

To: National Grid Electricity Transmission plc

**Electricity Act 1989
Section 11A(2)**

Notice of statutory consultation on a proposal to modify the special conditions of the electricity transmission licence held by National Grid Electricity Transmission plc

1. The Gas and Electricity Markets Authority ('the Authority')¹ proposes to modify the special conditions of the electricity transmission licence held by National Grid Electricity Transmission plc ('NGET') granted or treated as granted under section 6(b) of the Electricity Act 1989 by:
 - a. amending special condition 4B (Balancing Services Activity Condition: Interpretation)
 - b. amending special condition 4C (Balancing Services Activity Revenue Restriction on External Costs)
 - c. removing special condition 4D (Restriction on contracting with BSC parties)
 - d. removing special condition 4E (Requirement to Conduct a Review and Continue to Develop Enduring Models for Forecasting the Costs of Procuring and Using Balancing Services)
 - e. removing special condition 4F (Requirement to Develop Enduring Methodologies for the Purposes of Identifying a Target for the Costs of Procuring and Using Balancing Services)
 - f. removing special condition 4H (Forecasting Incentive)
 - g. removing special condition 4I (Requirement to Report on System Transmission Losses)
 - h. amending special condition 4J (SO-TO mechanism) and
 - i. inserting new special condition 4M (Electricity System Operator Reporting and Incentive Arrangements).
2. We are proposing these modifications to replace the existing System Operator incentive scheme with a new scheme, the 'The Electricity System Operator Reporting and Incentive Arrangements' ('ESORI Scheme') to run from regulatory year 2018/19. The new scheme will create transparency around NGET's actions and performance and encourages it to identify and make changes to the way it performs its role as the System Operator for the benefit of current and future consumers. We are also continuing the SO-TO mechanism and are removing the sunset clause in the COS_t term so this part of the mechanism can continue from the regulatory year 2018/19.
3. The effect of the proposed modification will be to:
 - a. require NGET to have greater stakeholder engagement;
 - b. require NGET to have in place, at the beginning of each regulatory year, a forward plan that sets out:
 - i. how it will perform its role to the benefit of consumers
 - ii. the steps it proposes to take to meet its deliverables in the performance of its role; and
 - iii. the performance metrics to be used to measure that performance;
 - c. implement within year, mid-year and end of year reporting;
 - d. allow the Authority to direct the value of the incentive payment for NGET's performance under the ESORI Scheme to a maximum value of no more than £30m and a minimum value of no less than (minus) -£30m; and
 - e. allow NGET to continue to be paid for payments made to the Scottish Transmission Owners in relation Commercial Operational Services.

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

4. A copy of the proposed modifications and other documents referred to in this Notice have been published on our website (www.ofgem.gov.uk). Alternatively they are available from our Research and Information Centre, 9 Millbank, London, SW1P 3GE (020 7901 7003).
5. Any representations with respect to the proposed licence modification must be made on or before **Friday 23 March 2018** to: David Beaumont, Office of Gas and Electricity Markets, 9 Millbank, London, SW1P 3GE or by email to electricityS0reform@ofgem.gov.uk.
6. We normally publish all responses on our website. However, if you do not wish your response to be made public then please clearly mark it as not for publication. We prefer to receive responses in an electronic form so they can be placed easily on our website.
7. If we decide to make the proposed modifications they will take effect not less than 56 days after the decision is published.

Philippa Pickford

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Associate Partner, Energy Sytems
Duly authorised on behalf of the Gas and Electricity Markets Authority

23 February 2018

Schedule

Modifications to special licence conditions

Special Condition 4B: Balancing Services Activity Conditions: Interpretation

- 4B.1 In this Special Condition and in Special Conditions 4C (Balancing Services Activity Revenue Restriction on External Costs) to ~~4J~~ Special Condition 4M (Electricity System Operator Reporting and Incentive Arrangements) inclusive, all revenue shall be measured on an accruals basis, after deduction of value added tax (if any) and any other taxes based directly on the amounts so derived.
- 4B.2 Any term used in the formulae appearing in Special Conditions 4C to ~~4J~~ Special Condition 4M (Electricity System Operator Reporting and Incentive Arrangements) inclusive and defined for the purposes of those formulae shall have the same meaning if used in any other formulae in those Special Conditions.
- 4B.3 In this Special Condition and in Special Conditions 4C to ~~4J~~ Special Condition 4M (Electricity System Operator Reporting and Incentive Arrangements), any cost, charge, payment or amount may either be positive or negative.

