

Steven Becker
SO Regulation
9 Millbank
London SW1P 3GE

26th January 2018

Dear Steven,

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

In January 2017 National Grid, BEIS and Ofgem issued a tri-partite statement alongside Ofgem's consultation on the future role and structure of the SO. These documents set out an objective to create a more independent Electricity System Operator (ESO) with the scope for separation as being primarily between the ESO and National Grid Electricity Transmission (NGET). Ofgem's consultation document, published in August 2017, outlined the key areas of change to achieve this objective; governance, physical separation, information and financial ring-fencing, employee incentivisation and transfer and culture and visual identity.

We are in full agreement with Ofgem in wanting to make these changes and support continuing to work together to develop the appropriate licence changes required to deliver the separation objectives. Furthermore, we support the two key goals for the proposals as outlined in the Executive Summary of the Consultation which are to a) underpin the minimum requirements for separation, and b) to identify and specify interfaces between NGET, ESO and the wider industry.

We agree with the four guiding principles for the future separation arrangements set out in Section 1 of the Consultation and believe that in most of the licence drafting these have been suitably applied. However, whilst we are in alignment with the policy aims that Ofgem is pursuing, we think there are some instances these principles have not been appropriately applied. More detail on these areas our concerns with regard to the application of the guiding principles for the future separation is provided below:

No re-opening of RIIO-T1

Subject to a couple of minor amendments, our view is that the principle of not re-opening RIIO-T1 has been consistently applied when considering the approach to separating incentives, and the treatment of the Price Control Financial Model.

Minimal change for separation

At the heart of effective legal separation of the ESO are the restrictions and obligations in place within the **ESO licence**, principally in the proposed new Special Condition 2O. Through our extensive discussions with Ofgem, three models have emerged which require incrementally more change to achieve separation:

Model 1: Defined ring fence between ESO and both NGET and Relevant Other Competitive businesses (ROCBs).

Model 2: Defined ring fence between ESO and both NGET and Relevant Other Competitive businesses (ROCBs), together with greater clarity on the ESO / NGG interface, captured in the compliance statement.

Model 3: Defined ring fence between ESO and all National Grid companies including NGG, with special provision (stated in the license and captured in the compliance statement) made for allowable interactions with NGG to support combined ESO and GSO activity (i.e. the 'One SO' operating model and organisational design).

Our view is that the minimum change for separation is to define restrictions between ESO and both NGET and ROCB, however we share Ofgem's view that Model 1 does not provide sufficient opportunity for transparency of the relationship between NGG and the ESO. We also recognise the Ofgem preference for Model 3, but consider that this imposes unnecessary additional change.

With reference to the principle of minimal change for separation, we are exploring license drafting under Model 2. We have shared drafting that we believe presents a compliant and minimal change option, which leverages the existing prohibitions present in the licenses and Utilities Act, as well as providing clear triggers in the licence to request transparency around the governance and activity under the 'One SO' operating model in the compliance statement.

Whatever approach to separation is ultimately selected, we welcome Ofgem's willingness to recognise the value of the SO's 'One SO' operating model. Our current 'One SO' Operating model allows the Electricity and Gas System Operator businesses to be led by a single management team, headed by a single Director, and undertake a number of "Dual Fuel Activities" such as creation of the Future Energy Scenarios. This management approach and these dual fuel activities create integrated, cross fuel outputs which enhance the UK energy sector's capability to think across electricity and gas topics (and heat and transport) and create genuinely whole system outcomes.

This capability will be increasingly relevant to ensure optimal evolution of the system, meaning that our 'One SO' model brings clear value to consumers and the industry. We welcome steps to ensure that these new requirements for separation of the ESO from NGET do not inadvertently erode value for consumers by preventing this value adding activity, or adding restrictions to the ESO licence that may prevent efficient and value adding changes to the ESO's operating model.

For the **NGET licence**, our view is that the separation requirements set out within this Consultation document go further than are needed to achieve the policy aims. In particular the replication of Special Conditions 2B and 2H from the Scottish TO licenses is not appropriate as these were written in recognition of the Scottish TOs' vertically integrated structure. Again, through discussions with Ofgem, three potential models have emerged:

1. No Special Condition 2B and associated Special Condition 2H.

The minimum change needed to meet the policy aims is to not include Special Conditions 2B and 2H. These originated in the Scottish TO licences to meet the specific vertically integrated nature of these businesses; this is not applicable to NGET.

2. Bespoke Special Condition 2B and associated 2H.

Whilst we see the inclusion of 2B and 2H as going beyond the minimum change required for separation, we would welcome continuing to work with Ofgem to further understand any residual concerns that need addressing associated with NGET sitting within the same Group as both the ESO and ROCBs.

