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Dear Colleague

DETERMINATION UNDER SPECIAL CONDITION AA5A PART 2(iv), PARAGRAPH 24 OF NATIONAL GRID ELECTRICITY TRANSMISSION PLC'S TRANSMISSION LICENCE(NGET) – OUTAGE COST ADJUSTING EVENT: NGET'S INTERNAL SYSTEM OPERATOR INCENTIVE SCHEME 2009/10

Background

The transmission licence makes allowance in National Grid Electricity Transmission's (NGET) revenue restriction for £1m (in 2004/05 prices) each year to cover the costs incurred in moving transmission outages¹. These costs, referred to in the transmission licence as outage change costs, reflect payments to the other transmission owners, SP Transmission (SPT) and Scottish Hydro Electric Transmission Ltd (SHETL). The purpose of this allowance is to enable NGET, as National Electricity Transmission System Operator (NETSO) to reschedule transmission outages in Scotland to reduce the costs of balancing the system.

The licence makes provision for this annual allowance to be adjusted where the actual costs incurred for moving outages differs from the allowance by more than £300,000 (the 'outage threshold amount') in a single year. The licence provides that where such a variation occurs, the licensee shall submit an outage cost adjusting event notice to the Authority within three months of the end of the relevant financial year². The Authority then has three months to determine whether the allowance should be adjusted.

On 17 May 2010, NGET submitted a notice of an outage cost adjusting event for financial year 2009/10 setting out that it has incurred, or reasonably expects to incur, outage change costs totalling £146,738 (equivalent to £122,964 in 2004/05 prices). This amount is £1,046,602 (equivalent to 877,036 in 2004/05 prices) lower than the amount allowed in the licence. Therefore NGET's expenditure on outage costs during 2009/10 exceeds the outage threshold amount of £300,000³ (£358,002 in nominal prices).

¹ Special Condition AA5A, Part 2(iv), paragraph 22

² Special Condition AA5A, Part 2(iv), paragraph 23 (d)

³ Note that the licence does not stipulate the price base for the materiality threshold, but we interpret that the £300,000 is in 2004/05 prices.

During the process of considering NGET's outage change notice, we confirmed that 2009/10 is the fifth year following implementation of the outage change allowance provisions in which NG has under-spent by a sufficient amount to trigger an adjustment notice. Consequently, Ofgem issued an information request to NGET to seek clarification as to why NGET had been unable to use the full annual allowance (see Appendix 2 – "Briefing note by NGET for Ofgem on outage change costs for the period 2005/06 to 2009/10"). Ofgem also sought NGET's view on the effectiveness of the mechanism, given Ofgem and NGET's ongoing work regarding better management of the costs of system operation, and in particular constraint costs, by more coordinated behaviour between NGET as NETSO and the transmission owners (TOs) across GB.

Licence provisions

Special Condition AA5A, Part 2(iv), paragraphs 22, 23 and 24⁴ of NGET's transmission licence set out the legal framework by which notices of outage cost adjusting events are submitted to the Authority, and the subsequent process culminating with the Authority's determination. In accordance with Special Condition AA5A, Part (iv), paragraph 23, NGET gave particulars to the Authority of the outage cost adjusting event in its notice as follows:

- I. The total estimated outage change cost for the relevant year 2009/10, at £146,738, is £1,046,602 less than the allowance of £1,193,340 (all in nominal prices). The difference between the actual cost and the allowance is greater than the outage threshold amount of £300,000⁵ (£358,002 in nominal prices) and therefore NGET proposes that this constitutes an outage cost adjusting event under Special Condition AA5A Part (iv), paragraph 22(a)(i).
- II. For the relevant year 2009/10, NGET has incurred, or reasonably expects to incur, outage change costs totalling £146,738.
- III. NGET therefore proposes that the allowed income adjustment (ION_t) should be - £1,046,602.
- IV. Further information from NGET on the issues that have contributed to the underutilisation of the full outage change allowance is detailed in Appendix 2 of this Determination.

