

To: National Grid Electricity Transmission plc

**Electricity Act 1989
Section 11A(2)**

**Notice of statutory consultation on a proposal to modify special condition 7D of
the electricity transmission licence held by National Grid Electricity
Transmission plc**

1. The Gas and Electricity Markets Authority ('the Authority')¹ proposes to modify special condition 7D (Arrangements For The Recovery Of SO Uncertain Costs) ('the Condition') of the electricity transmission licence held by National Grid Electricity Transmission plc (NGET) granted or treated as granted under section 6(1)(b) of the Electricity Act 1989 by amending the Condition in the manner set out in the Annex to this Notice.
2. The modification introduces an additional application window relating to uncertain costs. We are proposing this modification to ensure mechanisms in relation to the recovery of uncertain costs are in place for NGET in its role as the Electricity Market Reform (EMR) Delivery Body from 1 April 2016 to 31 March 2021.
3. The effect of the proposed modification is to allow NGET or the Authority to propose an adjustment to NGET's allowed revenue in relation to EMR uncertain costs that cannot accurately be determined at this time. Further detail on the effect of the proposed modification is set out in our 17 September 2015 decision entitled 'Decision on revenue, outputs and incentives for National Grid Electricity Transmission plc's roles in Electricity Market Reform'.
4. A copy of the proposed modification and other documents referred to in this Notice have been published on our website (www.ofgem.gov.uk). Alternatively they are available from our Research and Information Centre, 9 Millbank, London, SW1P 3GE (020 7901 7003).
5. Any representations with respect to the proposed licence modification must be made on or before 15 October 2015 to: Phillip Heyden, Office of Gas and Electricity Markets, 9 Millbank, London, SW1P 3GE or by email to phillip.heyden@ofgem.gov.uk.
6. We normally publish all responses on our website. However, if you do not wish your response to be made public then please clearly mark it as not for publication. We prefer to receive responses in an electronic form so they can be placed easily on our website.
7. If we decide to make the proposed modification it will take effect on 1 April 2016.

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**Adam Cooper, Duly authorised on behalf of the
Gas and Electricity Markets Authority**

17 September 2015

¹ The terms "the Authority", "we" and "us" are used interchangeably in this document.

Special Condition 7D. Arrangements for the recovery of SO uncertain costs

Introduction

7D.1 The purpose of this condition is as follows:

- (a) to allow the licensee or the Authority to propose, and the Authority to determine, adjustments to the licensee's levels of Allowed Expenditure (“relevant adjustments”) in relation to the categories set out in paragraph 7D.3 of this condition (-each “uncertain cost category”); and
- (b) to determine any appropriate revisions to PCFM Variable Values necessary to implement relevant adjustments and to determine the Relevant Years to which those revised PCFM Variable Values relate for use in the Annual Iteration Process for the ET1 Price Control Financial Model, as described in Special Condition 5B (Annual Iteration Process for the ET1 Price Control Financial Model).

7D.2 The application of the mechanisms set out in this condition ensures that, as a consequence of the Annual Iteration Process, the value of the term $SOMOD_t$ as calculated for Relevant Year t for the purposes of Part B of Special Condition 4A (Restriction of System Operator Internal Revenue) will result in an appropriate adjustment to the licensee’s Maximum SO Internal Revenue -in a manner that takes account of Allowed Expenditure levels in relation to the uncertain cost categories specified in paragraph 7D.3 of this condition, determined under Part A of this condition for the purposes of the Totex Incentive Mechanism Adjustment, in accordance with the methodology set out in chapters 6 and 7 of the ET1 Price Control Financial Handbook.

7D.3 The uncertain cost categories referred to in paragraph 7D.1 of this condition are:

- (a) Enhanced Security Costs; and
- (b) Electricity Market Reform Enduring Solution.

7D.4 This condition should be read and construed in conjunction with Special Condition 5A (Governance of ET1 Price Control Financial Instruments) and Special Condition 5B.

Part A: Proposal and determination of relevant adjustments

7D.5 This Part provides for:

- (a) the proposal of relevant adjustments by the licensee or by the Authority;
- (b) the determination of relevant adjustments by the Authority; and
- (c) the deeming of relevant adjustments in certain circumstances.

Proposal of relevant adjustments

7D.6 Subject to paragraph 7D.9 and 7D.10 of this condition, the licensee may by notice to the Authority, and the Authority may by notice to the licensee, propose a relevant adjustment in relation to any uncertain cost category for any Relevant Year or Relevant

Years from 2013/14 to 2020/21, provided that the proposed change to Allowed Expenditure:

- (a) is based on information about actual or forecast levels of efficient expenditure requirements, for an uncertain cost category that was not available when the licensee's SO Opening Base Revenue Allowance was derived;
- (b) takes account of any relevant adjustments previously determined under this condition;
- (c) except where the proposed change is in relation to paragraph 7D.10(a) of this condition~~Electricity Market Reform Enduring Solution~~, in aggregate constitutes a material amount within the meaning of paragraph 7D.7 of this condition;
- (d) relates to costs incurred or expected to be incurred after 1 April 2013; and
- (e) constitutes an adjustment to Allowed Expenditure which cannot be made under the provisions of any other Special Condition of this licence.