3. Special Condition 2B and associate 2H (as currently used in Scottish TO licence)

If applied as currently proposed in Appendix 5 of the document, our current TO operating arrangements would not be viable and the required changes would introduce significant inefficiency without furthering the policy aims.

For both licenses, we believe the inclusion of Special Condition 2I is unnecessary to achieve the policy aims. As the Consultation recognises, this condition originates from the Scottish TO licenses as a consequence of their vertically integrated structure, a situation which will not apply to either NGET or ESO. In addition, for ESO, such a condition would prevent effective operation and coordination of our 'One SO' model which has previously been identified as beneficial to consumers.

Alignment with Scottish TOs

In addition to the comments made above in relation to the proposal to include Special Conditions 2B and 2H in the NGET licence, in our view there are two further specific areas where Ofgem has not provided sufficient rationale to support the proposals outlined in the document.

Firstly, the inclusion of Special Condition 2C in the NGET licence is not aligned with the existing Scottish TO licenses, which do not include this condition. In our opinion there is no substantial policy change as a consequence of omitting this condition, as other onshore TOs have the ability in principle to hold an OFTO licence.

Secondly, the inclusion of an amended form of Special Condition 2O in the NGET licence is not consistent with the existing Scottish TO licenses which again do not include this condition; this condition in the current NGET licence is a consequence of NGET currently carrying out the Relevant System Planning Activity (RSPA) which is an ESO activity. The inclusion of the proposed 2O condition is not needed to achieve the policy aims and does not align with the Scottish arrangements.

No housekeeping

The principle of no housekeeping has been maintained.

As outlined in the Consultation document, NGET is expecting to use existing legal provisions within Section 7A of the Act to voluntarily request Ofgem for consent to transfer part of its existing licence to a new ESO legal entity. The outcome of this process will result in two transmission licenses; one held by NGET and a new one held by the ESO. In addition we note that provisions within Section 11A of the Act will be used to achieve a limited number of changes to Standard Conditions in all transmission licensees. We are aiming to request consent for this partial licence transfer in March

2018, however this will be dependent on stakeholder responses to this Consultation and Ofgem's consideration of these.

Our full responses to the questions in the Consultation document are at Appendix 1 and our detailed comments on the licence drafting proposals in Appendices 4, 5 and 6 to the Consultation are set out in Appendices 2, 3 and 4 to this letter.

Yours sincerely

A handwritten signature in blue ink that reads "Chris Bennett". The signature is written in a cursive style with a long horizontal stroke extending to the right.

Chris Bennett
Director, UK Regulation

Appendix 1 – Question responses

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?

As outlined in our covering letter, we consider that the proposed licence amendments impose unnecessary additional change. We are committed to provide more transparency in particular on the interaction between ESO and NGG in the compliance statement. We will continue to work with Ofgem to further develop the licence draft to achieve the right balance of increased transparency and limited restriction on the potential evolution of ESO operating model.

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

Yes, we are in agreement with the Guiding Principles as set out in this document. As outlined in our covering letter, we highlight in our response the areas where we feel these principles have not been consistently applied. There are some further points that we would like to highlight in response to this question, these are:

No re-opening of RIIO-T1

We agree with this principle provided that the overall risk profile is unaffected and no other changes are introduced. We have identified a small number of additional changes required to Special Condition 3A (Restriction on Transmission Network Revenue) for NGET and ESO licenses and Special Condition 6J (Allowed Expenditure for Incremental Wider Works) for NGET in relation to treatment and recovery of certain costs. These changes require some further development with Ofgem to ensure drafting reflects correct treatment of certain costs, however we do not consider these changes as contentious as they deal with drafting omissions or corrections. High level context is included in Appendix 3 (NGET) and Appendix 4 (ESO).

Minimal change for separation

The Consultation document sets out the measures that need to be in place for Shared Services in order to ensure sufficient level of separation of the ESO. Some shared services have been categorised as a 'strategic shared service', for example Finance, and as such will be managed under a Business Partner model. We want to provide clarity that those activities that are strategic (eg strategic financial support) a business partner model is adopted, and for those activities that are not strategic (eg transactional undertakings) the more generic model is adopted and these activities are shared on the same basis as they are currently provided across National Grid.

Section 2 of the Consultation document outlines Ofgem's position that the Price Control Financial Model (PCFM) will remain unchanged, and continue to be a single model for the remainder of RIIO-T1. Whilst we do not agree with this principle and have shared our rationale for this with Ofgem, the drafting outlined in the document does reflect Ofgem's position. Further, we do not agree that separate ESO and NGET representatives will be required to attend PCFM working groups. The PCFM is an Excel model containing formulae to transact the RIIO framework. The role of the working group is to consider whether agreements made elsewhere or Authority determinations are fairly reflected in the model. Our view is that this forum/activity is transactional rather than strategic in nature. It is not a strategic forum and so we see customer benefit in requiring separate attendees.

