

To: National Grid Electricity System Operator Limited

**Electricity Act 1989
Section 11A(1)(a)**

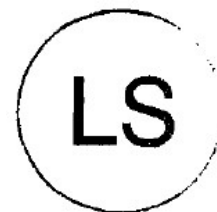
**Modification of the special conditions of the electricity transmission licence held
by National Grid Electricity System Operator Limited**

1. National Grid Electricity System Operator Limited (NGESO) is the holder of an electricity transmission licence ('the Licence') granted or treated as granted under section 6(b) of the Electricity Act 1989 ('the Act').
2. Under section 11A(2) of the Act the Gas and Electricity Markets Authority ('the Authority')¹ gave notice on 26 June 2019 ('the Notice') that we propose to modify Special Condition 4C (Balancing Services Activity Revenue Restriction on External Costs) of the Licence. We stated that any representations to the modification proposal must be made on or before 24 July 2019.
3. A copy of the Notice was sent to the Secretary of State in accordance with section 11A(4)(b) of the Act, and we have not received a direction that the change should not be made.
4. Under the NGESO's incentive scheme, the final decision on the NGESO's incentive payment for Relevant Year t is made on an ex-post basis in summer in Relevant Year t+1. Any differences between the incentive payments NGESO recovers during Relevant Year t (based on its reasonable expectations of its performance) and the actual value the Authority directs has to be reconciled. The NGESO can do this by making retrospective adjustments to Balancing Services Use of System (BSUoS) charges via settlement runs for Relevant Year t.
5. On 26 June 2019, we proposed a licence modification to allow the NGESO to reconcile any differences through adjustments to BSUoS charges in Relevant Year t+1. For instance, if NGESO forecasts and recovers BSUoS payments of £Xm during Relevant Year t, but the Authority determines (during summer Year t+1) the actual incentive for Relevant Year t should be £Ym, then this licence change would allow the Authority to consent to an adjustment of allowed revenue of £Y-Xm during Relevant Year t+1. This would minimise the need for NGESO to make retrospective adjustments to BSUoS charges. We consider that this modification will increase certainty around the charges market participants face as a result of incentive payments incurred by NGESO. If NGESO does not seek to reconcile differences using the proposed new licence term (and/or the Authority does not consent to this) then NGESO would have to ensure differences between what it has recovered and the actual incentive payment are reconciled via settlements runs for Relevant Year t.
6. We received 6 responses to the Notice, which we carefully considered. We have placed all non-confidential responses on our website. The majority of the responses agreed with our proposal to increase certainty around the BSUoS charges market participants face as a result of incentive payments incurred by NGESO.

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

7. Some stakeholders requested further clarification on when the incentive reconciliation mechanism would be used and under which circumstances it would be used by the NGESO. A number of stakeholders also raised wider points around charging arrangements. We consider these wider points to be outside the scope of this licence change but these points will be considered further as part of our Future Charging and Access reforms. Further details of our responses to these representations are set out in Schedule 1. Overall we considered that the proposed licence text is sufficient and we have decided to proceed with the proposed licence modification
8. Where an application for permission to appeal our decision is made to the Competition and Markets Authority (CMA) under section 11C of the Act, Rule 5.7 of the Energy Licence Modification Appeals: Competition and Markets Authority Rules² requires that the appellant must send to any relevant licence holders who are not parties to the appeal a non-sensitive notice setting out the matters required in Rule 5.2. Section 11A(10) of the Act sets out the meaning of 'relevant licence holder'. National Grid Electricity System Operator Limited is the only relevant licence holder
9. Under the powers set out in section 11A(1)(a) of the Act, we hereby modify a special condition of the transmission licence of NGESO in the manner specified in attached Schedule 2. This decision will take effect from 4 October 2019.
10. This document is notice of the reasons for the decision to modify the electricity transmission licence held by NGESO as required by section 49A(2) of the Act.