7D.7 A material amount is an amount of change to Allowed Expenditure which, when multiplied by the licensee's Totex Incentive Strength Rate set out in Appendix 1 of this condition, exceeds or is likely to exceed one per cent of the licensee's materiality threshold amount as set out in Appendix 2 of this condition.

7D.8 A proposal made under paragraph 7D.6 of this condition must include statements setting out:

- (a) the uncertain cost category to which the proposal relates;
- (b) the changes to the licensee's Allowed Expenditure levels that are proposed and the Relevant Years to which those changes relate; and
- (c) the basis of calculation for the changes to the licensee's Allowed Expenditure levels referred to in sub-paragraph (b) of this paragraph.

Application windows for relevant adjustment proposals

7D.9 In relation to relevant adjustment proposals that are not proposals on Electricity Market Reform Enduring Solution, the licensee and the Authority may only propose relevant adjustments during the following application windows:

- (a) the first application window which opens on 1 May 2015 and closes on 31 May 2015; and
- (b) the second application window which opens on 1 May 2018 and closes on 31 May 2018.

7D.10 In relation to relevant adjustment proposals on Electricity Market Reform Enduring Solution, ~~and subject to paragraph 7D.12 of this condition,~~ the licensee or the Authority may only propose relevant adjustments during the following application windows:

- (a) the first application window which opens on 1 August 2014 and closes on 12 January 2015; and
- ~~(b)~~ (b) the second application window which opens on 1 May 2019 and closes on 31 May 2019. The only relevant adjustments that may be proposed in this window

are those in relation to implementing major scope changes to the Electricity Market Reform Enduring Solution.

7D.11 Relevant adjustments relating to any uncertain cost category may be proposed during any applicable application window provided that each such relevant adjustment proposal complies with the provisions of paragraphs 7D.6 to 7D.8 of this condition, to the extent that those paragraphs apply.

~~7D.12 Except as provided for in this paragraph, relevant adjustment proposals made outside the application windows set out in paragraph 7D.9 and 7D.10 of this condition will not be determined by the Authority under the provisions of this condition. If no relevant adjustment proposal on Electricity Market Reform Enduring Solution is made within the application window set out in paragraph 7D.10 of this condition, a proposal for relevant adjustments on Electricity Market Reform Enduring Solution may be made outside that application window and may be determined by the Authority under the provisions of this condition.~~

Authority's power to determine relevant adjustments

~~7D.13~~7D.12 Where a proposal has been duly made under paragraph 7D.6 of this condition, the Authority may determine any relevant adjustments that are to be made to the licensee's Allowed Expenditure levels and the Relevant Years to which those changes relate, in such manner as it considers appropriate:

- (a) in the case of a proposal on Electricity Market Reform Enduring Solution, made during the first application window under paragraph 7D.10(a) of this condition, by 31 October 2015 (or as soon as reasonably practicable thereafter); and
- (b) in the case of any other proposal, within four months after the close of the relevant application window.

~~7D.14~~7D.13 In determining any relevant adjustment under paragraph 7D.~~12~~13 of this condition, the Authority will:

- (a) consult with the licensee and other interested parties;
- (b) have particular regard to the purposes of this condition; and
- (c) take no account of the general financial performance of the licensee under the price control arrangements set out in the Special Conditions of this licence.

~~7D.15~~7D.14 A determination under paragraph 7D.~~12~~13 of this condition may confirm, reject, or vary the proposed relevant adjustment.

~~7D.16~~7D.15 Without limiting the general effect of paragraph 7D.~~14~~15 of this condition, a determination by the Authority of a relevant adjustment may specify changes to Allowed Expenditure levels for the licensee in relation to an uncertain cost category for any Relevant Year from 2013/14 to 2020/21.

~~7D.17~~7D.16 The Authority will notify the licensee of any determination made under paragraph 7D.~~12~~13 of this condition within 14 days of making the determination concerned.

~~7D.18~~7D.17 Except in relation to a proposal made under paragraph 7D.10(a) on Electricity Market Reform Enduring Solution, if the Authority has not determined a relevant adjustment in relation to a proposal duly made by the licensee under paragraph 7D.6 of this condition within four months after the close of the relevant application window, and

the proposal has not been withdrawn, then the relevant adjustment, insofar as it relates to changes to Allowed Expenditure levels for the licensee for Relevant Years specified in the proposal, will be deemed to have been made.