Standard Licence Conditions

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

Yes we agree that the ESO having its own Board with three independent directors (SIDs) provides the appropriate structure to further mitigate real or perceived conflicts of interest

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?

No, we do not think that a restriction on the activities that the ESO can undertake is required in the ESO licence. Special Condition 2A as drafted in the current NGET and Scottish TO licenses is linked to the transmission area which is a TO concept. The new ESO licence will relate to SO activity only and will not have a transmission area, therefore preventing asset building. The provisions of condition B6 (Restriction on Activity and Financial Ring Fencing) must also be considered in the context of the system operator's ability to build assets. We agree with the proposed approach outlined in Appendix 6 of the document where Special Condition 2A is 'not used'.

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?

No, we do not agree that allowing NGET to acquire an OFTO business is beyond the scope of the separation project. We agree that condition Special Condition 2C was included in NGET's licence as a result of the TO and SO operating as a single licensee and our understanding is that the current prohibited activity licence condition is aimed at the SO activity. This is supported by the Scottish TO licenses where 2C is 'not used' so no prohibited activity in relation to holding an OFTO licence exists. We do not believe that any rationale to support Ofgem's position that allowing NGET to acquire OFTO business (or, put differently as per the licence condition, allowing NGET to hold an OFTO licence) constitutes a substantial policy change has been provided. We believe that the guiding principles of minimal change for separation and maintaining alignment between the NGET and Scottish TO licenses are not being met if Special Condition 2C point 1 (Prohibited Activities) remains in force in NGET's licence.

We accept that the process of separating the TO and SO licenses does not automatically grant NGET the ability to acquire OFTO business and that this would require further and targeted discussions outside the scope of separation. Therefore we see no risk in removing this section of the condition as part of separating the licence, as in itself it does not confer the ability of NGET to acquire an OFTO business, and doesn't constitute a policy change. We welcome further discussion to understand more fully why Scottish TO's are not restricted in acquiring an OFTO business but NGET potentially could be.

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

No we do not think that a modified version of Special Conditions 2B and 2H are necessary for NGET.

2B (Restriction on the use of certain information)

Appendix 5 of the document sets out that Special Condition 2B as drafted in the current NGET licence will no longer apply to NGET in its current form following separation, as the TO will not receive connection applications. The document also acknowledges that the form of Special Condition 2B in the Scottish TOs licence exists to address the specific issue of vertical integration which does not apply to NGET. We agree with this position and believe that as a consequence, in line with the guiding principle of minimal change for separation, Special Condition 2B is not required in the NGET licence.

As such we consider Ofgem's minded to position that a modified Special Condition 2B is still necessary in NGET's licence as a regulatory mechanism to restrict certain information goes above the guiding principle of minimal change for separation, and that existing regulatory and statutory provisions (referred to in our covering letter) adequately address both now and post separation the use of certain information and maintenance of confidentiality. As drafted in Appendix 5 of the Consultation document, the proposed Special Condition 2B is 'all encompassing' and does not allow our current TO operating arrangements to continue without introducing significant inefficiency. We would welcome further debate in this area to understand Ofgem's specific policy aims.

2H (Appointment of a Compliance Officer) - TO

As noted in the Ofgem consultation document Special Condition 2H is closely linked to Special Condition 2B, therefore as we do not agree that NGET's licence should include Special Condition 2B it is not appropriate or necessary for the NGET licence to include Special Condition 2H.

We would note that that Special Condition 2B as included in NGET's current licence is aimed at the SO activity, and as such our compliance officer obligations and resource required by Special Condition 2H are SO driven. Should a Special Condition 2H obligation be included in NGET's licence following separation we would need to consider the resource impact required to develop and report on any associated formal assurance frameworks.

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

No we do not think that Special Condition 2C should apply to NGET. We note that this condition does not currently appear in the Scottish TO licenses and believe that Ofgem should follow its guiding principle to maintain alignment between the NGET and Scottish TO licenses where appropriate.

This condition has 2 elements; paragraph 1 of the condition relates to 'Prohibited Activities' and our response to Question 5 provides our thoughts on this point. Paragraph 2 relates to 'Conduct of the Transmission Business' and is aimed at ensuring that the licensee conducts its transmission business in the manner best calculated to secure that the listed entities in the paragraph obtain no unfair commercial advantage. As noted in our response to Question 5 we are of the view that Special Condition 2C was included in NGET's licence as a result of the TO and SO operating as a single licensee and is aimed at the SO activity. Our view therefore is that it would not be appropriate to include in the NGET TO licence only when it does not appear in the Scottish TO licenses.

