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Date: 25 January 2010

Dear Colleagues

Notice under Section 11(2) of the Electricity Act 1989 to modify Special Condition D4 (Pass Through Items) of the electricity transmission licence of National Grid Electricity Transmission plc

This letter sets out proposals to modify Special Licence Condition D4 (Pass Through Items) of the electricity transmission licence of which is held by National Grid Electricity Transmission plc. The letter seeks the views of interested parties and constitutes Notice under section 11(2) of the Electricity Act 1989.

Background

The Electricity Act 1989 makes provision for the modification of licences by the Authority. The Authority may modify the special conditions of licences where it considers it to be necessary or expedient, having regard to its statutory duties.

On 15 November 2007 Ofgem granted conditional consent for National Grid Electricity Transmission plc ("NGET")¹ to participate, on behalf of Great Britain ("GB"), in the voluntary European Union Inter-Transmission System Operator Compensation ("ITC") scheme for calendar years 2008 and 2009 ("the 2008/9 scheme"). This consent was conditional on NGET:

- Conducting a consultation of the charging methodology on how NGET would recover from the GB transmission users the costs it would incur in participating in the ITC scheme;
- Producing a report on the model adopted in the 2008/2009 scheme for treating transmission losses; and
- Confirming support for forward looking costs in development of future arrangements.

In complying with the first action, NGET completed a charging consultation on ITC arrangements (ECM-12²) in April 2009 and confirmed to Ofgem that the costs would be recovered from network users through the residual element of the Transmission Network Use of System (TNUoS) charges. NGET subsequently wrote to Ofgem on 16 November 2009 reporting how it complied with the remaining two conditions.

¹ NGET is the owner of the high-voltage transmission network in England and Wales and the system operator of Great Britain's high-voltage national transmission networks.

² Relevant information is available from NGET's website:
<http://www.nationalgrid.com/uk/Electricity/Charges/modifications/uscmc/>.

In setting out the transmission price control for the five-year period from 1 April 2007 to 31 March 2012, we created a term in the revenue calculation for NGET that would provide for the pass-through of the potential costs of NGET participating, on behalf of GB, in any future ITC scheme. The term, ITC_t , is contained in Special Condition D4 (Pass Through Items) of NGET's electricity transmission licence. Currently, this is deemed to take the value of zero unless otherwise determined by the Authority.

On 9 December 2009 NGET formally requested that the Authority determine the value of the ITC_t term contained in Special Condition D4 of its licence to allow it to recover the direct costs of participating in the 2008/9 scheme.

In considering the approach to making the allowances relevant to the ITC_t term, we have taken into account the following:

- The on-going development of the European Union ITC scheme (after the completion of the 2008/9 scheme), and therefore the expectation of further costs to be incurred by NGET in participation in such a scheme;
- The process by which the cost information relevant to an ITC scheme can be reported to and assessed by the Authority, and the interaction with the process of the setting of the annual TNUoS tariffs; and
- The treatment of other pass-through items, which, instead of being set by explicit directions by the Authority, are set automatically at the conclusion of the annual regulatory reporting mechanism where the costs are reported to the Authority in accordance with obligations under NGET's Standard Condition B16 (Price Control Revenue Reporting and Associated Information).

Having considered the above, we believe that it is appropriate to align the treatment of ITC_t with that currently in place for other pass-through cost items, i.e. to allow the value of the ITC_t term to be set automatically at the conclusion of the annual regulatory reporting mechanism. This approach would also be consistent with the treatment of other variable elements of revenue allowances derived through formulae based on input values as reported through the annual regulatory reporting mechanism.

Proposed modification

We propose to modify paragraph 1 of Special Condition D4 to revise the definition of the ITC_t term so that its value is set to be equal to an amount that would be reported in due course, where the Authority has approved the participation in that scheme.

For the avoidance of doubt, this approach is intended to apply to the recovery of direct costs of participating in the 2008/9 scheme and to accommodate the participation of NGET in any future ITC scheme where the Authority has approved the participation in that scheme.

Appendix A to this letter sets out the notice, required by Section 11(2) of the Electricity Act 1989, of the Authority's intention to make the proposed revision to the definition for the ITC_t term contained in paragraph 1 of Special Condition D4. Revised licence text, which constitutes Schedule 1 to the notice, is set out in Appendix B to this letter.

