

# Consultation

## TNUoS Revenue Collection Risk

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In October 2019, we made decisions on key aspects of the RIIO-2 price control methodology for the Electricity System Operator (ESO).<sup>1</sup> We outlined our next steps, including to investigate in further detail the allocation and management of risks associated with revenue collection. In particular, we said we would consult on our considerations for where the cashflow timing risk associated with the collection of Transmission Network Use of System (TNUoS) charges would best be placed and how any changes would be implemented.

In this document, we are consulting on the revenue collection risk associated with TNUoS charges, with regards to how it could be moved from the ESO to the onshore Transmission Owners<sup>2</sup>. We aim to publish our decision on this consultation at or before our RIIO-2 draft determinations in 2020. Statutory consultations on any

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<sup>1</sup> RIIO-2 financial methodology and roles framework for the Electricity System Operator - Decision: [https://www.ofgem.gov.uk/system/files/docs/2019/10/riio-2\\_financial\\_methodology\\_and\\_roles\\_framework\\_for\\_the\\_eso\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/10/riio-2_financial_methodology_and_roles_framework_for_the_eso_0.pdf)

<sup>2</sup> Onshore Transmission Owners: National Grid Electricity Transmission (NGET); Scottish Power Transmission (SPT); and Scottish Hydro Electricity Transmission (SHE-T).

licence modifications necessary to implement that decision will follow thereafter as part of the RIIO-2 licence modifications, or earlier, as necessary.

Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at

[Ofgem.gov.uk/consultations](https://www.ofgem.gov.uk/consultations).

If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

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## Contents

<b>1. Introduction .....</b>	<b>4</b>
What are we consulting on? .....	4
Consultation stages .....	6
How to respond .....	6
Your response, data and confidentiality .....	7
General feedback .....	7
How to track the progress of the consultation .....	8
<b>2. Background, proposal and rationale .....</b>	<b>9</b>
ESO separation and RIIO-2 .....	9
TNUoS revenue collection risk and allocation .....	9
<b>3. Proposed Changes .....</b>	<b>13</b>
Background to the K correction term and Revenue Allocation .....	13
Summary of proposed changes to licences and codes .....	14
Step I – Changes to Special Licence Condition 3A of the ESO’s licence – Revenue Restriction of Transmission Network Revenue .....	15
ESO Special Licence Condition 3A – Proposed addition .....	15
Step II – Changes to Special Licence Condition 3A of NGET’s licence – Revenue Restriction .....	15
NGET Special Licence Condition 3A – Proposed modification .....	15
Step III – Proposed modifications to Standard Licence Condition B12 of electricity transmission licences .....	17
Standard Licence Condition B12 – Proposed modification .....	17
Step IV – Changes to STCP 13-1 .....	18
STCP 13-1 – Illustrative modified text .....	18
<b>4. Questions and next steps .....</b>	<b>21</b>
Consultation Questions .....	21
Next Steps .....	21

## 1. Introduction

### What are we consulting on?

1.1. Transmission Network Use of System (TNUoS) revenues are currently collected by the Electricity System Operator (ESO) and paid to the Transmission Owners (TOs), both onshore<sup>3</sup> and offshore (OFTOs). Currently, the ESO pays the TOs based on ex-ante estimates, rather than on the basis of the TNUoS revenues it has collected, giving rise to a cashflow timing risk for the ESO. In this consultation we seek views on how this risk could be reallocated from the ESO to the onshore TOs.

1.2. Our August 2019<sup>4</sup> publication asked whether it could be more efficient if onshore TOs were to bear this cashflow timing risk. Three of the five responses<sup>5</sup> to this question agreed that there was benefit in further considering a reallocation of this risk. Centrica agreed with our proposals but Scottish and Southern Energy Networks (SSEN) and SPT raised concerns. SSEN considered that the proposal effectively asks the onshore TOs to take on a risk over which they have no control, it was unclear how the allocation of the risk would work, and the proposal would also introduce volatility to TO revenue. SPT's view was that the proposal represents a significant new consideration at this stage in the development of the ESO funding model and that the scale of these charges is significant. NGET agreed that there is benefit in considering where the TNUoS revenue collection risk should best lie. It felt our approach should follow the RIIO principle of risk lying with the party or parties best able to manage that risk, but that wherever the risk is managed, there is adequate recompense for the party.

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<sup>3</sup> Throughout this document, by onshore TOs we mean National Grid Electricity Transmission (NGET), Scottish Hydro Electric Transmission (SHE-T), and Scottish Power Transmission (SPT).