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

Duplicate – see question 5

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

We agree with Ofgem's view outlined in the Consultation document that Special Condition 2I is not required in NGET's licence. This condition is not used in the current NGET licence but is used in Scottish licenses where the provisions are specifically seeking to manage a vertically integrated undertaking which is not applicable to NGET. We believe that this is in line with the guiding principle to maintain alignment between the NGET and Scottish TO licenses only where appropriate. Including Special Condition 2I in NGET's licence would be disruptive to our operating model as it would prohibit existing management arrangements in respect of the de minimis and consented business activity we undertake where managerial responsibility is with the Director of NGET.

We do not agree with Ofgem's view to create a new Special Condition 2I in the ESO licence. Our view is that including obligations that are based on the existing Special Condition 2I in the Scottish licenses around independence of the ESO managing director will be problematic. This would frustrate our existing 'One SO' model where managerial responsibility for both the electricity and gas SO is with a single Director of the SO.

It is also not clear what the addition of such a condition will add over and above proposals around governance that have been proposed for Special Condition 2O of the ESO licence within Section 3 of the Consultation document at paragraphs 3.11-3.12.

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?

Information Ring-fencing

We do not agree with the proposal outlined in the Consultation document as the information ring-fencing obligation extends to all of the National Grid Group. Our view is that the proposed modifications to this condition for the ESO licence should be more limited and targeted at NGET and other National Grid competitive businesses (ROCB as currently defined in the licence). This is consistent with the key goals set out in the Executive Summary to the Consultation. Any obligations in relation to disclosure of information by the ESO to other National Grid Group companies (eg NGG) and committees above the ESO Board (eg UK Executive) are already subject to regulatory and statutory restrictions described earlier in this response. Accordingly, to the extent that further clarity and transparency is required in relation to these interfaces, they should be detailed within the compliance requirements (Special Condition 2O Part D) rather than being expressed as licence

obligations and we will continue to work with Ofgem to get to the most appropriate solution. This will enable the 'One SO' model to continue to operate economically and efficiently as it does today.

The current licence allows the NGET Compliance Officer to be responsible for EMR activities (2N) and Relevant System Planning Activities (2O) under the NGET licence and compliance officer duties under the NGG plc gas transporter licence. This reflects the fact that the compliance officer must not be engaged in the management or operation of the electricity transmission/gas transportation business and is able to share best practice and expertise across the compliance officer roles. We therefore would like to maintain the similar scope for this role, allowing the ESO compliance officer to discharge compliance officer duties to NGESO and NGG.

Governance

We agree with the principles for the ESO Board outlined in the document. We have committed that no members of the ESO board will sit on NGET, National Grid plc or other electricity subsidiary boards; in addition, the three SIDs on the NGESO Board would be sufficient to provide an independent view and scrutiny to the ESO businesses.

Financial Ring-fencing

We agree with the principles for the financial ring-fencing of the ESO outlined in the document. The following are more detailed comments on specific conditions:

- Standard Condition B5 (Prohibition of cross-subsidies) and Standard Condition B6 (Restriction on Activity and Financial Ring Fencing) – we anticipate that any consents currently granted by Ofgem for NGET will be replicated or transferred to the appropriate licence.
- Standard Condition B10 (Credit Rating) - we agree that the ESO will maintain an investment grade issuer credit rating. We note that the cost associated with (i) acquiring and maintaining an additional credit rating (credit rating agency fee) and (ii) the financing arrangements to provide a credit facility and corresponding arrangement fee need to be reflected in the licence drafting to reflect these points.

Physical Separation

We agree in principle with the proposal outlined in the document that only ESO employees and dual fuel staff will be able to access ESO premises, equipment, facilities and property without restriction. However we think this is too much detail to be included in the licence. Our proposal is to provide the access and occupancy arrangements in the Compliance Statement in line with Ofgem's expected level of detail. The compliance statement will also include the exceptions such as special arrangement for some Shared Services activities, evacuation procedures, disaster recovery activity etc. This will provide the flexibility required to continue existing arrangements in place.

Employee Incentivisation and Transfer

We agree with the proposal outlined in the Consultation in relation to ESO employees and how they are incentivised. ESO employees will be employed directly by the ESO and governed by National Grid Group's HR policy, and we will provide recruitment statistics on how roles are advertised and filled (internally/externally) as part of the ESO annual Compliance Statement.