**The Official Seal of the Gas and Electricity Markets Authority
here affixed is authenticated by the signature of**



.....
Grendon Thompson
Duly authorised on behalf of the
Gas and Electricity Markets Authority

9 August 2019

² CMA70 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/655601/energy-licence-modification-appeals-rules.pdf

Schedule 1:

Stakeholder comment	Our Response
<p>Unclear text on the consultation covering letter. The use of measures in the proposal will be optional for National Grid. Industry will clearly need to know in good time whether National Grid intends to deploy the revenue adjustment approach or not.</p>	<p>The licence allows any differences in BSUoS to be adjusted with the consent of the Authority. In some cases, it might be better for BSUoS payers if bills are corrected retrospectively, e.g. for when differences are small. When the difference is large, it might be better if BSUoS is adjusted in Year t+1 using the IncPayRec_t term. We consider that larger differences would need to be adjusted using the IncPayRec_t term. The NGESO must consider the size of the difference and consider the best method of adjusting BSUoS. We consider that the proposed licence text is sufficient and allows this flexibility.</p>
<p>Ambiguity on whether Ofgem will use this reconciliation mechanism for 'any material difference', or simply 'any difference', between the incentive payments NGESO recovers during Relevant Year t and the actual value the Authority directs.</p>	<p>As per above</p>
<p>Internal costs (SOTOC_t) and incentive payments are unrelated to the half-hourly performance of the network, they are not incurred on a half-hourly basis and should be viewed as cost recovery. Following the principles of the Targeted Charging Review, it seems logical to recover these costs from demand as a fixed charge, as attempting to recover them based on network users' half-hourly volume risks creating distortions.</p>	<p>As per above.</p>
<p>The benefits of fixing BSUoS can be realised sooner and it is unclear why such change is contingent on RIIO-2. Clarity from Ofgem would be welcome on what changes are required to BSUoS given the conclusion of the Task Force and principles of cost recovery given in the TCR.</p>	<p>We consider this to be outside the scope of this licence change but these points will be considered further as part of our Future Charging and Access reforms.</p>

Schedule 2 – Licence drafting

Special condition 4C. Balancing Services Activity Revenue Restriction on External Costs

Part A: Balancing services activity revenue restriction on external costs

4C.1 The licensee shall use its best endeavours to ensure that in respect of Relevant Year t the revenue derived from and associated with procuring and using balancing services (being the external costs of the Balancing Services Activity) shall not exceed an amount calculated in accordance with the following formula:

$$BXext_t = CSOBM_t + BSCC_t + TotAdj_t - OM_t + IncPayExt_t + BSC_t + SOTOC_t$$

$$\underline{BXext_t = CSOBM_t + BSCC_t + TotAdj_t - OM_t + IncPayExt_t + IncPayRec_t + BSC_t + SOTOC_t}$$

where:

BXext _t	represents the maximum allowed revenue derived in Relevant Year t from and associated with procuring and using balancing services;
CSOBM _t :	which represents the cost to the licensee of bids and offers in the Balancing Mechanism accepted by the licensee in Relevant Year t less the total non-delivery charge for that Relevant Year, is the sum across Relevant Year t of the values of CSOBM _j (being the daily System Operator BM cash flow for each settlement period j as defined in Table X- 2 of Section X of the BSC in force immediately prior to 1 April 2001);
BSCC _t	means the costs to the licensee of contracts for the availability or use of balancing services during the Relevant Year t, excluding costs within CSOBM _t and BSC _t but including charges made by the licensee for the provision of balancing services to itself in the Relevant Year t;
TotAdj _t	means the amount of any adjustment to be made during the Relevant Year t as provided in paragraph 4C.2;
OM _t	means an amount representing the revenue from the provision of balancing services to others during the Relevant Year t, calculated in accordance with paragraph 4C.10;
IncPayExt	means an incentive payment for Relevant Year t calculated in accordance with Special Condition 4M (Electricity System Operator Reporting and Incentive Arrangements);

<u>IncPayRec_t</u>	<u>means an amount treated as a cost or payment by the licensee for Relevant Year t with the prior written consent of the Authority, which equals the difference between the value of IncPayExt_t in respect of Relevant Year t-1 (directed by the Authority in accordance with paragraph 4M.19 of Special Condition 4M (Electricity System Operator Reporting and Incentive Arrangements)) and the amount the licensee has recovered in Relevant Year t-1 based on its reasonable expectations of revenue associated with IncPayExt_t in respect of Relevant Year t-1;</u>
SOTO _t	means the SO-TO cost allowance term in each Relevant Year t calculated in accordance with Special Condition 4J (SO-TO Mechanism);
BSC _t	means the allowed revenue derived in Relevant Year t from and associated with Black Start services in accordance with Special Condition 4G (Black Start Allowed Revenue); and
j	shall mean a settlement period (being half an hour) as defined in the BSC.