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:

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

The term $FIIR_t$ in the formula above will be removed as part of the proposal to modify the licence under the statutory consultation

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 cashflow 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_t means an incentive payment for Relevant Year t calculated in accordance with ~~paragraph 4C.11~~ Special Condition 4M (Electricity System Operator Reporting and Incentive Arrangements);
- SOTOC_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
- ~~FHR_t means the incentive payment which the licensee may derive from the forecasting incentive for Wind Generation Output and National Demand in Relevant Year t in accordance with Special Condition 4H (Forecasting incentive);~~
- j shall mean a settlement period (being half an hour) as defined in the BSC.

Parts B and C of this Special Condition 4C will remain unchanged as part of the proposal to modify the licence under the statutory consultation

Parts D to M (the remainder) of this Special Condition 4C are being removed as part of the proposal to modify the licence under the statutory consultation

Special Condition 4D: Restriction on contracting with BSC parties

This Special Condition 4D is being removed as part of the proposal to modify the licence under the statutory consultation and will become 'Not used'

Special Condition 4E: Requirement to Conduct a Review and Continue to Develop Enduring Models for Forecasting the Costs of Procuring and Using Balancing Services

This Special Condition 4E is being removed as part of the proposal to modify the licence under the statutory consultation and will become 'Not used'

Special Condition 4F: Requirement to Develop Enduring Methodologies for the Purposes of Identifying a Target for the Costs of Procuring and Using Balancing Services

This Special Condition 4F is being removed as part of the proposal to modify the licence under the statutory consultation and will become 'Not used'

Special Condition 4H: Forecasting Incentive

This Special Condition 4H is being removed as part of the proposal to modify the licence under the statutory consultation and will become 'Not used'

Special Condition 4I: Requirement to Report on System Transmission Losses

This Special Condition 4I is being removed as part of the proposal to modify the licence under the statutory consultation and will become 'Not used'

Special Condition 4J. SO-TO mechanism

Part A: Purpose of licence conditions

4J.1 The purpose of this condition is to:

- (a) establish the value of the SO-TO Cost allowance term (SOTOC_t) in the formula in Special Condition 4C (Balancing Services Activity Revenue Restriction); ~~and~~
- (b) ~~place an obligation on the licensee in relation to the production of a quarterly report on the Commercial Operational Services and Joint Works Projects incurred or considered by the licensee.~~

4J.2 For the purposes of paragraph 4J.1, the term OC_t shall be derived from the following formula:

$$\text{SOTOC}_t = (\text{OC}_t + \text{COS}_t + \text{OCTRU}_t + \text{ONTRU}_t) \times \text{RPIF}_t + \text{JW}_t + \text{OIPay}_t + \text{IONT}_t$$

where:

OC_t means an allowance for payments by the licensee to SP Transmission Ltd, Scottish Hydro Electric Transmission Plc or any successor company to each in respect of Outage Changes and has the value £1,146,800 (in 2009/10 prices) for the Relevant Year t unless determined otherwise by the Authority in accordance with Part D of this condition;

COS_t means an allowance for payments to SP Transmission Ltd, Scottish Hydro Electric Transmission Plc or any successor company by the licensee in respect of Commercial Operational Services and has the value £1,146,800 (in 2009/10 prices) for 2017/18 and zero for any other Relevant Year t unless determined otherwise by the Authority in accordance with Part D of this condition;

OCTRU_t means the revenue adjustment made in Relevant Year t in respect of the actual value of the Retail Prices Index in Relevant Year t-2 minus the assumed value of the Retail Prices Index in Relevant Year t-2, as derived in accordance with paragraph 4J.3 of this condition;

ONTRU_t means the revenue adjustment made in Relevant Year t in respect of the actual value of the Retail Prices Index in Relevant Year t-2 minus the assumed value of the Retail Prices Index in Relevant Year t-2, as derived in accordance with paragraph 4J.4 of this condition and has the value zero in Relevant Years 2018/19 and in each subsequent Relevant Year.