We agree with the proposal outlined in the document to monitor the employee moves into and out of the ESO and these would potentially be subject to a "cooling off" period (reviewed by the Compliance Officer). We recognise the need to provide transparency around the electricity and gas

interface and will document all transfers out of the ESO in the compliance statement. We will continue to use our judgement as to whether the move is sensitive, and apply a cooling off period if necessary.

We are committed to developing additional training and compliance activities at separation, and continuing these on an ongoing basis. National Grid employees undertake compliance training regularly and this is monitored and reported annually as part of our compliance obligations. Whilst we are not expecting to provide Individual Compliance Statements across ESO, NGET and NGG entities, we agree that those ESO employees with access to ESO confidential information will sign an Individual Compliance Statement.

Shared Services

We agree with the proposal outlined in the document recognising that our business partner model for strategic shared services provides a robust solution while minimising costs. We agree that a robust compliance control framework is appropriate to ensure that real or perceived conflicts of interest are being managed and agree to provide the details of the arrangements in the compliance statement.

Culture & Visual Identity

We agree with the proposal outlined in the document to include an obligation within the licence for the ESO to develop a new and distinct visual and corporate identity from other National Grid Group plc companies.

We believe that it is very important that customers and stakeholders can clearly identify the ESO, for example through the publications it produces (e.g. the Network Options Assessment) or the ESO employees who engage externally. Therefore, we will create an NGESO identity for such circumstances including ESO e-mail addresses.

We are structured internally as 'One SO', where both gas and electricity SOs form one organisation under a single director. This model will continue in the future and we will therefore have a small number of dual fuel roles who represent both gas and electricity. It is important that we can clearly identify these roles externally. We will therefore also create an NGSO identity which will be used on publications which cover both gas and electricity content, for example, the Future Energy Scenarios or the Winter Outlook. This identity will only be used by people in dual fuel roles when engaging externally for example, the SO Director would have an SO e-mail address.

11. Do you think an amended version of Special Condition 20 for NGET is required for business separation requirements and compliance obligations?

We do not agree that an amended version of Special Condition 20 for NGET is required. As outlined in our covering letter this is not consistent with the Scottish TO licence which does not include this condition. Ofgem's minded to position outlined in Appendix 5 of the document to place reciprocal NGET/ESO business separation requirements in the NGET licence is not required as existing regulatory and statutory provisions govern NGET information flowing to ESO, and it would not be appropriate to include any additional obligations in this respect in the NGET TO licence and not in other TO licenses. ESO separation from NGET will be addressed by the proposed Special Condition 20 in the ESO licence.

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

We agree with Ofgem's proposal to keep Special Condition 3D in the NGET licence only, and that the existing amount of 0.5% for the Stakeholder Engagement Reward, and +/-1% of NGET revenue

available for the Stakeholder Satisfaction Survey (currently split 70:30 for Customers:Stakeholders) would remain available within NGET's licence. As part of the new ESO regulatory and incentive framework for 2018-21 the ESO is developing a proposal for a new performance metric on ESO customer and stakeholder satisfaction, which has recently been consulted on.

For clarity, the Stakeholder Engagement Reward today is based only on ETO evidence (ESO case studies are not included), so there will be no change to the format of this incentive following separation.

For the Stakeholder Satisfaction incentive, our expectation is that National Grid 'Customers' and 'Stakeholders' will continue to be surveyed to understand how satisfied they are with the service we provide. The material change post-separation is that the survey scores used will relate to customer and stakeholder satisfaction in relation to NGET activity only.

It's important to establish that NGET as a separate TO will continue to have both customer and stakeholder interactions. NGET will play a vital role in many processes driven by network users that are physically connected/connecting to NGET's network or want to establish a connection, ie from formulating transmission owner connection offers and building connection assets, through to network maintenance (outages) and operational control of the network through the Transmission Network Control Centre (TNCC).

These processes already involve regular, direct contact between network users and NGET employees on operational and commercial matters, and the nature of these interactions and relationships is one of customer and service provider. Our work with network users tells us that they see themselves as customers of NGET as a TO as they pay for the services delivered through Connection and TNUoS charges, regardless of who they directly pay for these charges.

The Customer Satisfaction incentive is a critical mechanism to encourage NGET as a separate TO to innovate and drive continuous improvements in its performance for its customers, aligned to the needs for consumers. As a result of separation NGET is expected to have greater level of interactions with a wider set of existing and potential network customers, so this incentive will become even more important to ensuring customers of the network receive the level of service that they expect and pay for. In summary, a Customer is anyone that pays for electricity transmission services or for establishing a direct connection to an electricity transmission network; they are a customer of the network.

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.