<sup>4</sup> RIIO-2 methodology for the Electricity System Operator – Decision & Further Consultation: [https://www.ofgem.gov.uk/system/files/docs/2019/08/riio-2\\_methodology\\_for\\_the\\_electricity\\_system\\_operator\\_-\\_decision\\_and\\_further\\_consultation.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/08/riio-2_methodology_for_the_electricity_system_operator_-_decision_and_further_consultation.pdf)

<sup>5</sup> RIIO-2 financial methodology and roles framework for the Electricity System Operator (paragraph 2.65 to paragraph 2.89): <https://www.ofgem.gov.uk/publications-and-updates/riio-2-financial-methodology-and-roles-framework-electricity-system-operator>

1.3. NGET argued that the ESO is best placed to manage forecasting and tariff calculation errors. Given this, NGET suggested it is important that accurate forecasting and tariff calculations remain a priority for the ESO, for example by implementing suitable performance incentives. NGET suggested that any transfer of the revenue risk to TOs should be consistent across all TOs (or reflect that one owner is taking risk on behalf of others). The simplest approach, NGET suggested, would be allocation pro-rata by proportion of total revenue (whether from onshore TOs, OFTOs, future Competitively Appointed Transmission Owners (CATOs<sup>6</sup>) or interconnectors). The ESO agreed that there are potentially other ways to manage the cash collection risk and welcomed further discussion to ensure the risk is held by the most appropriate party. In addition, there was a general consensus in all responses that any consideration of moving this risk should recognise that it affects multiple industry participants and consumers. Therefore, any changes should be fully consulted on before any final decisions are made.

1.4. In October 2019<sup>7</sup> we decided that we would investigate in further detail the most appropriate allocation of TNUoS revenue collection risks. We committed to consulting on where the cashflow timing risk associated with the collection of TNUoS revenues is best placed, and how any changes to reflect this would be implemented. We are now seeking views on our proposal to reallocate the cashflow timing risk of TNUoS revenue collection from the ESO to the onshore TOs; how this risk should be apportioned between the onshore TOs; and how any changes would be implemented. We are not proposing to move the revenue collection function from the ESO. We are instead proposing that the ESO continues to pay the onshore TOs monthly, but only the TNUoS revenues that it has collected, net of the payments due to the OFTOs and other parties,<sup>8</sup> under the same procedures that are in place currently. This would be a change to the current procedure whereby the ESO pays the onshore TOs the revenues that the onshore TOs have notified to the ESO under their price controls.

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<sup>6</sup> <https://www.ofgem.gov.uk/electricity/transmission-networks/competition-onshore-transmission>

<sup>7</sup> Ibid.

<sup>8</sup> In addition to payments to TOs, the ESO is responsible for paying a range of industry costs including licence fees, the inter-transmission system operator compensation mechanism and payments to Interconnector owners and licensees, as set out in Special Licence Condition 3B of its licence. These costs are covered via Transmission Network Use of Charges, representing around 4% of revenue in 2018/19, and we do not propose to modify the payment of these items.

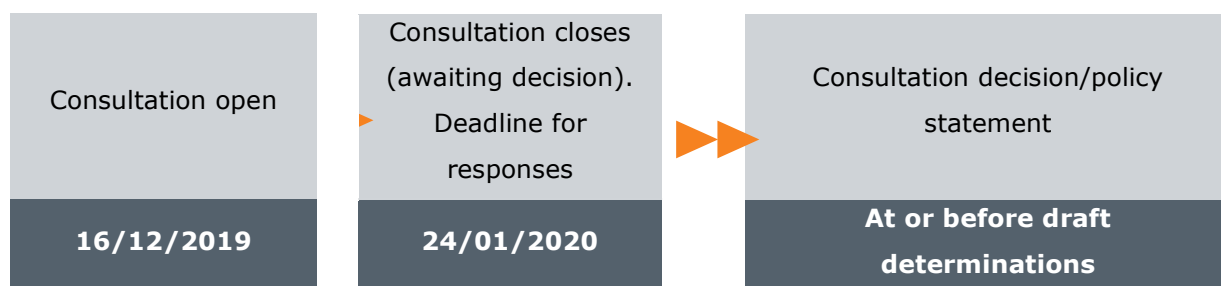
## Consultation stages

1.5. We are seeking responses to the questions set out in this document by **31 January 2020**. This will enable us to make a decision at or before our price control draft determinations next year and align with the start of RIIO-2. Statutory consultations on any licence modifications necessary to implement that decision will follow thereafter as part of the RIIO-2 licence modifications or earlier, as necessary.

1.6. Any decisions made to change the allocation of the TNUoS cashflow timing risk in time for the start of RIIO-2 would be taken into account in our price control determinations for the ESO and onshore TOs.

1.7. Figure 1 outlines the key stages we will progress through to get to a final decision on the ESO's financial methodology and incentives.