RPIF_t has the value given to it by Special Condition 3A (Restriction of Transmission Network Revenue);

JW_t means an allowance for payments to SP Transmission Ltd, Scottish Hydro Electric Transmission Plc or any successor company to each by the licensee in respect of a Joint Works Projects and has the value of zero unless

determined otherwise by the Authority in accordance with Part D of this condition;

~~OIPay_t means an incentive payment for Relevant Year t determined in accordance with Part F of this condition; and~~

IONT_t means the amount of any allowed outage cost adjustments in each Relevant Year t determined in accordance with Part D of this condition;

4J.3 For the purposes of paragraph 4J.2, OCTRU_t is derived in accordance with the following formula:

$$OCTRU_t = \left(\frac{RPIA_{t-2} - RPIF_{t-2}}{RPIA_{t-2}} \right) \times \frac{SOTOC_{t-2}}{RPIF_{t-2}} \times PVF_{t-2} \times PVF_{t-1}$$

where:

RPIA_{t-2} has the value given to it by Part C of Special Condition 3A;

RPIF_{t-2} has the value given to it by Part C of Special Condition 3A;

SOTOC_{t-2} means the SO-TO Cost allowance as derived in accordance with paragraph 4J.2 of this condition; and

PVF_t has the value given to it by Part C of Special Condition 3A.

4J.4 For the purposes of paragraph 4J.2, ONTRU_t is derived in accordance with the following formula:

$$ONTRU_t = \left(\frac{RPIA_{t-2} - RPIF_{t-2}}{RPIA_{t-2}} \right) \times \frac{NC_{t-2}}{RPIF_{t-2}} \times PVF_{t-2} \times PVF_{t-1}$$

where:

RPIA_{t-2} has the value given to it by Part C of Special Condition 3A;

RPIF_{t-2} has the value given to it by Part C of Special Condition 3A;

NC_{t-2} means the Outage Change cost allowance calculated in accordance with the licence in effect in Relevant Year 2016/17; and

PVF_t has the value given to it by Part C of Special Condition 3A.

Parts B to D of this Special Condition 4J will remain unchanged as part of the proposal to modify the licence under the statutory consultation

Part E and F of this Special Condition 4J are being removed as part of the proposal to modify the licence under the statutory consultation

Part H E Definitions

4J.25 The definitions in this condition will have the following meaning:

<p>Commercial Operational Services</p>	<p>means a service provided to the licensee by SP Transmission plc, Scottish Hydro Electric Transmission Plc or any successor company to each with the purpose of lowering the overall costs associated with the procurement and use of balancing services by the licensee above these parties obligations under the licence or the STC.</p>
<p>Joint Works Projects</p>	<p>means where the licensee and SP Transmission plc, Scottish Hydro Electric Transmission Plc or any successor company agree to a Commercial Operational Services so as to minimise costs on the national electricity transmission system when the costs are higher than £1,146,800 (in 2009/10 prices);</p>
<p>Outage Change</p>	<p>means a change notified to a SP Transmission plc, Scottish Hydro Electric Transmission Plc or any successor company by the licensee to the Outage Plan on or after Week 49, as updated from time to time in accordance with the STC, other than:</p> <ul style="list-style-type: none"> (a) a change to the Outage Plan requested by SP Transmission plc, Scottish Hydro Electric Transmission Plc or any successor company (the “original change”); and (b) such changes notified to the SP Transmission plc, Scottish Hydro Electric Transmission Plc or any successor company by the licensee which: <ul style="list-style-type: none"> (i) the licensee and SP Transmission plc, Scottish Hydro Electric Transmission Plc or any successor company agree are necessary in order to give effect to the original change; or (ii) where there is a failure to agree, the Authority determines are necessary in order to give effect to the original change, and (c) without prejudice to sub-paragraphs (a) and (b) above, any change to the Outage Plan notified to SP Transmission plc, Scottish Hydro Electric Transmission Plc or any successor company by the licensee which the licensee and the Transmission Owner agree is not an Outage Change

	under this licence condition (a “non-chargeable outage change”)
Outage Plan	has the meaning used or given in the STC;
Week 49	has the meaning used or given in the STC;

Special Condition 4M: Electricity System Operator Reporting and Incentive Arrangements

Part A: Introduction

4M.1 The purpose of this licence condition is to:

- (a) establish the arrangements known as the Electricity System Operator Reporting and Incentive (ESORI) Scheme, which includes the arrangements for determining the amount of the IncPayExt_t term in respect of Relevant Year t under paragraph 4C.1 of Special Condition 4C (Balancing Services Activity Revenue Restriction on External Costs); and
- (b) make provision for the arrangements relating to the governance and of the ESORI Scheme.

