

Steven Becker/Shashi van de Graaff
SO Regulation
Ofgem
9 Millbank
London
SW1P 3GE

26 January 2018

Dear Steven and Shashi,

Future Arrangements for the Electricity System Operator: Informal Consultation on ESO Licence Drafting

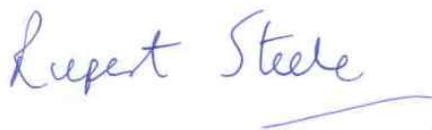
Thank you for the opportunity to respond to this consultation. Our responses to the consultation questions are in Annex 1 to this letter.

We are supportive of the proposals to achieve greater separation of the electricity system operator (ESO) from NGET's transmission Owner (TO) and other businesses within the National Grid (NG) Group.

We agree that given the range of ESO functions, including administering the Capacity Mechanism, undertaking the Network Options Assessment (NOA), there is significant potential for conflicts of interest concerning other NG businesses such as interconnectors and onshore transmission. These conflicts of interest are significantly more acute than those facing other network licensees, and the more stringent separation requirements on the ESO, compared to the unbundling and ring-fencing requirements on other network licensees, are therefore a proportionate response.

Should you have any questions in relation to this response, please do not hesitate to contact me.

Yours sincerely,



Rupert Steele
Director of Regulation

**FUTURE ARRANGEMENTS FOR THE ELECTRICITY SYSTEM OPERATOR:
INFORMAL CONSULTATION ON ESO LICENCE DRAFTING**

SCOTTISHPOWER RESPONSE

General Questions

1. Do you agree that the licence changes we are proposing are sufficient for ensuring effective separation between the ESO and all other National Grid Group transmission and competitive businesses?

In so far as we can determine, the proposed licence modifications appear to implement the policy intent set out in August 2017. We are broadly content that the proposed elements of the separation of the ESO within National Grid (NG) are sufficient to mitigate the potential conflicts of interest the ESO may encounter in undertaking its current set of licensed activities.

2. Do you agree with the Guiding Principles that we have set out? Are there any further principles that we should consider?

We support the guiding principles Ofgem has identified, namely: implementing the minimum changes required to give effect to Ofgem's proposals regarding ESO separation, no re-opening of the RIIO-T1 settlement, and (in general) aligning NGET TO's licence with the Scottish TOs. These principles should not prevent Ofgem from allowing the NGET TO licence to diverge from the Scottish TO licences if this is required to ensure that the separation of the ESO within the NG Group is fully effective.

Standard Licence Conditions

3. Do you think that our proposals for Independent Directors will provide sufficient separation?

We agree that the requirement for the board of the ESO to have three sufficiently independent directors (SIDs) alongside four NG directors (including the CEO) should lead to a balanced board and facilitate sufficient separation and independence of the ESO within NG.

We consider the current ring-fencing obligations are effective in respect of other network licensees, and there would be no rationale for requiring other network licensees to have more than two SIDs. As set out in the covering letter, we believe the potential conflicts of interest confronting the ESO within NG are more acute than for other network licensees.

Special Licence Conditions

4. Do you think that the ESO should have a licence condition which restricts the activities it can undertake? If so, what activities should be restricted?

We think inclusion of some form of Special Condition 2A in the ESO licence would be a helpful enhancement to the separation proposals, for example by specifying a restriction on TO/OFTO activities.

5. Do you think allowing NGET to acquire OFTO business is beyond the scope of the separation project and therefore should not be considered at this stage?

Yes, we agree that changes in respect of NGET TO's ownership of OFTOs should not be considered at this stage. They would not meet the principle of 'no housekeeping changes' as set out in paragraph 1.3, which precludes licence modifications that implement policy changes that go beyond the minimum required to effect the ESO separation. We would welcome a separate more holistic consultation on OFTO ownership by NGET and other transmission licensees, including Ofgem's interpretation of EU unbundling requirements and OFTO ownership.

6. Do you think a modified version of Special Conditions 2B and 2H are necessary for NGET?

To the extent that information ring-fencing with respect to connection offers will be included in Special Condition 2O of the ESO licence, it is not essential for Special Conditions 2B and 2H to be retained in their current form in NGET TO's licence (ie in relation to connection offers).