**Figure 1: Consultation stages**



## How to respond

1.8. We want to hear from anyone interested in this consultation. Please send your response to [RIIO2@ofgem.gov.uk](mailto:RIIO2@ofgem.gov.uk), addressed to the Regulatory Finance team.

1.9. We've asked for your feedback to our questions and proposals (summarised in Chapter 4). Please respond to each one as fully as you can. We will publish non-confidential responses on our website at [www.ofgem.gov.uk/consultations](http://www.ofgem.gov.uk/consultations).

## Your response, data and confidentiality

1.10. You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

1.11. If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.

1.12. If the information you give in your response contains personal data under the General Data Protection Regulation 2016/379 (GDPR) and domestic legislation on data protection, the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see the Appendix.

1.13. If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

## General feedback

1.14. We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?

5. Did it make reasoned recommendations for improvement?
6. Any further comments?

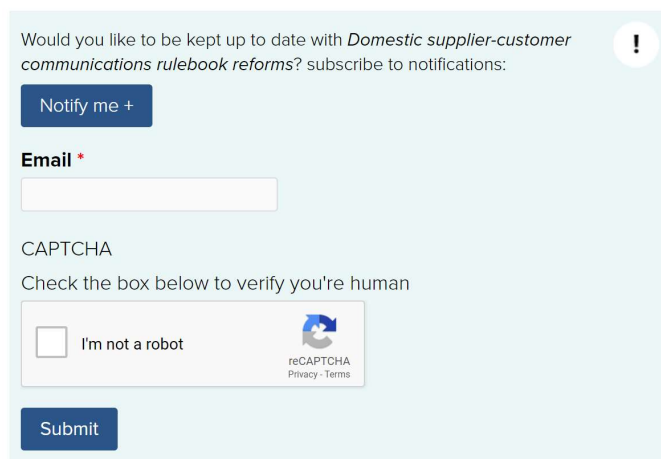
Please send any general feedback comments to [stakeholders@ofgem.gov.uk](mailto:stakeholders@ofgem.gov.uk)


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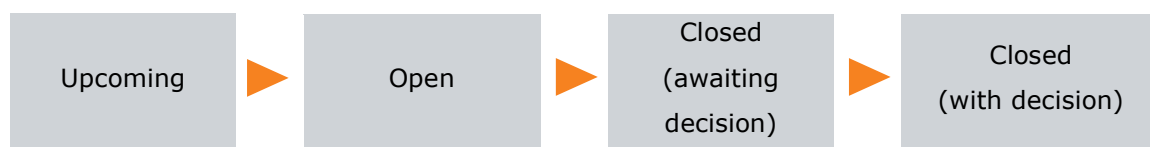
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Once subscribed to the notifications for a particular consultation, you will receive an email to notify you when it has changed status. Our consultation stages are:





## 2. Background, proposal and rationale

### Consultation Questions:

**Question 1: If the TNUoS cashflow risk is allocated to the onshore TOs, are there any other interactions we need to consider or aspects that should be taken into account in our RIIO-2 determinations?**

**Question 2: Do you agree that appropriate incentivisation of the ESO for accurate forecast and tariff calculations can be maintained through licence obligations and the ESO's incentives scheme?**

## ESO separation and RIIO-2

2.1. On 1 April 2019, the ESO separated from NGET, and became a legally separate company within the National Grid group. NGET's RIIO-T1 price control settlement was not re-opened as part of the legal separation process.<sup>9</sup>

2.2. From April 2021, we will introduce the first standalone price control for the ESO under the RIIO-2 framework. As part of developing a new, separate price control for the ESO we have been considering any changes (such as appropriate allocation of revenues, incentives and outputs between the ESO and TOs) that could reduce overall costs for consumers.

## TNUoS revenue collection risk and allocation

2.3. TNUoS charges recover the cost of installing and maintaining the transmission system in England, Wales, Scotland and offshore. The ESO recovers the revenue from TNUoS charges on behalf of: NGET; SPT; Scottish Hydro Electricity Transmission (SHE-T); OFTOs and other network schemes<sup>1011</sup>. In terms of scale, for the year ending March 2019, 87% of TNUoS

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<sup>9</sup> See paragraph 1.10 of Future Arrangements for the Electricity System Operator: Informal Consultation on ESO Licence Drafting:

[https://www.ofgem.gov.uk/system/files/docs/2017/12/licence\\_separation\\_informal\\_consultation.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/12/licence_separation_informal_consultation.pdf)

<sup>10</sup> Ibid

<sup>11</sup> In addition to TNUoS, the ESO is responsible for collecting revenue associated with the Assistance to Areas of High Electricity Distribution Costs (AAHEDC) scheme, recovered through a charge on all

charges related to onshore TOs (NGET 61%, SPT 13% and SHE-T 13%) with the remaining 13% split between OFTOs (11%), over-recovery (-2%) and other items (4%), according to NGET's 2018/19 Regulatory Financial Performance Reporting (RFPR) submission<sup>12</sup>.