The Authority's determination

In accordance with the provisions of Special Condition AA5A of NGET's transmission licence, the Authority is required to determine whether:

- (i) any or all of the costs and/or expenses given in the notice pursuant to paragraph 23(a) were caused or saved by an outage cost adjusting event;
- (ii) the event or circumstance has increased or decreased the licensee's relevant costs in making outage changes such that they will be either less than or in excess of ON_t in each case by more than the outage threshold amount; and
- (iii) if so, that the amount of the proposed income adjustment ensures that the financial position and performance of the licensee are, insofar as is reasonably

⁴ The transmission licence can be found at the following link: http://epr.ofgem.gov.uk/document_fetch.php?documentid=15103, and the relevant sections are repeated in Appendix 2.

⁵ Please note the licence does not specify whether the materiality threshold of £300,000 is in nominal or 2004/05 prices. However, in either event the threshold has been exceeded.

practicable, the same as if that outage cost adjusting event had not taken place, and if not, what allowed income adjustment would secure that effect.

In accordance with the provisions of the transmission licence, the Authority takes the view that all relevant criteria set out in the licence have been met. We agree that costs have been saved in relation to an outage cost adjusting event, and that this saving exceeds the threshold amount. For the reasons set out in this document, and in accordance with paragraph 24 of Special Condition AA5A, the Authority determines that the allowed income adjustment (ION_t) for relevant year t , 2009/10, should be -£1,046,602 (nominal prices), equivalent to -£877,036 in 2004/05 prices.

Future development

We are satisfied that NGET's outage cost adjusting event notice meets all the requirements of the transmission licence. However, we consider that there is a wider issue associated with the effectiveness of the outage change allowance mechanism, and consider that after successive years of significant under-spend, it should be reviewed. We continue to believe that there is significant merit in the TOs and the NETSO working closely in a coordinated manner to achieve savings in the costs of operating the transmission system, particularly in reducing constraint costs. Ofgem therefore intends to consider the outage change allowance mechanism more fully in a separate process in due course.

If you have any queries in relation to the issues raised in this letter, please feel free to contact David Hunt on 020 7901 7429 or via email at david.hunt@ofgem.gov.uk.

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For and on behalf of the Authority

Appendix 1 - Notice of proposed outage cost adjusting event

22. (a) An outage cost adjusting event in relevant year t may arise from either of the following:

(i) where the actual costs incurred by the licensee in making outage changes are, or where the licensee's reasonable expectation of the actual costs in making outage changes will be either less than or in excess of ON_t in each case by more than £300,000 (the "outage threshold amount) or such other figure as the Authority has specified for the relevant year where ON_t has the value ascribed to it in paragraph 14 above; and

(ii) an event or circumstance other than listed above which is, in the opinion of the Authority, an outage cost adjusting event and is approved by it as such in accordance with paragraph 24 of this licence condition.

23. Notice of proposed outage cost adjusting event

(a) Where the licensee considers, and can provide supporting evidence that, in respect of relevant year t , there have been costs and/or expenses that have been incurred or saved by an outage cost adjusting event, then the licensee shall give notice of this event to the Authority.

(b) A notice provided to the Authority under paragraph 23(a) shall give particulars of:

(i) the event to which the notice relates and the reason(s) why the licensee considers this event to be an outage cost adjusting event;

(ii) the amount of any change in costs and/or expenses that can be demonstrated by the licensee to have been caused or saved by the event and how the amount of these costs and/or expenses has been calculated;

(iii) the amount of any allowed income adjustment proposed as a consequence of that event and how this allowed income adjustment has been calculated; and (iv) any other analysis or information which the licensee considers to be sufficient to enable the Authority and the relevant parties referred to in subparagraph 24(a) to fully assess the event to which the notice relates.

(c) If the Authority considers that the analysis or information provided in sub paragraphs 23(b)(i) to 23(b)(iv) above is insufficient to enable both the Authority and the relevant parties referred to in subparagraph 24(a) to assess whether an outage cost adjusting event has occurred and/or the amount of any allowed income adjustment that should be approved, the Authority can request that the supporting evidence be supplemented with additional information that it considers appropriate.

