

**MODIFICATION OF THE SPECIAL CONDITIONS OF NATIONAL GRID
ELECTRICITY TRANSMISSION PLC'S ELECTRICITY TRANSMISSION
LICENCE UNDER SECTION 11 OF THE ELECTRICITY ACT 1989**

**NOTICE OF REASONS FOR THE DECISION TO MODIFY THE SPECIAL
CONDITIONS OF NATIONAL GRID ELECTRICITY TRANSMISSION PLC'S
ELECTRICITY TRANSMISSION LICENCE UNDER SECTION 49A OF THE
ELECTRICITY ACT 1989**

WHEREAS:

1. National Grid Electricity Transmission plc ("NGET") holds an electricity transmission licence (the "licence") treated as granted pursuant to section 6(1)(b) of the Electricity Act 1989 (the "Act").
2. In accordance with section 11(2) and (3) of the Act, the Gas and Electricity Markets Authority (the "Authority"):
 - (a) gave notice (the "Notice") on 27 February 2007 that it proposed to modify the special conditions of the licence in accordance with the Schedule to the Notice;
 - (b) published the Notice in the manner it considered appropriate; and
 - (c) served a copy of the Notice on NGET.
3. The Authority gave notice of its intention to make the proposed licence modifications to the Secretary of State. The Authority did not receive a direction from the Secretary of State not to make the proposed licence modifications before the relevant time specified in the Notice.
4. The Authority received two representations (in addition to NGET's consent) in relation to the proposed licence modifications before the relevant time specified in the Notice. No representations were withdrawn. The Authority has carefully considered all representations made in relation to the proposed licence modifications and not withdrawn.

All non-confidential representations made in relation to the proposed licence modifications are available free of charge from the Ofgem Research and Information Centre, 9 Millbank, London SW1P 3GE or from the Ofgem website at www.ofgem.gov.uk.
5. It has come to the Authority's attention that some minor textual errors were contained in the Notice and that certain clarificatory amendments are required, namely:
 - (a) the definition of "security period" should be inserted after the definition of "remote transmission asset rentals" rather than after the definition of "relevant year t";
 - (b) "CSOC", which appears in the formula set out in paragraph 4(a) of the Notice, should include a small sub-script "t" rather than a capital sub-script "T";
 - (c) "CSOCET", where it appears in the first formula set out in paragraph 4(d) of the Notice, should include a sub-script "t";

- (d) the tables and the definition of ON_t set out in paragraph 4(d) of the Notice should refer to the 2004/05 price base;
- (e) "<" at the top of the first column of the table set out in paragraph 9 of the Notice should appear before "380,000,000"; and
- (f) the CSF_{Mt} and OS_{Mt} terms in proposed new paragraphs B5(a) and B6(a), set out in paragraph 13 of the Notice, are redundant and should be removed.

The Authority considers that these changes should be made.

- 5. NGET has given its written consent to the modifications proposed in the Notice, with the inclusion of the amendments set out in paragraph 5 above.
- 7. The reasons for making the licence modifications are set out in the following documents published by the Authority:
 - (a) "National Grid Electricity Transmission System Operator Incentives from 1 April 2007: Final proposals and statutory licence consultation", Ofgem, February 2007.
 - (b) "National Grid Electricity Transmission and National Grid Gas System Operator Incentives from 1 April 2007: Initial proposals consultation", Ofgem, December 2006;
 - (c) "National Grid Electricity Transmission and National Grid Gas System Operator Incentives from 1 April 2007: October consultation", Ofgem, October 2006; and
 - (d) "National Grid Electricity Transmission and National Grid Gas System Operator Incentives 2007-08 – Invitation to submit views", Ofgem, July 2006;

These documents are available free of charge from the Ofgem Research and Information Centre, 9 Millbank, London SW1P 3GE or from the Ofgem website at www.ofgem.gov.uk.