2.4. The TOs inform the ESO of their allowed revenues annually. The ESO then sets TNUoS charges to reflect this and these charges are paid to the ESO by suppliers and generators. There are various reasons why a difference may arise between the collected TNUoS revenue and what the ESO has paid to TOs and other parties. For example, the ESO's forecast of volumes may differ from outturn volumes<sup>13</sup>. Currently, the ESO pays the revenue that the TOs are allowed, as specified in the TOs' price controls, rather the actual TNUoS revenues the ESO has collected. Therefore, currently the ESO is exposed to the cash difference between collected and allowed revenues, until corrections are made.

2.5. The mechanism that allows the ESO to adjust subsequent TNUoS tariffs to reflect the differences between collected and allowed revenues is specified in Special Licence Condition 3A<sup>14</sup> of the ESO's transmission licence. This condition sets out the level of allowed revenue that may be recovered by the ESO through Transmission Network Use of System Charges - the 'K' correction term therein reflects the difference between allowed and collected revenues.

2.6. Based on this 'K' term, past experience shows that the absolute difference per year between allowed and collected revenues (the variance) has averaged around £31m since 2005/06, with the maximum under-recovery experienced so far being £99m in 2014/15. Because the 'K' term is an end-of-year value, it does not measure the differences between allowed and collected revenues within the year.

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suppliers. This revenue is passed on to Scottish Hydro Electric Power Distribution Ltd. We do not propose to modify any details of this scheme. <https://www.nationalgrideso.com/charging/assistance-areas-high-electricity-distribution-costs>

<sup>12</sup> Regulatory Financial Performance Report NGET (TO) 2019: <https://www.nationalgridet.com/document/131081/download>

<sup>13</sup> The K correction term is distinct from bad debt, which is the non-payment of invoices by suppliers or generators. This consultation does not propose to modify the regulatory treatment of bad debt.

<sup>14</sup> National Grid Electricity Transmission Plc - Electricity Transmission Licence Special Condition 3A: <https://epr.ofgem.gov.uk//Content/Documents/National%20Grid%20Electricity%20Transmission%20plc%20-%20Special%20Conditions%20Consolidated%20-%20Current%20Version.pdf>

2.7. Prior to legal separation, the magnitude of the variance was modest compared to the size of NGET's Regulatory Asset Value (RAV) (over £13bn) and borrowings. In contrast, the size of the variance is less modest relative to the ESO's RAV (£211m in nominal terms at the end of 2019/20<sup>15</sup>) and borrowings. In March 2019, a credit rating performed by Moody's<sup>16</sup> noted that the ESO's rating was constrained by exposure to such revenue collection activities. The rating provided by Moody's (which was "investment grade") was reliant on Moody's assigning a high likelihood of parental support should it become necessary to maintain ESO credit quality. We understand that prior to legal separation, NGET managed TNUoS cashflow variances using the wider working capital needs of NGET's business. Further, the ESO currently has – and would likely continue to need – a Working Capital Facility (WCF) to manage the TNUoS cashflows. Ofgem will need to take into consideration the ability of a relatively small standalone company to procure and support a WCF of equivalent size.

2.8. During the separation from NGET, a reallocation from NGET to the ESO of £7-8m per year (for 2019/20 & 2020/21) was implemented, to reflect "the costs to the [ESO] relating to the provision of financial facilities allocated from National Grid Electricity Transmission plc".<sup>17</sup>

## Proposal

2.9. Taking into account the responses to our August 2019 consultation, including the concerns outlined in paragraph 1.2 above, we set out below our proposal and rationale for reallocating the TNUoS collection cashflow timing risk from the ESO to the onshore TOs.

