

David Beaumont
Electricity System Operator Incentives
Ofgem
9 Millbank
London
SW1P 3GE

23 March 2018

ESO incentives – Notice of proposed modifications to the special conditions of the electricity transmission licence held by National Grid Electricity Transmission plc

Dear David,

We refer to the statutory consultation republished on 23 February 2018 to modify National Grid Electricity Transmission plc's ("National Grid") licence to facilitate the introduction of the Electricity System Operator Reporting and Incentive Arrangements ("ESORI Scheme").

We have reviewed the drafting of the proposed text in the Schedule and have some suggested amendments. Our proposed changes can be found in the attached marked up version. We would appreciate the consideration and subsequent adoption of these comments to ensure that the appropriate changes be made to the licence. These should be read in conjunction with the comments we submitted on 16 March on the draft ESORI guidance document.

Special Condition 4M (Electricity System Operator Reporting and Incentive Arrangements)

We broadly agree with the proposed licence condition. We have suggested some minor amendments which are in the attached marked-up version.

Special Condition 4J (SO-TO mechanism)

We support the continuation of the SO-TO mechanism as it has the potential to realise significant consumer savings. We note the mechanism has not yet been used, primarily because of the limitations of the one year timescale. In order to facilitate its use, we would welcome confirmation and clarification on whether either of the following two plausible uses for the SO-TO mechanism can be accommodated within the existing drafting:

- Whether the ESO can fund the Scottish TOs (say) £500,000 in 2018/19 for works in 2019/20.
- Whether the ESO can commit in 2018/19 to funding the Scottish TOs (say) £500,000 in 2019/20 for works in 2019/20.

Special Condition 4C (Balancing Services Activity Revenue Restriction on External Costs)

In our extensive engagement around our draft Forward Plan, BSUoS payers have told us they are concerned around BSUoS volatility, given the evaluative and subjective nature of the new framework. In addition, paragraph 2.78 of Ofgem's Final Decision document recognises that the

recovery of incentive payments as finally determined by the Authority under an evaluative approach may impact on charge volatility. It highlights that even with steps to evaluate and forecast performance throughout the year between ESO and Ofgem, the risk of volatility to the charge remains until the final decision is made by the Authority on 31 July in Relevant Year t+1. We know that the potential magnitude of such a decision means the risk for BSUoS payers on cost in Year t could be significant. We believe in order to minimise the impact that such a decision made in Relevant Year t+1 may have on charge volatility in Relevant Year t, there is a need to decide whether the licence should allow for this adjustment to be recovered in Relevant Year t+1.

One possible way forward is the potential addition of a new third element within the definition of the term $TotAdj_t$ in Special Condition 4C.2. The aim of such a term would be to allow for an adjustment to be made during Relevant Year t+1 in respect of a determination made by the Authority in relation to $IncPayExt_t$ in respect of a Relevant Year t prior to Relevant Year t+1.

We recognise that stakeholders will want to be involved in this and are willing to work with Ofgem and industry to determine a suitable approach, including the possibility of a related term being introduced into the licence via subsequent modification prior to the Authority's first final decision in relation to the $IncPayExt_t$ term.

Overall comments

We support the new incentives framework for the Electricity System Operator (ESO) and feel it reflects the full range of the ESO's function and the context of the changing energy system. The proposed arrangements bring a welcome increase in transparency and support our stronger focus on meeting the needs of customers and stakeholders. It has the potential to drive significant additional benefits for customers and consumers.

As part of the new scheme on 12 February 2018 we published our draft 2018-19 Forward Plan for consultation. This plan was built on extensive customer and stakeholder engagement. We engaged widely during the consultation, including hosting a consultation event on 22 February and a webinar on 6 March. We will publish the final version of the Forward Plan on 27 March.

If you would like to discuss this response further please contact me. We look forward to working with you over the coming regulatory year.

Yours sincerely,

Charlotte Ramsay

Programme Director, Future of the SO Programme