THEREFORE:

In accordance with section 11 of the Act, the Authority hereby modifies the special conditions of NGET's licence in accordance with the Schedule to this Modification with effect on and from 00:00 hours on 1 April 2007.

This document constitutes a notice of reasons for the decision to modify the special conditions of NGET's licence under section 49A of the Act.

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



Sonia Brown
Director, Wholesale Markets
Duly authorised on behalf of the Gas and Electricity Markets Authority
29 March 2007



SCHEDULE

MODIFICATION OF THE SPECIAL CONDITIONS OF NATIONAL GRID ELECTRICITY TRANSMISSION PLC'S ELECTRICITY TRANSMISSION LICENCE UNDER SECTION 11 OF THE ELECTRICITY ACT 1989

1. In special condition AA5 (Revenue Restriction Conditions: Definitions), after the definition of "remote transmission asset rentals" insert:

""security period"	means a period commencing on the date on which any direction issued by the Secretary of State under section 34(4) of the Act enters effect and terminating on the date (being not earlier than the date such direction, as varied, is revoked or expires) as the Authority, after consultation with such persons (including, without limitation, licence holders liable to be principally affected) as it shall consider appropriate, may with the consent of the Secretary of State by notice to all licence holders determine after having regard to the views of such persons."
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2. In special condition AA5A:

- (a) for the heading, substitute "AA5A: Balancing Services Activity Revenue Restriction";
- (b) for "relevant period", where it appears, substitute "relevant year".

3. In special condition AA5A, Part 2 (i) (balancing services activity revenue restriction on external costs):

- (a) in paragraph 5, for the definition of "BXext_t", substitute;

"BXext_t represents the maximum allowed revenue derived in relevant year t from and associated with procuring and using balancing services";
- (b) paragraph 5A is omitted;
- (c) in paragraph 10(a)(iii), "as defined in special condition AA5D" is omitted;
- (d) in paragraph 10(b):
 - (i) for "1 April 2005", substitute "1 April 2007";
 - (ii) for "31 March 2006", substitute "31 March 2008";
 - (iii) for Table 1 (Proposed modifications to the BSC), substitute:

BSC Modification Proposal	BSC Modification Title (as entitled by the proposer of the modification)
None applicable	

(iv) for Table 2 (Proposed amendments to the CUSC), substitute:

CUSC Amendment Proposal	CUSC Amendment Title (as entitled by the proposer of the amendment)
None applicable	

4. In special condition AA5A, Part 2 (ii) (balancing services activity revenue restriction on internal costs):

- (a) in paragraph 13, for the formula and words from “in accordance with the following formula” substitute:

$$BXint_t = CSOC_t + IncPayInt_t + NC_t + IAT_t + IONT_t$$

where:

$BXint_t$ means the balancing services activity revenue associated with internal costs in relevant year t other than any revenue in relevant year t accounted for under paragraph 5 of part 2(i) of this special condition and is derived from the following components:

$CSOC_t$ which is the aggregate of all incentivised internal costs associated with the balancing services activity in respect of relevant year t, calculated in accordance with paragraph 15;

$IncPayInt_t$ which means the incentive payment associated with the internal operating costs of undertaking the balancing services activity in respect of relevant year t, calculated in accordance with paragraph 15B;

NC_t which means non-incentivised costs, calculated in accordance with paragraph 15C;

IAT_t which means, in respect of each relevant year t, the amount of any allowed income adjustment given by paragraph 18(b);

$IONT_t$ which means, in respect of each relevant year t, the amount of any allowed income adjustments given by paragraph 24(b)”;

- (b) for paragraph 14 substitute the words “Not used.”;

(c) for paragraph 15, substitute:

"15. Determination of incentivised internal costs

For the purposes of paragraph 13, the term $CSOC_t$ shall be derived from the following formula:

$$CSOC_t = CSOOC_t + CSOCEC_t$$

where:

$CSOOC_t$ means the aggregate of the incentivised internal operating costs associated with the balancing services activity in respect of relevant year t;

