

System operators, transmission
system owners, generators,
suppliers, traders, consumers,
aggregators and other interested
parties

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Date: 19 June 2015

Dear Colleagues

Decision to modify Special Conditions 4C, 4D, 4E, 4F, 4G, 4H and 4J of National Grid Electricity Transmission plc's electricity transmission licence to introduce the System Operator (SO) incentive scheme for the period 2015-17.

This letter sets out the Authority's decision to modify the special conditions shown above of National Grid Electricity Transmission plc's (NGET) electricity transmission licence. These changes are to introduce the SO incentive scheme for 2015-17.

Background to the licence modification

NGET is responsible for balancing the electricity system on a continuous basis. The costs that NGET incurs in carrying out this role are passed through to users of the system via Balancing Services Use of System (BSUoS) charges. We regulate the actions of the SO to ensure its operational costs are optimised, delivering value for money to the consumer. Building on statutory obligations which require the SO to act in an economic, efficient and co-ordinated manner, we have historically driven the performance of the SO and shaped aspects of its behaviour through incentives.

The previous electricity SO incentive scheme expired on 31 March 2015. We have consulted on introducing a new two year incentive scheme based on the existing incentives, updating and developing the scheme for the period from 1 April 2015 to 31 March 2017.¹

Summary of responses and our views

We received three responses to our final proposals. Those who responded were NGET, SSE and Haven Power. All responses were non confidential and are published alongside the final proposals consultation on our website.

Respondents broadly supported our proposed licence modifications. They commented on improving the clarity of the licence as well as certain incentive targets with respect to:

- SO Methodologies
- Black Start incentive
- Calculation of forecast error under the wind generation forecasting incentive
- Future incentive schemes

¹Our final proposals and statutory consultation on proposed licence changes to implement the SO incentive schemes for 2015-17 can be found at: <https://www.ofgem.gov.uk/publications-and-updates/electricity-system-operator-incentives-2015-17-final-proposals>

SO methodologies²

NGET asked for amendments to Special Condition 4C.36. This licence condition establishes the mechanism for NGET to submit revisions for the second incentive scheme year (2016-17) of the methodologies underpinning the incentive schemes to the Authority for approval. NGET's proposed amendments sought to clarify the dates for the submission and approval of proposed revisions of the methodology. In its view, this would increase clarity in the licence.

We agree with NGET's comments that the proposed change would increase the clarity in the licence. As such, we have decided to amend the relevant special condition accordingly.

Black Start³

NGET sought clarification about whether the mid-scheme update feature (Special Condition 4G.3) would also allow for an adjustment to the Black Start target for 2015-16.

Similarly to the 2013-15 scheme, we proposed including an option for a mid-scheme update to the black start target. Under this option, NGET can apply for the 2016-17 target to be adjusted to take into account capital contributions, warming costs and/or provider availability (costs that are more volatile and difficult to predict). We also proposed to extend this to current service providers, in the previous scheme it is restricted to new service providers. Our proposals did not include the possibility for NGET to apply for a retrospective adjustment to the 2015-16 target as at present the proposed target reflects what we deem to currently be appropriate.

Haven Power expressed its support for extending the mid-scheme update to include current service providers. However it expressed its concern that maintaining⁴ a stable black start target in the midst of a changing generation and system mix would force NGET to optimise for costs and not for system security.

NGET is already required outside of the incentive schemes to ensure that the system can be re-energised in the event of a total or partial shut-down. Our incentives build on this to encourage NGET to achieve this level of security at the lowest possible cost to consumers. We are confident that our proposed target will not lead to a deterioration in system security, but rather ensure that NGET procures the most efficient bundle of services.

We have therefore decided not to make this change to the licence drafting for Special Condition 4G.3 as set out in our notice of 19 March 2015.

Wind generation forecast incentive⁵

NGET proposed the exclusion of Balancing Mechanism Units (BMU) trades from the calculation of forecast error under the wind generation forecasting incentive. It argued that wind generation forecasts should reflect the expected output from wind generation unaffected by transmission system constraints and as such BMU trades should not be included in the forecast error.

We believe that although this addition may have the potential to provide value to consumers, it is a significant change to the incentive scheme and its potential benefits and

² The SO methodologies establish how the targets for the Balancing Services Incentive Scheme (BSIS) is calculated. These methodologies are approved by the Authority and have to be published by NGET.

³ NGET is incentivised to reduce the costs it incurs to be ready to respond in the event that there is a need to re-energise part or the whole transmission system, a process known as Black Start.

⁴ The target for the 2015-17 incentive scheme has been raised to £22.35m (£21.05m target in the previous incentive period). NGET has the opportunity to apply for a mid-scheme update to the target for the 2016-17 year.

⁵ NGET is incentivised to provide an accurate day ahead forecast of wind generation, it is financially rewarded/penalised for a forecast error falling inside/outside target. This incentive aims to encourage more accurate forecasts which allow for better informed decision making by stakeholders.

drawbacks must be further considered. We believe it is appropriate to consider this further as part of the 2017 incentive scheme review.

We have therefore decided not make this change to the licence drafting for Special Condition 4H.2 set out in our notice of 19 March 2015 for the period 2015–17 but we will consider it as part of the incentive review ahead of 2017.

Future incentive scheme

Two respondents (SSE and Haven Power) expressed views on the future development of the incentive schemes.

SSE highlighted its view of the importance of commencing work on future incentives in advance of the 2017 review, in particular, encouraging NGET to take a more proactive and longer term approach to efficient system operation.

Haven Power expressed that it would like further incentivisation of annual average BSUoS cost forecasts and believes that going forward, industry should work towards the introduction of fixed-price system balancing costs together with advance notice of future cost levels. Haven Power also expressed the view that predicting wind generation is part of BSUoS forecasting and feels it should not be incentivised independently.

We will consider these views going forward into the incentive review ahead of 2017.

Housekeeping

No further changes have been made to the drafting of our proposed licence modifications set out in our final proposals and statutory consultation document. However, please note that, unlike the version of the drafting published in our statutory consultation, we have tracked all changes to reflect the drafting that has been deleted or moved.

Our decision

Having carefully considered the responses to our statutory consultation, we have decided to proceed with the modifications to Special Conditions 4C, 4D, 4E, 4F, 4G, 4H and 4J of NGET's licence that are set out in the statutory decision notice referred to below. These modifications to the licence will take effect on 14 August 2015 and will apply to the period from 1 April 2015.

A statutory decision notice modifying NGET's licence has today been issued to NGET. The statutory decision notice has also been published on our website.⁶

Next steps

The licence modification will take effect on 14 August 2015.

If you have any questions regarding the content of this letter, please contact Leonardo Costa on 0203 263 2764 or by email soincentive@ofgem.gov.uk.

Yours faithfully

Mark Copley
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⁶ The direction letter can be found at <https://www.ofgem.gov.uk/publications-and-updates/decision-electricity-system-operator-incentives-2015-17>