That said, we agree with Ofgem's proposal to align NGET TO's Special Conditions 2B and 2H with the Scottish TOs. Whilst we recognise that the Scottish TO obligations are driven by different business separation requirements, we agree with Ofgem that the Scottish TO information ring-fencing and compliance officer obligations would be of benefit with respect to the conduct of the NGET TO. And given that this would require relatively small changes to NGET TO's current obligations, these proposals should not be disproportionate.

7. Do you think that Special Condition 2C should apply to NGET in its current form?

Yes, as noted in our response to Question 5, we agree changes to allow NGET TO to own OFTOs do not meet the principle of 'no housekeeping changes' and are therefore beyond the scope of ESO separation. Accordingly Special Condition 2C should remain in its present form for the ESO and NGET TO. As noted above, we would support a holistic consultation on TO licensee ownership of OFTOs, and Special Condition 2C could be reviewed in light of such consultations. We cannot conceive of any circumstances in which it would be appropriate for the ESO to be allowed to own an OFTO and no doubt this can be confirmed in any future consultation on OFTO ownership.

8. Do you think that allowing NGET to acquire OFTO business is beyond the scope of the separation project?

Yes, see our responses to Questions 5 and 7.

9. Do you think Special Condition 2I should apply to NGET and/or the ESO?

We agree with Ofgem that applying Special Condition 2I to the ESO, thereby requiring the independence of its management and operations, would enhance the ESO separation proposals. It is our view that application of Condition 2I to the ESO should

not require an increase in NG's submitted forecast of the costs of implementing ESO separation. We agree that there is presently little rationale to have similar obligations on NGET's TO business.

10. Do you think an amended version of Special Condition 2O, as described in this document, will provide sufficient safeguards regarding the separation of the ESO from other National Grid Group plc companies?

Yes, the proposed changes to the ESO's Special Condition 2O would implement all the elements of Ofgem's proposals regarding ESO separation. We would welcome the opportunity to review drafting of proposed modifications to Special Condition 2O in future consultations.

11. Do you think an amended version of Special Condition 2O for NGET is required for business separation requirements and compliance obligations?

Yes, we agree that retaining an amended version of Special Condition 2O in NGET's TO licence would enhance the separation of the ESO. If, as proposed, Special Conditions 2B and 2H of NGET's TO licence are aligned with the Scottish TOs, the information ring-fencing requirements within Special Condition 2O for NGET TO can be removed or switched off.

12. Do you think that Special Condition 3D should be included in NGET's licence only?

We agree with Ofgem that Special Condition 3D regarding the stakeholder satisfaction incentive should only be retained in NGET's TO licence. We note that in Ofgem's parallel consultation on the ESO incentives from 2018, stakeholder engagement is a prominent feature of the proposed "balanced scorecard" performance incentive and its associated remuneration, and there is therefore no requirement for an additional stakeholder satisfaction incentive for the ESO.

13. Do you agree with our proposal to keep Special Condition 3F in NGET licence only? This includes updating the EDR guidance so that the reward is calculated solely on TO activities.

Yes, we agree that as presently constructed, the environmental discretionary reward is primarily driven by TO activities and therefore removal of the reference to SO activities and retention of Condition 3F solely in NGET's TO licence is appropriate.

14. Do you agree with our proposal for amending Special Condition 3H (Network Innovation Allowance), to assign 0.5% of NGET revenue to the NGET licence and the remaining 0.2% of NGET revenue to the NGESO licence?

Yes, this reflects the current split of the NIA between the NGET TO and SO and therefore continuation of this will be in line with Ofgem's principle not to re-open the RIIO-T1 settlement.

15. Do you think both the NGESO and NGET should participate in the Network Innovation Competition going forward? How should the licence drafting of Special Condition 3I be amended to effect this?

Yes we believe that both the ESO and NGET TO should be able to participate in the NIC. To be consistent with Ofgem's guiding principle, we would suggest Special Condition 3I is retained in its present form for the ESO and aligned with the Scottish TO's with respect to NGET TO.

ScottishPower
January 2018