$CSOCEC_t$ means the aggregate of the incentivised internal capital expenditure associated with the balancing services activity in respect of relevant year t and shall be derived from the following formula:

$$CSOCEC_t = CSOD_t + CSOR_t$$

where:

$CSOD_t$ means the depreciation on the SO regulatory asset base (as defined below) in respect of relevant year t and is calculated on a straight-line basis using an asset life of 7 years;

$CSOR_t$ means the return on the SO regulatory asset base in respect of relevant year t and is calculated as 5.05% of the SO regulatory asset base;

"SO regulatory asset base" means the aggregate of assets associated with the balancing services activity excluding, for the avoidance of doubt, Plant (which has the meaning given to it in the CUSC) expenditure and has the value £43.3 million at 1 April 2007. Allowed internal capital expenditure ($ASOCE_t$) shall be added to the SO regulatory asset base in respect of any relevant year t and is determined in accordance with paragraph 15A.";

(d) after paragraph 15, insert:

"15A. Determination of Allowed Internal Capital Expenditure ($ASOCE_t$)

$ASOCE_t$ means the allowed internal capital expenditure that shall be added to the SO regulatory asset base in respect of any relevant year t and is derived in the following manner:

$$ASOCE_t = \left(\left[1 + \left(\frac{IRPI_t}{100} \right) \right] \times CSOCET_t \right) - \left(\left(\left[1 + \left(\frac{IRPI_t}{100} \right) \right] \times CSOCET_t \right) - ACE_t \right) \times 0.75$$

where:

CSOCET_t means the internal capital expenditure target in respect of relevant year t as set out in the following table:

	Relevant year				
Variable	2007 /08	2008 /09	2009 /10	2010 /11	2011 /12
CSOCET _t , £ million 2004/05 prices	11.1	7.5	8.3	7.4	6.7

ACE_t means the internal capital expenditure associated with the balancing services activity excluding Plant (which has the meaning given to it in the CUSC) in respect of relevant year t;

IRPI_t in respect of relevant year t, means the percentage change (whether of a positive or a negative value) between (a) the arithmetic average of the retail price index published or determined with respect to each of the six months from May to October (both inclusive) in relevant year t-1 and (b) the value 181.80 (being the value for t-1 in 2004/05).

15B. Determination of incentive payments on internal operating costs

For the purposes of paragraph 13, the term IncPayInt_t shall be derived from the following formula:

$$IncPayInt_t = \left((1 - ISF_t) \left(\left[1 + \left(\frac{IRPI_t}{100} \right) \right] IMOT_t \right) - CSOOC_t \right) + \left[\sum_M (1 - CSF_{Mt}) (CP_{Mt} - OS_{Mt}) \right]$$

where:

ISF_t is the balancing services activity sharing factor in respect of relevant year t, and is calculated in accordance with the formula set out below:

if $IMOT_t > CSOOC_t$ then $ISF_t = IUSF_t$ otherwise $ISF_t = IDSF_t$

where:

$IUSF_t$ is the balancing services activity upside sharing factor in respect of relevant year t and has the value specified in paragraph B7 of Part B of Schedule A;

$IDSF_t$ is the balancing services activity downside sharing factor in respect of relevant year t and has the value specified in paragraph B7 of Part B of Schedule A;

$IMOT_t$ is the target for the incentivised internal operating costs associated with the balancing services activity in respect of relevant year t as specified in the following table:

	Relevant year				
Variable	2007 /08	2008 /09	2009 /10	2010 /11	2011 /12
$IMOT_t$ £ million 2004/05 prices	47.9	47.0	45.9	46.9	46.5

CSF_{Mt} is a Contingency Provisions (as defined in the BSC from time to time) sharing factor in respect of each month M of relevant year t and has the value determined in accordance with paragraph B5 of Part B of Schedule A;

CP_{Mt} is the sum of the Ad-Hoc Trading Charges (as defined in the BSC from time to time) payable by the licensee in respect of the Contingency Provisions in month M of relevant year t;

OS_{Mt} is the Contingency Provisions offset in respect of each month M of relevant year t and has the value determined in accordance with paragraph B6 of Part B of Schedule A;

means the summation over all months M in relevant year t;

$CSOOC_t$ has the meaning given in paragraph 15;

$IRPI_t$ has the meaning given in paragraph 15A.