We agree with Ofgem's proposal to keep Special Condition 3F in the NGET licence only and to remove any links to ESO activities and to remove the current requirement to provide evidence relating to the ESO. As stated in the Consultation document, this is in line with the guiding principles to maintain alignment between the NGET and Scottish TO's EDR scheme, and not re-opening RIIO-T1.

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?

We agree with Ofgem's proposal to maintain the current level of NIA funding allowance available to NGET, and to split this across the NGET and ESO licenses as this is still relevant for both. This is in line with the guiding principle to maintain alignment between the NGET and Scottish TO's and not re-opening RIIO-T1.

We agree that assigning 0.5% of the NGET revenue to the NGET licence is consistent with the minimum level of funding available to any TO under the RIIO-T1 arrangements. This would allow NGET to continue the current level of spending on smaller scale innovation projects. We agree that the current split between internal (25%) and external (75%) costs is appropriate for NGET, and that no change to the existing licence provisions is required.

We agree that assigning 0.2% of the NGET revenue to the ESO licence and that this would allow the ESO to continue the current level of spending on smaller scale innovation projects. We agree that the current split between internal (25%) and external (75%) costs is not appropriate for ESO, and our initial view is that 50/50 is more realistic. Our intention is to apply to the Authority for a consent (as provided for in Special Condition 3H) to change the internal and external cost percentage for the ESO licence, and will work with Ofgem on the process and evidence required to achieve this.

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 agree that both NGET and ESO should participate in the Network Innovation Competition going forward. This is in line with the guiding principle to maintain alignment between the NGET and Scottish TO's and not re-opening RIIO-T1.

Ofgem has set out two options to recover NIC funding for all projects in the Consultation. Our strong view is that this should be recovered by the ESO and that the provisions in Part D of Special Condition 3I should be retained in the ESO licence, unchanged. NGET's licence should be amended to reflect the drafting used in the Scottish TO licence.

Fundamentally the role of recovering transmission costs from the industry lies with NGET but in its SO role. NGET in its SO role transfers NIC funding to other licensees as directed by Ofgem, and it would be inappropriate for NGET as a separate TO to be responsible for this activity. Our view is that recovery and distribution of NIC funding is clearly an ESO role, and we see no reason that this should change post separation, and that this is in line with the guiding principle of minimal change for separation.

Other network licensees NIC conditions, for example Scottish TO's Special Condition 8B and ES6, reference that payments are received from the SO. Adoption of the second option would therefore require a further change to all applicable network licence conditions under section 11A and goes beyond minimal change to achieve separation.

Appendix 2 – Standard conditions table [Appendix 4 to Informal Consultation on ESO Licence Drafting: NGET and NGESO Standard Conditions]

Standard Condition	Title	Issue for NGET	Issue for NGESO
A1	Definitions	The change to the definition of “licensee’s transmission system” to be made under section 11A will be made in all transmission licenses. This should be clarified	The change to the definition of “licensee’s transmission system” to be made under section 11A will be made in all transmission licenses. This should be clarified
A1	Definitions	The definition of “transmission business” needs to be further amended as we have discussed with Ofgem so as to exclude the affiliated transmission business of NGESO from the definition of the NGET transmission business. This may be recognised by the drafting note at paragraph 2 of B1	The definition of “transmission business” needs to be further amended as we have discussed with Ofgem so as to exclude the affiliated transmission business of NGET from the definition of the NGESO transmission business. This may be recognised by the drafting note at paragraph 2 of B1
A1	Definitions	In relation to the drafting note in the definition of “transmission business” it is not immediately clear why the insertion “or commercial management” is required in the NGET licence and not other licenses so we suggest that it is removed (via deleting from Special Condition 1C)	In the definition of “transmission business” there is no reference to the term “transmission owner activity” which applies to NGET in its capacity as SO by virtue of Special Condition 1C and standard condition C1. It needs to be deleted from both of those conditions (via section 7A) as it has been from condition B1 and hence will be removed from the definition of “transmission business” as it applies to NGESO
A4	Payments by Licensee to the Authority	The drafting note is a little misleading. The condition will continue to appear in the NGET licence but it will not apply to NGET by virtue of paragraph 1	
A6	Application of Section E	The drafting note is not clear. There is no requirement or expectation that Section E will have effect in the NGET licence but Section E will still appear in the NGET licence	The drafting note is not clear. There is no requirement or expectation that Section E will have effect in the NGESO licence but Section E will still appear in the NGESO licence
B1	Regulatory Accounts	It should perhaps be clarified that the amendment to the definition of “transmission owner activity” to be made under section 11A will be made in all transmission licenses	It should perhaps be clarified that the amendment to the definition of “transmission owner activity” to be made under section 11A will be made in all transmission licenses
B1	Regulatory Accounts		In conjunction with the change to the definition of “transmission owner activity”, the definition of “transmission owner activity” in C1 (inserted by Special Condition