2.10. We are not proposing to change how the ESO allocates TNUoS revenue to OFTOs or other parties.

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<sup>15</sup> RIIO-ET1 Financial Model following the Annual Iteration Process 2019:  
<https://www.ofgem.gov.uk/publications-and-updates/riio-et1-financial-model-following-annual-iteration-process-2019>

<sup>16</sup> [https://www.moody.com/research/Moodys-assigns-Baa1-rating-to-National-Grid-Electricity-System-Operator--PR\\_396553](https://www.moody.com/research/Moodys-assigns-Baa1-rating-to-National-Grid-Electricity-System-Operator--PR_396553)

<sup>17</sup> As set out in paragraph 3A.4 of Special Condition 3A of the ESO's licence,  
[https://epr.ofgem.gov.uk/Content/Documents/NGESO%20-%20Special%20Conditions%20Consolidated%20-%20Current%20Version.pdf?utm\\_source=ofgem&utm\\_medium=&utm\\_term=&utm\\_content=licencecondition&utm\\_campaign=epr](https://epr.ofgem.gov.uk/Content/Documents/NGESO%20-%20Special%20Conditions%20Consolidated%20-%20Current%20Version.pdf?utm_source=ofgem&utm_medium=&utm_term=&utm_content=licencecondition&utm_campaign=epr), Appendix 1 to that condition sets out these values as £7.18m & £6.34m.

## Rationale

2.11. The onshore TOs' larger RAVs, and direct interest in their allowed and collected revenues, make them a more natural, and more economical, owner of this cashflow timing risk exposure. As set out at paragraphs 2.6 & 2.7, the difference between allowed and collected revenues can be material in relation to the size of the ESO – this means that the finance cost would, in our view, if allocated to the ESO, be less efficient because financiers (both debt and equity) in the ESO would require a larger allowance than financiers (both debt and equity) in the onshore TOs.

2.12. This proposal would bring onshore TOs into line with other network companies, including those in electricity and gas distribution, as well as the water industry, who have the equivalent of a K correction term such that in the short term each company is exposed to some small uncertainty on the exact quantum of collected revenues. Further, the proposed change would avoid a perverse incentive where the ESO could intentionally make inaccurate volume forecasts in order to justify higher allowances for managing cash collection variances.

2.13. It is our view that the obligations and incentives on the ESO to produce accurate forecast and tariff calculations can be maintained or improved through other options, at a lower cost to industry. This can be achieved through licence obligations and the ESO's incentives scheme.

2.14. We are not proposing to move OFTO-related cashflow timing risk because these are a much smaller proportion of overall revenues (approximately 11%) and therefore a smaller proportion of the difference between allowed and collected revenues. In addition, doing so would run contrary to the assumptions on which OFTO bidders bid during the competitive bid stage and their project-financed structures are based; namely, that OFTOs were not exposed to revenue collection timing risk. In addition, we expect Competitively Appointed Transmission Operators (CATOs) to exist in the future. At this stage, we consider that CATOs should be treated in the same way as OFTOs but will consider the approach for CATOs as and when we further develop CATO policy.

2.15. Any decisions made to change the allocation of the TNUoS cashflow timing risk in time for the start of RIIO-2 would be taken into account in our price control determinations for the ESO and onshore TOs.

### 3. Proposed Changes

#### **Consultation Questions:**

**Question 3: Are the proposed licence and code modifications the most appropriate way to move TNUoS cashflow risk from the ESO to the onshore TOs?**

**Question 4: Is there any alternative/improved method of reallocating the TNUoS cashflow timing risk from the ESO to the onshore TOs that you think should be considered?**

**Question 5: Do you think any other considerations or changes could be required to accommodate the reallocation of this risk?**

### **Background to the K correction term and Revenue Allocation**

3.1. In the ESO's electricity transmission licence, Special Licence Condition 3A sets out the level of Maximum Revenue that may be recovered by the ESO through Transmission Network Charges and the associated application of the K correction term. Whilst there is no licence condition related explicitly to how the ESO allocates collected TNUoS revenue to TOs<sup>18</sup>, Standard Condition B12 of the electricity transmission licence requires licensees to have in force the System Operator - Transmission Owner Code (STC)<sup>19</sup>, where the payment of TNUoS<sup>20</sup> revenue to TOs is set out.

3.2. The payment of revenues from the ESO to the TOs is covered by Section E of the STC and the associated STC Procedure, STCP 13-1 - Invoicing and payment. This STC procedure sets out how the ESO pays TOs their respective allowed revenues in twelve equal monthly

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<sup>18</sup> Special Licence Condition 3A (Restriction of Transmission Network Revenue), which relates to Revenue Restriction and the K correction term, refers only to 'revenue derived by the licensee'.

<sup>19</sup> For OFTOs, Standard Licence Condition E13 of their licences requires them to have in force the STC.

<sup>20</sup> TNUoS revenue is referred to as "TO General Services Charges" in the STC.

payments. The TOs' allowed revenues are set out in their respective licence and are notified to the ESO by the TOs on an annual basis, updated as appropriate.

## Summary of proposed changes to licences and codes

3.3. We aim to publish our decision on this consultation at or before our RIIO-2 draft determinations in 2020. Statutory consultations on any licence modifications necessary to implement that decision will follow thereafter, either as part of the RIIO-2 licence modifications, or earlier, as necessary, e.g. the proposed modifications discussed in paragraph 3.11 below.