Determination of non-incentivised costs

For the purposes of paragraph 13, NC_t shall be derived from the following formula:

$$NC_t = (NSOC_t + BI_t + T_t + P_t + ON_t) \times \left(1 + \frac{IRPI_t}{100}\right)$$

where:

$NSOC_t$ has the value set against relevant year t as set out in the following table:

	Relevant year				
Variable	2007 /08	2008 /09	2009 /10	2010 /11	2011 /12
$NSOC_t$, (£,million 2004/05 prices)	17.8	2.1	1.7	1.6	1.6

BI_t represents the costs incurred by the licensee for preparing for the introduction of BETTA and has the value for the relevant year t set out in the following table:

	Relevant year				
Variable	2007 /08	2008 /09	2009 /10	2010 /11	2011 /12
BI_t , (£,million 2004/05 prices)	3.6	3.4	3.3	3.2	3.0

T_t means the tax allowance in respect of relevant year t as set out in the following table:

	Relevant year				
Variable	2007 /08	2008 /09	2009 /10	2010 /11	2011 /12
T_t , (£,million 2004/05 prices)	8.4	3.9	3.2	2.5	2.4

P_t means the pension cost allowance in respect of relevant year t as set out in the following table:

	Relevant year				
Variable	2007 /08	2008 /09	2009 /10	2010 /11	2011 /12

P _t (£,million 2004/05 prices)	15.6	15.4	15.1	15.0	15.0
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ON_t unless determined otherwise by the Authority, has the value £1,000,000 (in 2004/05 prices) for the relevant year t and represents an allowance for payments by the licensee in respect of outage changes.”;

(e) in paragraph 16:

(i) in sub-paragraph (a)(iii), for “CSOC_t by more than £1,000,000 (the “STC” threshold amount)”, substitute, “CSOOC_t or ACE_t by more than £1,000,000 (the “STC threshold amount”) and is demonstrably not included in IMOT_t or CSOCET_t respectively for relevant year t”;

(ii) in sub-paragraph (b), for “1 April 2006”, substitute “1 April 2007”;

(iii) in sub-paragraph (b), for “31 March 2007”, substitute “31 March 2008”;

(f) in paragraph 18(a)(ii), for “CSOC_t by more than the STC threshold amount”, substitute “CSOOC_t or ACE_t by more than £1,000,000 (the “STC threshold amount”) and is demonstrably not included in IMOT_t or CSOCET_t respectively for relevant year t”;

(g) in paragraph 20:

(i) in sub-paragraph (b)(ii)(B) for “standard condition 5”, substitute “standard condition B1 (Regulatory accounts)”;

(ii) in sub-paragraph (c), delete “CSOC_t”, “PSC_t”, “ASO_t” and “SOBR_t” and after “IncPayInt_t” insert “CSOC_t, CSOOC_t, CSOD_t, CSOR_t, ACE_t”.

5. In special condition AA5C, in paragraph 8(a), “save in relation to the relevant year t commencing on 1 April 2005” is omitted.

