



Making a positive difference
for energy consumers

National Grid Electricity System
Operator Limited

Direct Dial: 020 3263 2701

Email: Chris.Thackeray@ofgem.gov.uk

Date: 05 June 2020

Dear colleague,

Decision on adjusting the Electricity Market Reform Delivery Body Incentives and mechanisms to recover uncertain costs.

On 11th March 2020, we¹ published a statutory consultation² on proposed modifications to National Grid Electricity System Operator's (NGESO) Electricity Transmission Licence (Licence). We invited views on the proposed modifications to Special Condition 7D of NGESO's Licence in respect of installing an Uncertainty Mechanism (UM) for funding adjustments, to fulfil its role as the Delivery Body (DB) for Electricity Market Reform (EMR), and Special Condition 4L regarding the removal of one of the incentives from NGESO's incentive framework.

Proposed Modifications

Special Condition 7D: Arrangements for the recovery of SO uncertain costs

We proposed to make changes to NGESO's Licence Special Condition 7D to include an additional UM window in March 2021. This UM will provide NGESO an opportunity to make a relevant adjustment proposal to manage uncertain costs incurred in exercising its EMR function from May 2019 to 31 March 2021. This UM will provide funding to cover uncertain costs associated with a replacement Information Technology (IT) system that the EMR DB

¹ The use of "we", "us" and "our" refers to the Authority. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day-to-day work.

² See: [Statutory Consultation for adjusting the Electricity Market Reform Delivery Body Incentives and mechanisms to recover uncertain costs](#)

are in the process of delivering, and costs associated with urgent unavoidable policy changes. It is our view that EMR Delivery Partners³ should seek to avoid inefficient spend, where possible. The additional funding associated with the replacement IT system will be assessed against achieving the required outcomes as noted in paragraph 2.2 in our statutory consultation.

Special Condition 4L: Financial incentives on EMR

Upon review of NGESO's incentive framework for undertaking the role of the EMR DB, and following prior consultation, we proposed to modify NGESO's Licence Special Condition 4L to remove one of the four incentives. We intend to retain three of the four incentives, which includes the demand forecasting accuracy, dispute resolution, and customer and stakeholder satisfaction incentives. The Demand Side Response (DSR) participation incentive does not appear to be fit for purpose. We therefore proposed that the DSR incentive be removed from NGESO's Licence Special Condition 4L for the 2020/21 financial year.

Responses to our Statutory Consultation

We received four responses to the statutory consultation that closed on 17th April 2020. One response was marked confidential; the three remaining responses have been published on our website alongside this decision.

All four respondents supported our proposal to introduce this UM to enable the EMR DB to recover efficient and appropriate costs related to the replacement IT system.

Of the four responses, two explicitly discuss the EMR DB's delivery of the replacement IT system in-line with industry needs. One respondent expressed the need for the DB to engage with market participants in the scoping and design of the replacement IT system, to ensure it meets user needs. Both respondents support our required outcomes from the replacement IT system against which the submission for additional funding would be assessed. We state in these outcomes the need for the DB to focus on user needs.

All four respondents supported our proposed removal of the DSR incentive from NGESO's EMR incentive framework. Respondents agreed that the removal is appropriate, with two noting that the incentive penalises or rewards the DB for outcomes that are outside its control.

³ See: [EMR Delivery Partners](#)

Three of the four respondents broadly agreed with our intentions to fully consider integrating the EMR DB incentives framework into the wider ESO incentive regime.

Our Decision and next steps

Having considered all responses to our statutory consultation, we have decided to proceed with the proposed modifications to Special Conditions 7D and 4L of NGESO's Licence. The modifications to NGESO's Licence are set out in Schedule 1 of the decision notice published on our website alongside this letter. The modifications to the Licence will enable an UM window in March 2021 to manage uncertain costs, and the removal of the DSR incentive from NGESO's incentive framework for undertaking the role of the EMR DB.

Enabling the UM window in March 2021 will require NGESO to submit a relevant adjustment proposal on their funding by 31st March 2021. We encourage NGESO to fully engage with us as costs are understood and incurred leading up to and throughout the UM window. Based on the information provided by NGESO and their justification of costs and efficient spending, we will undertake a thorough assessment. We outline our expectations of NGESO's funding adjustment proposals in paragraph 2.9 in our statutory consultation.

Based on a full assessment of the costs, and careful consideration of responses to our consultation on NGESO's funding adjustment proposals, we will decide on additional allowances by 31st July 2021 as per Special Condition 7D12(b).

Removing the DSR incentive from the 2020/21 financial year will remove +/- £1m from NGESO's total EMR incentive value, reducing it to +/- £3.8m. Having reviewed NGESO's EMR incentive framework, we will retain the three remaining incentives. This includes the demand forecasting accuracy, dispute resolution, and customer and stakeholder satisfaction incentives. We intend to fully consider integrating the EMR DB's funding and incentive framework with NGESO's wider framework. In addition, we will continue to monitor the effectiveness of the DB in encouraging market wide participation in the Capacity Market auctions and providing support to participants based on their requirements.

We have published the decision notice on our website alongside this letter. The licence changes will come into effect 56 days from the date of publication of our decision on 01 August 2020.

Yours faithfully,

Chris Thackeray

**Chris Thackeray, Head of GB Wholesale Markets
For and on behalf of the Gas and Electricity Markets Authority**