3.4. We consider the following steps would need to be taken in order to implement our proposal:

- (i) Modify Special Licence Condition 3A of the ESO licence to remove the K correction term from 1 April 2023<sup>21</sup>.
- (ii) Modify Special Licence Condition 3A of NGET's licence to clarify the application of the K correction term from 1 April 2021.
- (iii) Modify Standard Licence Condition B12 of electricity transmission licences of the ESO, NGET, SHE-T and SPT to include an explicit requirement for the STC to detail that the ESO will pay the (onshore) TOs the revenues it *collected* from TNUoS charges on their behalf and for any under- or over-recovery to be shared between the onshore TOs. This licence condition would also be modified to state explicitly that licensees shall use best endeavours to ensure the STC modification is in place by 1 April 2021.
- (iv) STCP 13-1 to be modified to provide that *collected* TNUoS revenue is paid to the TOs, and a process is set out to share any over- or under-recovery between the onshore TOs.

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<sup>21</sup> Special Licence Condition 3A of SHE-T and SPT's licences already contains a K correction term, so this would not need to be modified. Special Licence Condition 3A of NGET's licence also contains a K correction term, however, this would need to be modified to remove the reference to "in the form in which it was in force at 31 March 2019".

3.5. In the section below we provide more details on what these steps may mean in practice. Please note that proposed deleted text is struck through, and proposed additional text is underlined.

### **Step I – Changes to Special Licence Condition 3A of the ESO’s licence – Revenue Restriction of Transmission Network Revenue**

3.6. The first step would be to remove the K term from the ESO licence.

#### **ESO Special Licence Condition 3A – Proposed addition**

3.7. We propose to introduce a new paragraph, 3A.12, into Special Condition 3A in which the  $K_t$  term for year 2023/24 onwards would be set at zero.

*[New]3A.12 In Relevant Year 2023/24 and subsequent Relevant Years,  $K_t$  will have the value zero.*

### **Step II – Changes to Special Licence Condition 3A of NGET’s licence – Revenue Restriction**

3.8. The second step would be to modify Special Licence Condition 3A of NGET’s licence.

#### **NGET Special Licence Condition 3A – Proposed modification**

3.9. In order to remove TNUoS under- or over-recovery cashflow timing risk from the ESO from 1 April 2021 onwards, it is proposed to modify paragraph 3A.14 and introduce a new paragraph 3A.15 with different applicable dates. The current paragraphs relating to the early years of RIIO-1 are not required for the RIIO-2 price control, and can be deleted for presentational purposes.

*3A.14 ~~For Relevant Years 2019/20 and 2020/21, for the purposes of the Principal Formula, subject to paragraph 3A.15 and 3A.16,  $K_t$  is derived in accordance with the following formula:~~*

$$K_t = (TNR_{t-2} - TO_{t-2}) \times (1 + I_{t-2} + PR_t/100) \times (1 + I_{t-1} + 2/100)$$

*where:*

*TNR<sub>t-2</sub> means the Transmission Network Revenue as defined in Special Condition 1A (Definitions and interpretation) of this licence in the form in which it was in force at 31 March 2019 in respect of Relevant Year t-2.*

$TO_{t-2}$  means the Maximum Revenue as derived in accordance with Part B of this condition of this licence in the form in which it was in force at 31 March 2019 in respect of Relevant Year  $t-2$ .

$I_t$  means the Average Specified Rate in Relevant Year  $t$ .

$PR_t$  means the interest rate adjustment in Relevant Year  $t$  as derived in accordance with the formula set out in Part F of this condition.

[New]3A.15 For Relevant Year 2021/22 and subsequent Relevant Years, for the purposes of the Principal Formula,  $K_t$  is derived in accordance with the following formula:

$$K_t = (TNR_{t-2} - TO_{t-2}) \times (1 + I_{t-2} + PR_t/100) \times (1 + I_{t-1} + 2/100)$$

where:

$TNR_{t-2}$  means the Transmission Network Revenue as defined in Special Condition 1A (Definitions and interpretation) of this licence in respect of Relevant Year  $t-2$ .

$TO_{t-2}$  means the Maximum Revenue as derived in accordance with Part B of this condition in respect of Relevant Year  $t-2$ .

$I_t$  means the Average Specified Rate in Relevant Year  $t$ .

$PR_t$  means the interest rate adjustment in Relevant Year  $t$  as derived in accordance with the formula set out in Part F of this condition.