(d) A notice of an outage cost adjusting event shall be given as soon as is reasonably practicable after the occurrence of the outage cost adjusting event, and, in any event, not later than three months after the end of the relevant year in which it occurs.

(e) The Authority will make public, excluding any confidential information, any notice of an outage cost adjusting event following its receipt.

(f) Any notice submitted to the Authority under either paragraph 23(a) above should clearly identify whether any of the information contained in the notice is of a

confidential nature. The Authority shall make the final determination as to confidentiality having regard to:

- (i) the need to exclude from disclosure, so far as is reasonably practicable, information whose disclosure the Authority considers would or might seriously prejudicially affect the interests of a person to which it relates; and
- (ii) the extent to which the disclosure of the information mentioned in subparagraph 23(f)(i) is necessary for the purposes of enabling the relevant parties to fully assess the event to which the notice relates.

24. The Authority's determination

(a) The Authority shall determine (after consultation with the licensee and such other persons as it considers desirable):

- (i) whether any or all of the costs and/or expenses given in a notice pursuant to paragraph 23(a) were caused or saved by an outage cost adjusting event;
- (ii) whether the event or circumstance has increased or decreased the licensee's relevant costs in making outage changes such that they will be either less than or in excess of ON_t in each case by more than the outage threshold amount; and
- (iii) if so, whether the amount of the proposed income adjustment ensures that the financial position and performance of the licensee are, insofar as is reasonably practicable, the same as if that outage cost adjusting event had not taken place, and if not, what allowed income adjustment would secure that effect.

(b) In relation to the relevant year t , the allowed income adjustment ($IONT_t$) shall be:

- (i) the value determined by the Authority under paragraph 24(a) above; or
- (ii) if the Authority has not made a determination under paragraph 24(a) above within three months of the date on which notice of an outage cost adjusting event was provided to the Authority, the amount of the allowed income adjustment proposed as a consequence of the event in the notice given to the Authority under subparagraph 23(b)(iii); or
- (iii) in all other cases zero, including situations where the Authority has not made a determination under paragraph 24(a) above within three months of the date on which notice of an outage cost adjusting event was provided to the Authority and the Authority has, before the end of that three month period, informed the licensee that the Authority considers that the analysis or information provided in accordance with paragraphs 23(b) and/or 23(c) is insufficient to enable the Authority to assess whether an outage cost adjusting event has occurred and/or the amount of any allowed income adjustment.

(c) The Authority's decision in relation to any notice given under paragraph 23(a) shall be in writing, shall be copied to the licensee and shall be in the public domain.

(d) The Authority may revoke an approval of an outage cost adjusting event and allowed income adjustment with the consent of the licensee, following consultation

with the licensee and relevant parties. Revocation of any outage cost adjusting event and allowed income adjustment shall be in writing, shall be copied to the licensee and shall be in the public domain.

Appendix 2 - Briefing note by NGET for Ofgem on outage change costs for the period 2005-06 to 2009-10

1. Licence Obligation

Special Condition AA5A of NGET's licence provides an annual allowance of £1m⁶ for costs incurred for payments to the Scottish Transmission Owners (Scottish TOs) for the movement of outages. Part 2(iv), paragraph 23, states that, where actual costs vary from this figure by more than the materiality threshold of £300,000 (the outage threshold amount), then the licensee should submit an outage cost adjusting event notice to the Authority within three months of scheme end. The allowance has been in place since 2005.

2. Historical Outage Change Costs

Table 1 provides a summary of the historical outage change costs for the period 2005-06 to 2009-10.

Table 1 – annual outage change costs by TO

Year	Annual Outage Change Costs		
	SP	SSE	Total
2005-06	£274,069	£245,770	£519,839
2006-07	£229,662	£167,935	£397,597
2007-08	£342,598	£295,842	£638,440
2008-09	£270,912	£31,390	£302,302
2009-10	£107,076	£39,662	£146,738

The table shows that, in each year, the actual costs have varied from the allowance by more than £300,000. Consequently, National Grid has provided notice of outage cost adjusting event to the Authority.