			1C) needs to be removed from these conditions via 7A
B16	Electricity Network Innovation Strategy	The drafting in B16 does not reflect the drafting in Schedule 1 to the section 11A direction dated 30 June 2017 that introduced the new condition. This will need to be updated	The drafting in B16 does not reflect the drafting in Schedule 1 to the section 11A direction dated 30 June 2017 that introduced the new condition. This will need to be updated
Section C	System operator standard conditions	Drafting note should refer to condition A2. The section will appear in the NGET licence but it will not be in effect	
C1	Interpretation of Section C		The definition of "transmission owner activity" needs to be deleted from C1 (as inserted by 1C). See comment at B1 above
C1	Definition of "balancing services activity"	As noted in Paragraph 2.8 of Consultation Document the references to Special Condition AASA in the definition of "balancing services activity" will need to be updated to refer to Special Condition 4C (via 11A)	As noted in Paragraph 2.8 of Consultation Document the references to Special Condition AASA in the definition of "balancing services activity" will need to be updated to refer to Special Condition 4C (via 11A)
C2	Prohibited Activities		The change at paragraph 1 should be implemented via section 11A as it is a correction not linked to legal separation. It will still only impact on NGENSO as NGENSO will be the only relevant licensee for the purposes of the s11A notice
C2	Prohibited Activities		We agree with the drafting note at paragraph 2 but the proposed drafting change at paragraph 2 appears to go beyond this intention. We suggest that the deleted text is retained but is amended to read "and shall procure that any affiliate or related undertaking of the licensee that is not subject to Condition D6 (prohibition on selling electricity) shall not..."
C4	Charges for use of system		As per consultation document, paragraph 2.8 the reference in Paragraph 4 (re. AASA) needs amending
C5	Use of system charging methodology		As per consultation document, paragraph 2.8 the reference in Paragraph 8 (re. AASA) needs amending

C6	Connection charging methodology		As per consultation document, paragraph 2.8 the reference in Paragraph 15 (re. AA5A) needs amending
C17	Transmission system security standard and quality of service		The SQSS v2.3 will be updated as a consequence of the legal separation process. Accordingly reference to 2.3 will need to change to 2.4 this change will be implemented by S11A (see parallel comment at D3)
C26	Requirements of a connect and manage connection		2 nd drafting note should clarify that the amendments to paragraph 4 and 5 will be via Section 11A
D3	Transmission system security standard and quality of service	The SQSS v2.3 will be updated as a consequence of the legal separation process. Accordingly reference to 2.3 will need to change to 2.4 this change will be implemented by S11A (see parallel comment at C17)	

Appendix 3 – NGET Specials table

[Appendix 5 to Informal Consultation on ESO Licence Drafting: NGET Special Conditions]

Special Condition	Title	Issue for NGET
1C	Amended Standard Conditions	<p>Amendments to the definition of “transmission business” in paragraph 2c. We suggest that paragraph 2c can be deleted.</p> <p>It is not immediately clear why the insertion “or commercial management” is required in the NGET licence and not other licenses so we suggest that it is removed via deleting from Special Condition 1C. See comment at A1.</p> <p>The change inserting “transmission owner activity” applies in respect of the SO only but it is to be removed from 1C in the NGESO licence (so it will not appear in C1 or B1). The change is not relevant to the NGET licence and can be removed.</p> <p>Accordingly, the definition of “transmission owner activity” inserted at paragraph 8 should also be deleted (as per the NGESO licence)</p>
2B	Restriction on the use of certain information	<p>We note that the condition is based on the condition in the Scottish TO licenses.</p> <p>Paragraph 3(e) needs to be updated to reflect current circumstances as it currently anticipates BETTA implementation.</p> <p>Also “compliance officer” is not defined for the purposes of the definition of “competent authority”. Presumably this is the special condition 2H compliance officer?</p>
2C	Prohibited Activities and Conduct of the Transmission Business	<p>The drafting note states that the condition will be retained in an unchanged form. However, the drafting seeks to modify the condition so as to prevent NGET holding a licence with section C in effect.</p> <p>We do not agree that this change is required. Section C will only be in effect pursuant to a section C direction issued by the Authority. The Authority can therefore ensure that section C is not in effect so no prohibition is required in the licence.</p>
3A	Restriction of Transmission Network Revenue	<p>The Authority has agreed to reflect the costs of NGESO financing facility provided there is an corresponding decrease in NGET allowances. We propose to amend 3A.3 Principal Formula to include new term FINt</p> <p>FINt means the amount set out against the licensee’s name in Appendix 2 of this condition and represents the costs relating to the NGESO financial facilities in Relevant Year t transferred as agreed with the Authority</p>
3H	The Network Innovation Allowance	<p>The drafting that has been struck through does not reflect the current 3H drafting. The changes implemented by the 18 July 2017 direction need to be captured before any subsequent amendments are made. The drafting in the 3H of Appendix 6 is correct.</p>
3I	The Network Innovation Competition	<p>The drafting note suggests that the drafting has been struck out pending modification. The drafting has in fact only partially been struck out and reflects the first option drafting approach which we support.</p>