3A.15 For the Relevant Year commencing 1 April 2013,  $K_t$  is derived in accordance with the following formula:

$$K_t = (TNR_{t-1} - TO_{t-1}) \times \left(1 + \frac{I_{t-1} + PR_{t-1}}{100}\right)$$

$TNR_{t-1}$  means the Transmission Network Revenue in respect of the Relevant Year commencing 1 April 2012 as defined in Special Condition D1 of this licence in the form in which it was in force at 31 March 2013.

$TO_{t-1}$  means the Maximum Revenue in respect of the Relevant Year commencing 1 April 2012 as derived in accordance with Special Condition D2 of this licence in the form in which it was in force at 31 March 2013.

$I_t$  means the Average Specified Rate in Relevant Year  $t$ .



$PRO_t$  means the interest rate adjustment in Relevant Year  $t$  as derived in accordance with the formula set out in Part F of this condition.

3A.16 In the Relevant Year 2014/15  $K_t$  will have the value zero.

### **Step III – Proposed modifications to Standard Licence Condition B12 of electricity transmission licences**

3.10. The third step would be to modify Standard Licence Condition B12, which sets out, among other things, the obligation on the ESO and onshore TOs to have in force an STC, and the objectives thereof. It is the STC and its associated procedures which set out how the ESO pays the TOs for the provision of transmission services.

3.11. We propose to modify Standard Licence Condition B12 to include an explicit requirement for the STC to have a procedure in place to allocate collected revenues between the TOs. This procedure would be required to be consistent with the principles that the ESO would only pay collected TNUoS to the onshore TOs, net of payments to OFTOs and other parties, and that any under- or over-recovery would be shared between the onshore TOs. This licence condition would explicitly state that the licensees shall use best endeavours to ensure the procedure is in place by 1 April 2021.

#### **Standard Licence Condition B12 – Proposed modification**

3.12. We propose to modify Standard Licence Condition B12 to include an explicit requirement for the STC to have a procedure in place to allocate revenue between all TOs, consistent with the principle that the ESO will only pay collected TNUoS, net of payments due to OFTOs and other parties, to the onshore TOs. This modified licence condition would state explicitly that licensees shall use best endeavours to ensure the STC modification is in place by 1 April 2021:

*1. The licensee shall, in common with those other transmission licensees to which this condition applies, at all times have in force a STC, being a document which:*

*(a) sets out terms as between STC parties whereby the national electricity transmission system and each STC party's transmission system forming part thereof is to be planned, developed or operated and transmission services are to be provided together with any associated arrangements;*

*(b) set outs the terms by which the system operator allocates received Transmission Network Revenue, consistent with the principles that the system operator will only pay collected TNUoS revenue, net of payments to OFTOs and other parties, to onshore TOs, and any under- or over-recovery will be shared between NGET, SHE-T and SPT, proportionate to their share of total Transmission Owner revenue. The licensee shall use its best endeavours to ensure terms are in place that facilitate its compliance with the requirements of this condition no later than 1 April 2021.* <sup>22</sup>

*(b c) is designed to facilitate achievement of the objectives set out in paragraph 3; ....*

#### **Step IV – Changes to STCP 13-1**

3.13. To be consistent with the proposed licence changes, the ESO or other relevant STC parties would be required to raise a modification to STCP 13-1 - Invoicing and Payment.<sup>23</sup> This would be to ensure that the STC is consistent with the modified Standard Licence Condition B12. An example of new text is provided below as an illustration, but the relevant STC parties would be responsible for drafting the modification, which would be subject to the normal STCP modification process. The modified STCP 13-1 would need to be in place by 1 April 2021, as set out in the proposed modifications to Standard Licence Condition B12.

#### **STCP 13-1 – Illustrative modified text**

3.14. We would expect the existing STCP 13-1 to be modified to reflect the modified Standard Condition B12 that the ESO “pays-as-paid”. The additional new text is provided below as an illustration, but the relevant STC parties would be responsible for drafting the modified procedure, which would be subject to the normal STC modification process. The modified STC procedure would need to be in place by 1 April 2021, as set out in the proposed modifications to Standard Licence Condition B12.

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<sup>22</sup> In addition to the modification to Special Condition B12, we would add a term “Transmission Network Revenue” (as defined in the ESO licence) in Standard Licence Condition A1 - Definitions and interpretation of all onshore TOs licences. The term Transmission Owner in the Electricity Transmission Licence refers to onshore Transmission Owner.

