would reflect the ability of the licensee to improve its systems. By reducing the revenue adjustment factor under the Scottish reliability incentive scheme to half that of NGET's reliability incentive scheme means that the risk associated with an abnormal year in reliability performance by SPTL or SHETL is reduced for both the licensee and the consumer.

Weather Related Faults

1.22. Under NGET's reliability incentive scheme, NGET may exclude "exceptional events" from calculation of their actual unsupplied energy during an incentive period. One exceptional event is a severe weather event which causes electricity not to be supplied to a customer. This is defined in the NGET licence as "any severe weather event resulting in more than 50 faults being recorded by the licensee on the licensee's transmission system in any 24 hour period".

1.23. It is intended to include in the Scottish reliability incentive scheme an equivalent to the exemption for severe weather events. However, it is not considered appropriate for the number of faults on the licensees' transmission system to be the same as for NGET due to the different size and nature of the Scottish networks.

1.24. Ofgem has made an adjustment to the Scottish reliability incentive scheme to reflect the relative size and nature of the respective networks. Thus in the proposed definition of a severe weather event for the purposes of SPTL's licence the relevant number of faults is 7 faults in a 24 hour period. In the proposed definition of a severe weather event for the purposes of SHETL's licence the relevant number of faults is 4 faults in a 24 hour period.

Adjustments to calculation of unsupplied energy events

1.25. Under both the proposed Scottish reliability incentive scheme and NGET's reliability incentive scheme there are a number of specific exemptions to what would otherwise be considered an "incentivised loss of supply event". However,

it has been necessary to introduce a number of differences between the two schemes.

- 1.26. NGET is the GBSO and therefore is a signatory to the Connection and Use of System Code (CUSC). A number of exemptions in the NGET reliability incentive scheme are drafted by reference to the CUSC. SPTL and SHETL are not System Operators (SO) and are not parties to the CUSC. Some of the differences between the two schemes reflect that SPTL and SHETL are not the SO and are not parties to the CUSC. However, it is intended that the general purpose of the relevant NGET exemptions are reflected in the Scottish reliability incentive scheme.
- 1.27. The other difference in the incentivised loss of supply event exemptions relates to safety. A specific exemption has been included in the Scottish reliability incentive scheme for emergency de-energisations or disconnections that are necessary to ensure compliance with the Electrical Safety, Quality and Continuity Regulations 2002 or to otherwise ensure public safety.