5B	Annual Iteration Process	References to NGESO will need to refer to National Grid Electricity System Operator Limited
6J	Allowed Expenditure for Incremental Wider Works	We have reviewed our proposed drafting in Part C: Calculation of Allowed Expenditure for IWW Outputs and are now of the view that this is incorrect. Current drafting should be re-instated
Chapter 7	Annual Iteration Process – Adjustments to the SO Revenue	There is no mention of Chapter 7 in the Appendix. In the final licence the chapter heading should be included but as “Not Used” for completeness.
Schedules	Schedule 1: Specified Area	These schedules will need to be retained in NGET licence
Schedules	Schedule 2: Revocation	These schedules will need to be retained in NGET licence

Appendix 4 – NGESO specials table [Appendix 6 to Informal Consultation on ESO Licence Drafting: NGESO Special Conditions]

Special Condition	Title	Issue for NGESO
2A	Activities Restriction	Suggest no restriction is required given licence will relate to and authorise SO activity only and activity restriction condition will therefore prevent asset building
2C	Prohibited Activities and Conduct of the Transmission Business	The proposed modification is not referred to in the consultation document. The change is not required as the existing provision was aimed at preventing the SO holding an OFTO licence. Section D (a TO licence) will only be in effect if a section D direction is issued by the Authority. The Authority is therefore able to prevent section D being in effect without such a proposed prohibition.
2I	Independence of and Appointment of CEO of the Licensee	It is not clear what the condition will add over and above proposals around governance that will be set out in the proposed special condition 2O (see 3.11-3.12). Any suggestion that the proposed 2I will be based on the existing 2I in the Scottish licenses will be problematic and would frustrate the proposed 'One SO' model
2J	Network Access Policy	Agree with drafting proposal to include an amended condition to reflect ongoing role for ESO in interacting effectively with TO's ESO should not have an obligation to produce a Network Access Policy (NAP)
2N	Electricity Market Reform	Heading of Part B should refer to "Ltd." instead of "plc"
2N.19	Electricity Market Reform	How to raise issue of our suggested amendment? (Act)
3A	Restriction of Transmission Network Revenue	Changes to formula in 3A.3 that are referred to in drafting not are not visible in the formula underneath
3A	Restriction of Transmission Network Revenue	In Part B the insertion of TRU is not required as it already appears above
3A	Restriction of Transmission Network Revenue	The Authority has agreed to reflect the costs of NGESO financing facility provided there is an corresponding decrease in NGET allowances. We propose to amend 3A.3 Principal Formula to include new term FINt which relates to the FINt means the amount set out against the licensee's name in Appendix 1 of this condition and represents the costs relating to the licensee's financial facilities and parent company guarantee costs(PCG) in Relevant Year t as agreed with the Authority
3B	Calculation of allowed pass through items	Appendices 1, 2 & 3 should refer to National Grid Electricity System Operator Ltd.

3H	The Network Innovation Allowance	As per drafting note in Appendix 5 (Sp. 3H) NGESO will require consent to deviate from 25%/75% cost split
3I	The Network Innovation Competition	We support the first option referred to in the drafting note. Adopting the second option would mean that Scottish TO licenses would also need to be changed as they refer to the collection of revenue by the SO. Also, in Special Condition 8B of the TO licenses, ES6 assumes that payments are made by the SO.
4	System Operator – Revenue Restriction	We agree that Chapter 4 will need to reflect the changes that the Authority is intending to make to the SO incentives regime for 2018-21 before any subsequent amendments are made.
7B	Determination of PCFM Variable Values (System Operator)	Appendix 1 should refer to National Grid Electricity System Operator Ltd.
7D	Arrangements for the recovery of SO uncertain costs	Appendices 1, 2 and 3 should refer to National Grid Electricity System Operator Ltd.
8B	Services treated as excluded services	Reference in Paragraph 8B.8 to AA5A needs to be updated
Schedules	Schedule 1: Specified Area	These schedules will also need to be included in the NGESO licence
Schedules	Schedule 2: Revocation	These schedules will also need to be included in the NGESO licence