<sup>23</sup> STCP13-1 Issue 008 Invoicing & Payment:  
<https://www.nationalgrideso.com/document/41071/download>

3.1.4. The OFTO shall invoice NGESO<sup>24</sup> equal amounts over the remaining months of the year, matching the amounts shown in the schedule provided under clause 3.1.2 or 3.1.3 and totalling the annual General System Charges, Site Specific Charges forecast in 3.1.1, 3.1.2 and 3.1.3 less any one off General System Charges that have been invoiced during the year. NGESO shall pay the recurrent monthly OFTO invoice on the later of

- the 15th day following the day that the OFTO's invoice was despatched; and
- the 16th day of the month to which the invoiced payments relate,

unless, in such case, such payment day is not a Business Day in which case payment shall be made on the next Business Day.

3.1.5 The onshore TOs shall prepare a schedule of amounts spread evenly over the remaining months of the year, matching the amounts shown in the schedule provided under clause 3.1.2 or 3.1.3 and totalling the annual General System Charges, Site Specific Charges forecast in 3.1.1, 3.1.2 and 3.1.3 less any one off General System Charges that have been invoiced during the year.

3.1.6 Based upon the amount set out in paragraph 3.1.5. and the amount of revenue already recovered and paid out by the NGESO, the NGESO shall prepare a schedule of revenue owing to the onshore TOs. This schedule of revenue will be consistent with the standard licence condition B12, which sets out that the NGESO shall only pay collected revenues and any under- or over-recovery will be shared between onshore TOs, proportionate to their share of total onshore revenue. NGESO shall prepare this schedule of revenue on the [17<sup>th</sup>] day of each calendar month, unless, in such case, such day is not a Business Day in which case the schedule of revenue shall be produced on the next Business Day.

3.1.7 The onshore TO shall invoice NGESO the monthly amount shown in the schedule of revenue provided under clause 3.1.6. NGESO shall pay the monthly onshore TO invoice on the day following receipt of invoice from the onshore TO, unless, in such

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<sup>24</sup> The STC refers to the ESO as NGESO.

case, such payment day is not a Business Day in which case payment shall be made on the next Business Day.

## 4. Questions and next steps

### Consultation Questions

4.1. We are consulting on the following questions:

1. If the TNUoS cashflow timing risk is allocated to the onshore TOs, are there any other interactions we need to consider or aspects that should be taken into account in our RIIO-2 determinations?
2. Do you agree that appropriate incentivisation of the ESO for accurate forecast and tariff calculations can be maintained through licence obligations and the ESO's incentives scheme?
3. Are the proposed licence and code modifications the most appropriate way to move TNUoS cashflow timing risk from the ESO to the onshore TOs?
4. Is there any alternative/improved method of reallocating the TNUoS cashflow timing risk from the ESO to the onshore TOs, that you think should be considered?
5. Do you think any other considerations or changes could be required to accommodate the reallocation of this risk?

### Next Steps

4.2. We are seeking responses to the questions consulted on in this document by 31 January 2020. This will enable us to make a decision at or before our RIIO-2 draft determinations next year and align with the start of RIIO-2.

4.3. TNUoS is not the only industry cash flow that the ESO manages. It also manages Balancing Use of System Charges (BSUoS). We have recently asked the ESO to launch a second task force to consider the appropriate future arrangements for BSUoS.<sup>25</sup> It is possible

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<sup>25</sup> Please see:

[https://www.ofgem.gov.uk/system/files/docs/2019/02/decision\\_to\\_launch\\_a\\_balancing\\_services\\_charges\\_taskforce.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/02/decision_to_launch_a_balancing_services_charges_taskforce.pdf)

that changes to BSUoS arrangements could also have implications for the cashflow risk faced by the ESO. We will engage with this task force to ensure its conclusions consider the total impact on consumers, considering any interactions with the RIIO-2 price controls.

## Appendix – Privacy notice on consultations

### Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

### 1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, “Ofgem”). The Data Protection Officer can be contacted at [dpo@ofgem.gov.uk](mailto:dpo@ofgem.gov.uk)

### 2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

### 3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. i.e. a consultation.

### 4. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for ***(be as clear as possible but allow room for changes to programmes or policy. It is acceptable to give a relative time e.g. 'six months after the project is closed')***

### 5. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete
- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data

- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3<sup>rd</sup> parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at <https://ico.org.uk/>, or telephone 0303 123 1113.

**6. Your personal data will not be sent overseas** (Note that this cannot be claimed if using Survey Monkey for the consultation as their servers are in the US. In that case use “the Data you provide directly will be stored by Survey Monkey on their servers in the United States. We have taken all necessary precautions to ensure that your rights in term of data protection will not be compromised by this”.

**7. Your personal data will not be used for any automated decision making.**

**8. Your personal data will be stored in a secure government IT system.** (If using a third party system such as Survey Monkey to gather the data, you will need to state clearly at which point the data will be moved from there to our internal systems.)

**9. More information** For more information on how Ofgem processes your data, click on the link to our “[Ofgem privacy promise](#)”.