6. In special condition AA5E (Duration of the Transmission Network Revenue Restriction and the Balancing Services Activity Revenue Restriction):

(a) in the heading, omit “Transmission Network Revenue Restriction and the”;

(b) in paragraph 1, omit “and the transmission network revenue restriction”;

(c) in paragraph 2, omit “transmission network revenue restriction and the”;

- (d) for paragraph 3(ii), substitute "specify the balancing services activity revenue restriction or any part or parts thereof to which the request relates";
 - (e) for paragraph 4(i), substitute the words "Not used.";
 - (f) in paragraph 4(ii), for "31 March 2007" substitute "31 March 2008";
 - (g) in paragraph 4(iii), for "31 March 2007" substitute "31 March 2012";
 - (h) for paragraph 4(A), substitute the words "Not used.";
 - (i) in paragraph 4(B):
 - (i) before "Schedule A" insert "Part 2(ii) of special condition AA5A and";
 - (ii) for "1 April 2006" substitute "1 April 2007".
7. Schedule A (Supplementary Provisions of the Charge Restriction Conditions), Part B (Terms used in the balancing services activity revenue restriction), is amended in accordance with paragraphs 8 to 13.
8. For "relevant period", where it appears, substitute "relevant year".
9. For paragraph B1 substitute:
- "B1. For the purpose of paragraph 8 of Part 2(i) of special condition AA5A, the terms MT_t , SF_t and CB_t shall be selected against the appropriate value of IBC_t (which shall be determined in accordance with paragraph 9 of special condition AA5A):

- (a) in respect of the relevant year t commencing on 1 April 2007, from the following table:

IBC_t (£)	MT_t (£)	SF_t	CB_t (£)
$< 380,000,000$	0	0	10,000,000
$380,000,000 \leq IBC_t < 430,000,000$	430,000,000	0.2	0
$430,000,000 \leq IBC_t < 445,000,000$	IBC_t	0	0
$445,000,000 \leq IBC_t < 495,000,000$	445,000,000	0.2	0
$\geq 495,000,000$	0	0	-10,000,000

- (b) in respect of the relevant year t commencing on 1 April 2008 and each relevant year thereafter, the terms MT_t , SF_t and CB_t shall be set to zero."

10. For paragraph B2 substitute the words "Not used."

11. For paragraph B3, substitute:

"B3. For the purpose of paragraph 9 of Part 2(i) of special condition AA5A:

- (a) the term $TLRP_j$ in respect of each settlement period during relevant year t shall have the value in £ per megawatt hour of 29;
- (b) the term TLT_j in respect of each settlement period during relevant year t shall be given by the following formula:

$$TLT_j = \frac{TLT_t}{SP_t}$$

where:

TLT_t which is the target volume of transmission losses in relevant year t , shall have the value in megawatt hours of 5,950,000;

SP_t is the total number of settlement periods in the relevant year t ."

12. Paragraphs B5 to B15 are omitted.

13. After paragraph B4 insert:

"B5. For the purpose of paragraph 15B of Part 2(ii) of special condition AA5A, the term CSF_{Mt} shall have the value in respect of each month M of relevant year t :

- (a) $CSF_{Mt} = 0.4$ when $0 \leq \left[0.4 \cdot CP_{Mt} \right] \left[\left(\pounds 250,000 \left(1 + \frac{IRPI_t}{100} \right) \right) \right]$
- (b) $CSF_{Mt} = 0$ otherwise

where:

$IRPI_t$ shall have the meaning ascribed to it in paragraph 15A of special condition AA5A.

B6. For the purposes of paragraph 15B of Part 2(ii) of special condition AA5A, the term OS_{Mt} shall have the value in respect of each month M of relevant year t :

(a) $OS_{Mt} = 0$ when $CSF_{Mt} > 0$

(b) $OS_{Mt} = £250,000 \left(1 + \frac{IRPI_t}{100} \right)$ when $CSF_{Mt} = 0$

$IRPI_t$ shall have the meaning ascribed to it in paragraph 15A of special condition AA5A

- B7. For the purposes of paragraph 15B of Part 2(ii) of special condition AA5A, the terms $IUSF_t$ and $IDSF_t$ in respect of relevant year t shall be derived from the following tables:

	Relevant year				
Variable	2007 /08	2008 /09	2009 /10	2010 /11	2011 /12
$IUSF_t$	0.2				

	Relevant year				
Variable	2007 /08	2008 /09	2009 /10	2010 /11	2011 /12
$IDSF_t$	0.2				