Provisional allowance for Electricity Market Reform Enduring Solution for 2014/15 and 2015/16

~~7D.19~~7D.18 Without limiting the general effect of paragraphs 7D.~~14~~15 and 7D.~~15~~16 of this condition, relevant adjustments to the licensee's levels of Allowed Expenditure in relation to Electricity Market Reform Enduring Solution for the Relevant Years 2014/15 and 2015/16 are set out in Appendix 3 of this Condition.

Part B: Determination of revisions to PCFM Variable Values

~~7D.20~~7D.19 This Part provides for the determination and direction of revised PCFM Variable Values by the Authority for:

- (a) Enhanced Security Costs (SOIAEEPS values); and
- (b) Electricity Market Reform Enduring Solution (SOEMRES values).

~~7D.21~~7D.20 The Authority will determine whether any PCFM Variable Values should be revised for the purposes of implementing any relevant adjustments determined or deemed to have been made under the provisions of Part A of this condition.

~~7D.22~~7D.21 Determinations under paragraph 7D.~~20~~21 of this condition are to be made in accordance with the methodology contained in chapter 7 of the ET1 Price Control Financial Handbook.

~~7D.23~~7D.22 Where the Authority directs any revised PCFM Variable Values for Relevant Years earlier than Relevant Year t , the effect of using those revised values in the Annual Iteration Process for the ET1 Price Control Financial Model will, subject to a Time Value of Money Adjustment, be reflected in the calculation of the term $SOMOD_t$ for Relevant Year t and, for the avoidance of doubt, no previously directed value of the term $SOMOD_t$ will be retrospectively affected.

Part C: Procedure to be followed for the direction of revised PCFM Variable Values relating to the recovery of uncertain costs

~~7D.24~~7D.23 Subject to paragraph 7D.27 of this condition, revised PCFM Variable Values determined by the Authority in accordance with the provisions of Part B of this condition will be directed by the Authority by:

- (a) in the case of SOEMRES values:
 - (i) 30 November 2014 (or as soon as is reasonably practicable thereafter), in respect of the relevant adjustment set out in paragraph 7D.~~18~~19 of this condition; ~~and~~
 - (ii) 30 November 2015 (or as soon as is reasonably practicable thereafter), following the application window set out in paragraph 7D.10(a) of this condition; ~~and~~-
 - (iii) 30 November 2019 (or as soon as is reasonably practicable thereafter), following the application window set out in paragraph 7D.10(b) of this condition.
- (b) in the case of any of any other PCFM Variable Values:

- (i) 30 November 2015 (or as soon as is reasonably practicable thereafter), following the first application window set out in paragraph 7D.9(a) of this condition; and
- (ii) 30 November 2018 (or as soon as is reasonably practicable thereafter), following the second application window set out in paragraph 7D.9(b) of this condition.

~~7D.25~~7D.24 Before issuing any directions under paragraph 7D.~~23~~24 of this condition, the Authority will give notice to the licensee of all of the revised values that it proposes to direct.

~~7D.26~~7D.25 The notice referred to in paragraph 7D.~~24~~25 of this condition will:

- (a) state that any revised PCFM Variable Values have been determined in accordance with Part B of this condition; and
- (b) specify the period (which must not be less than 14 days from the date of the notice) within which the licensee may make any representations concerning the determination of any revised PCFM Variable Values.

~~7D.27~~7D.26 The Authority will determine the revised PCFM Variable Values having due regard to any representations duly received under paragraph 7D.~~25~~26 of this condition, and give reasons for its decisions in relation to them.

~~7D.28~~7D.27 If, for any reason, the Authority does not make a direction required under paragraph 7D.~~23~~24 of this condition by the date specified in that paragraph, the Authority will direct the values concerned as soon as is reasonably practicable thereafter, consistent with the purpose of paragraphs 5B.11 to 5B.13 of Special Condition 5B and, in any case, before directing a value for SOMOD_t under paragraph 5B.12 of that condition.

Part D:- Interpretation

~~7D.29~~7D.28 Expressions used in this condition and defined in Special Condition 1A (Definitions and interpretation) are to be read and given effect subject to any further clarification set out in the relevant Regulatory Instructions and Guidance issued by the Authority under Special Condition B15 (Regulatory Instructions and Guidance).

APPENDIX 1:- TOTEX INCENTIVE STRENGTH RATE

(see paragraph 7D.7 of this condition)

Licensee	Totex Incentive Strength Rate (%)
National Grid Electricity Transmission plc	46.89

APPENDIX 2:- MATERIALITY THRESHOLD AMOUNT

(see paragraph 7D.7 of this condition)

Licensee	£m
National Grid Electricity Transmission plc	120.517

APPENDIX 3: PROVISIONAL ALLOWANCE FOR ELECTRICITY MARKET REFORM ENDURING SOLUTION FOR 2014/15 AND 2015/16

(see paragraph 7D.1849 of this condition)

Licensee	£m (2009/10 prices)	
	2014/15 (8 months)	2015/16 (12 months)
National Grid Electricity Transmission plc	1.72	2.57