3. Possible reasons for under-utilisation of allowance

National Grid considers that a range of factors may have contributed to the underutilisation of the allowance, including the following:

1. The base outage plan to which the outage change requests apply is a one year 'Final Outage Plan' agreed at calendar week 49 for the following financial year. This 'within year' timescale for requesting changes to the Final Outage Plan does not always allow all outage changes requested by National Grid to be agreed and implemented by the Scottish Transmission Owners (TOs) because there is insufficient time from the request to allow optimal re-scheduling of the outages within the plan year. For example, National Grid may identify an opportunity where starting an outage a week earlier would reduce constraint costs but the Scottish TO is unable to accommodate the requested change because of lack of availability of skilled resource and/or equipment at short notice.
2. Whilst noting point 1 above, a key driver for requesting changes to the transmission outages is the short term changes to generator outages, i.e. a transmission outage will often be aligned to a generator outage in order to reduce constraint costs; when the generator moves their outage, it will often be desirable to also move the transmission outage.

⁶ The allowance of £1m is based on 2004/05 prices and is adjusted using the RPI index which is defined in paragraph 15A of Part 2(ii) of Special Condition AA5A.

3. All transmission companies have to take circuit outages on their system to allow them to undertake construction and maintenance activities in an efficient and economic manner. The Transmission Owners are incentivised to invest at lowest cost which may reduce opportunities for flexibility to be built into construction contracts (e.g. weekend working) to reduce outage costs.
4. A high level of construction activity is currently taking place to reinforce the transmission systems. The tight schedule for delivering the construction programme may be restricting the movement of outages.

As part of a wider (informal) industry consultation on **Potential Enhanced Electricity Transmission Owner (TO) Incentives**⁷, National Grid discussed the outage change allowance, and put forward a number of potential options for improving existing arrangements, including:

- Extending the outage plan to two years, allowing more time for outage optimisation;
- Enhancing outage coordination through greater collaboration (e.g. starting outage planning discussions at an earlier stage);
- Incentivising Scottish TOs' outage change activities

Further details of the above options can be found in the original consultation.

The work in the outage planning area is ongoing and National Grid has provided further updates to the industry via the following:

- National Grid Transmission System Operator (SO) Incentives for 1 April 2010⁸;
- Potential Enhanced Electricity Transmission Owner (TO) Incentives: Follow-Up Note⁹

National Grid is currently working with the Scottish TOs to further develop some of the options outlined above; two key areas of development focussing on minimising the overall outage costs are:

- Outage planning process: Consideration of improving the ability to work together in order to optimise the outages, and extending the current one year outage plan to two years;
- Investment planning process: Consideration of improving the ability to work together to deliver investment schemes, including earlier involvement of System Operator in the process.

National Grid has also set up an industry working group (Commercial Balancing Services Group) to discuss transparency of constraint-related information, including outage data and areas of likely constraints. This may reduce instances of generators moving their outages thus reducing the likelihood of constraints. The above work is likely to lead to changes to the various Codes and these changes will be raised in accordance with the relevant governance processes.

⁷ Consultation issued on 18 September 2009 and can be found at:
<http://www.nationalgrid.com/NR/rdonlyres/FB4A9925-15AB-462A-B516-33543A44B460/37082/PotentialEnhancedElectricityTransmissionOwnerIncen.pdf>

⁸ Consultation issued on 5 November 2009 and can be found at:
<http://www.nationalgrid.com/NR/rdonlyres/519DEB34-5CCE-40D6-9980-9DE23A41E666/38228/ElectricitySOIncentivesInitialProposalsConsultatio.pdf>

⁹ This note was issued on 7 May 2010 can be found at:
http://www.nationalgrid.com/NR/rdonlyres/33E9E2A1-2C2F-4E31-9704-C23987EB34F4/41079/SO_TO_Web_Summary_Issue1.pdf