



To: Interested Parties

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all gas and electricity customers*

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Date: 30 November 2009

Dear Colleague,

Extension regarding Electricity Transmission Standard Licence Condition B17 (Network Output Measures) ('SLC B17'), Part B

On 17 November 2009, National Grid Electricity Transmission plc ('NGET'), SP Transmission Limited ('SPTL') and Scottish Hydro-Electric Transmission ('SHETL') submitted to Ofgem for approval an amended 'network output measures methodology' (the 'methodology'). The amended methodology has been proposed to address the conditions Ofgem set when approving the methodology in December 2008¹. At that time, Ofgem requested that the licensees resolve the issues upon which our approval was conditional, such that an appropriate methodology is in place for 1 December 2009.

This letter sets out the background to this issue and our decision to extend our conditional approval of the methodology until 31 March 2010, to enable Ofgem to fully assess the amendments that the licensees have proposed. We currently expect to issue a decision regarding approval of the amended network output measures on or before 31 March 2010.

This letter constitutes Notice for the purposes of section 49A of the Electricity Act 1989.

Background

Under SLC B17, NGET, SPTL and SHETL are required to develop a joint methodology designed to produce network output measures to facilitate the objectives specified in the licence². The measures of network condition, risk and performance are intended to help Ofgem better assess the efficiency of historic capital expenditure by the licensees and the need for future investment. The measures should also provide a constructive basis for discussion on network investment requirements with the licensees in the future.

The licensees are required to submit the methodology to the Authority for approval. SLC B17 sets out that following review of the proposed methodology, the Authority may approve the methodology, approve the methodology with such amendments as the Authority shall direct or issue a notice of disapproval (which should direct the areas in which the licensees should make improvements).

¹ <http://www.ofgem.gov.uk/Networks/Trans/RegReporting/Documents1/20081218B17.pdf>

² The 'objectives' are set out in SLC B17 paragraph 4.

The licensees submitted the joint methodology (with licensee specific appendices) to the Authority for approval on 31 May 2008. The Authority appointed consultants (PB Power) to assist the Authority with its review.

On 17 October 2008 Ofgem published an open letter³ seeking views on the licensees' proposed methodologies. A copy of PBP's report⁴ of their findings was published with the open letter.

On 18 December 2008, the Authority issued its decision to approve the methodology proposed by NGET, SHETL and SPTL subject to the following amendments⁵:

- i. the licensees should ensure consistency between their remaining useful life scales
- ii. each licensee should provide sufficient detail of their rate of deterioration assumption to demonstrate the validity of the remaining useful life categorisation. The licensees should provide worked examples that illustrate how for a given asset category the rate of deterioration policy for that asset category has been applied to derive the categorisation of the asset population by remaining useful life.
- iii. the proposed measure of network risk should also be broken down and reported against its three constituent criticalities; safety, environmental, system and in each case the derivation and application of the criticality grading should be clear.
- iv. the licensees should develop a measure of longer term network wide risk.
- v. the licensees should report on measures of network reliability that can be correlated with asset condition and age including on a forecast basis e.g. expected fault and failure trends
- vi. the licensees should develop further measures of capability and utilisation that measure factors other than thermal capacity at boundaries e.g. voltage and stability performance which could be impacted by changes in generation connecting to the network.

Interactions and Timescales

Our decision letter of 18 December 2008 stated that the amendments should be completed to Ofgem's satisfaction by 1 December 2009. It further stated that there is an interaction between the electricity transmission reliability incentive and the network output measures. For this reason we stated that were the amendments not resolved, for the purposes of Special Condition D5 paragraph 3 of NGET's electricity transmission licence and Special Condition J5 paragraph 3 of SHETL's and SPTL's electricity transmission licences, the licensees would be deemed to have "failed to implement the methodology". This would allow the upside sharing factor to be set to zero from 2009/10 onwards, effectively making the incentive a penalty or a downside only.

Way forward and the Authority's decision

The licensees submitted the amended methodology to us on 17 November 2009. In order to be able to fully assess whether the amendments have been fully implemented and all issues identified in our conditional approval resolved, the Authority has decided to extend the conditional approval, granted to licensees on 18 December 2008 until 31 March 2010.

This would delay the full approval (or otherwise) of the network output measures and the impact, if any, on the electricity transmission reliability incentive. For the avoidance of

³Our open letter sought views on the methodology required under both SLC B17 and special condition C13. Link: <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=17&refer=Networks/Trans/RegReporting>

⁴ <http://www.ofgem.gov.uk/Networks/Trans/RegReporting/Documents1/PB%20Power%20Review.pdf>

⁵ As provided for under SLC B17, paragraph 8.

doubt, there is currently no impact on the reliability incentive since our conditional approval has been extended and hence the licensees are not deemed to have failed.

The Authority currently expects to issue a decision regarding the amended network output measures on or before 31 March 2010.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Stuart Cook', written over a horizontal line.

Stuart Cook

Acting Senior Partner, Transmission and Governance

Signed on behalf of the Authority and authorised for that purpose by the Authority