Yours sincerely

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

Stuart Cook
Senior Partner
Transmission and Governance

Appendix A

NOTICE CONCERNING THE PROPOSED MODIFICATION OF THE STANDARD LICENCE CONDITIONS OF TRANSMISSION LICENCE 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 electricity transmission licence granted or treated as granted to National Grid Electricity Transmission plc ("NGET") (company number 2366977) under section 6(1)(b) of the Act by amending Special Licence Condition D4 (Pass Through Items) in the manner set out in Schedule 1 to this Notice.
2. The reasons why the Authority proposes to implement the modification are set out in the covering letter for this Notice, dated 25 January 2010 and entitled "Notice under Section 11(2) of the Electricity Act 1989 to modify Special Condition D4 (Pass Through Items) of the electricity transmission licence of National Grid Electricity Transmission plc".
3. The proposed modification of Special Condition D4 specifically amends paragraph 1, revising the definition of the ITC_t term and modifying the process by which the value of the term will be set.
4. The effect of the proposed licence modification is that the value of the ITC_t term will be set at the conclusion of the annual regulatory reporting mechanism and be reflective of the actual outturn costs incurred by NGET from participating in any European Union Inter-Transmission System Operator Compensation ("ITC") scheme where participation has been approved by the Authority. This means the process for setting the value of the ITC_t term will be consistent with the process for other pass-through elements under Special Condition D4, i.e. to be equal to an amount as reported through the regulatory reporting mechanism where costs are reported to the Authority in accordance with obligations under NGET's Standard Condition B16 (Price Control Revenue Reporting and Associated Information). Such an approach is also consistent with the treatment of other variable elements of revenue allowances derived through formulae based on input values as reported through the regulatory reporting mechanism.
5. Any representations or objections to the proposed licence modification may be made on or before 22 February 2010. Responses should be sent electronically to maurice.golden@ofgem.gov.uk. Alternatively, written responses can be sent to Maurice Golden, Ofgem, 107 West Regent Street, Glasgow G2 2BA.
6. Copies of the proposed modification and other documents referred to in this Notice are available (free of charge) from the Ofgem website (www.ofgem.gov.uk) or from Ofgem Research and Information Centre, 9 Millbank, London, SW1P 3GE (telephone number: 020 7901 7003).
7. All responses will normally be published on Ofgem's website and held in the Research and information Centre. However, if respondent do not wish their response (or any part of it) to be made public then they should clearly mark their response (or a

relevant part of it) as not for publication. Ofgem prefers to receive responses in an electronic form so they can be placed easily on the Ofgem website.

A handwritten signature in black ink, appearing to read 'Stuart Cook', is written over a single horizontal line that extends to the right.

Stuart Cook
Senior Partner
Transmission and Governance
Authorised on behalf of the Authority

Date: 25 January 2010

Appendix B

Schedule 1: Proposed Licence drafting amendments to paragraph 1 of Special Condition D4 (“Pass through items”)

Special Condition D4: Pass Through Items

1. For the purposes of paragraph 2 of special condition D2 (Restriction on Transmission Network Revenue), in each relevant year t , PT_t shall be derived in accordance with the following formula:

$$PT_t = TSP_t + TSH_t + TOFTO_t + OFET_t + LF_t + RB_t - TSR_t + ITC_t + Term_t + TPD_t$$

where:

TSP_t means the amount specified to the licensee by SP Transmission Ltd or any successor company in relation to relevant year t pursuant to its transmission licence;

TSH_t means the amount specified to the licensee by Scottish Hydro-Electric Transmission Ltd or any successor company in relation to relevant year t pursuant to its transmission licence;

$TOFTO_t$ means the total of the revenue amounts specified to the licensee by those offshore transmission owners in relation to the relevant year t pursuant to their transmission licences;

$OFET_t$ means an amount equal to the payments made in aggregate by the licensee to electricity distributors with respect to charges for use of the electricity distribution systems by offshore generating stations connected to those systems via embedded transmission systems.

LF_t means the revenue adjustment term, whether of a positive or of a negative value, calculated in the relevant year t in respect of licence fee payments as derived from the formula set out in paragraph 2;

RB_t means the revenue adjustment term, whether of a positive or of a negative value, calculated in the relevant year t in respect of non-domestic rates as derived from the formula set out in paragraph 3;

TSR_t means the revenue adjustment term, whether of a positive or of a negative value, calculated in the relevant year t in respect of revenue earned by the licensee for tower space rental as derived from the formula set out in paragraph 6;

~~ITC_t shall take the value zero unless otherwise determined by the Authority in the event of the participation by Great Britain in a European Union inter-TSO compensation scheme, and following consultation with other interested parties;~~

ITC_t means an amount reported by the licensee in relation to relevant year t in respect of the direct costs arising from the participation by Great Britain in any European

Union inter-TSO compensation scheme, where the Authority has approved the participation in that scheme in respect of one or more relevant years;

- Term_t means an amount equal to the income received by the licensee in the relevant year t in respect of users who terminate relevant bilateral agreements for connection and /or access rights to the national electricity transmission system prior to commencing use of the national electricity transmission system (for the avoidance of doubt, net of any amounts that are treated as capital contributions); and
- TPD_t means the temporary physical disconnection term and shall be determined in accordance with paragraphs 7 to 8.