Part B: Function of the ESORI Scheme

4M.2 The function of the ESORI Scheme is to create transparency around the licensee's actions and its performance and encourage it to identify and make changes to improve the way it performs its role as the System Operator for the benefit of current and future electricity consumers in Great Britain.

Part C: Establish the Forward Plan

4M.3 The licensee shall have in place, at the start of each Relevant Year, a Forward Plan that sets out:

- (a) for each of the Principles, the changes the licensee considers it needs to make to the way it performs its role as the System Operator in order to benefit consumers, in both the Relevant Year t, and in as many of the years following the Relevant Year t as is reasonably possible (the "Long Term Vision");
- (b) the steps the licensee proposes to take to meet the Long Term Vision in the Relevant Year (the "Deliverables"); and
- (c) for each of the Principles, the information the licensee proposes to use to measure its performance against the Long Term Vision and Deliverables during the Relevant Year (the "Performance Metrics"), including what outcomes the licensee proposes would constitute a reasonable representation of performance that is:
 - (i) below the expectations of the FP Consultees in paragraph 4M.5;
 - (ii) in line with the expectations of the FP Consultees; and
 - (iii) above the expectations of the FP Consultees;

4M.4 The licensee shall, in developing the Forward Plan in respect of Relevant Year t, consult on the contents of the Forward Plan, including all the information specified in paragraph 4M.3, prior to 31 January in Relevant Year t-1.

4M.5 The licensee shall, in fulfilling its obligations under paragraph 4M.4 in relation to the Forward Plan, consult with:

- (a) current and potential new electricity industry parties;
- (b) the Authority;
- (c) the ESO Performance Panel (for a Forward Plan in respect of Relevant Year 2019/20 and any Relevant Year thereafter); and
- (d) any other interested parties, including consumer representatives and academics, (together the “FP Consultees”).

4M.6 The licensee shall, following consultation with the FP Consultees under paragraph 4M.5:

- (a) consider any responses made as part of the consultation;
- (b) make any changes to the Forward Plan that it considers appropriate;
- (c) demonstrate in the Forward Plan how it has taken into account the responses of the FP Consultees when making the changes under paragraph 4M.6(b); and
- (d) publish any non-confidential responses to the consultation on its website.

4M.7 The licensee shall, unless otherwise directed by the Authority, publish on its website a final version of the Forward Plan for Relevant Year t on or before 31 March in Relevant Year t-1.

4M.8 The licensee shall:

- (a) keep the Forward Plan under review during a Relevant Year t, including taking into account any representations made by FP Consultees in that year; and
- (b) make any appropriate changes to the Forward Plan for the Relevant Year t+1, ahead of any consultation on the contents of the Forward Plan under paragraph 4M.4 of this condition.

4M.9 The Authority will, in accordance with the ESORI Guidance Document established under Part D of this condition, compile and publish a Formal Opinion containing its views on the content of the Forward Plan on or before 1 May in Relevant Year t.

Part D: The ESORI Guidance Document

4M.10 The Authority will issue a document to be known as the ESORI Guidance Document that explains the process by which the Authority will assess the performance of the licensee and how it will determine the IncPayExt_t term in respect of Relevant Year t.

4M.11 The Authority may make appropriate provision about or impose requirements in the ESORI Guidance Document, which may include, but not be limited to:

- (a) the criteria against which the performance of the licensee will be assessed;
- (b) the process and procedures that will be in place for assessing the performance of the licensee, including the role of the ESO Performance Panel in this process;
- (c) the requirements the licensee must fulfil as part of the assessment process, including the information the licensee must provide and its attendance at ESO Performance Panel meetings;

- (d) the information used for the performance assessment, including how the Forward Plan, the Formal Opinion, the Mid-Year Report and the End of Year Report will be used in that evaluation;
- (e) how the assessment of the performance of the licensee will be used by the Authority to determine IncPayExt_t for the Relevant Year t; and
- (f) any other matters relating to the regulation, governance, or administration of the ESORI Scheme.

4M.12 Where provisions of the ESORI Guidance Document require the compliance of the licensee, the licensee must comply with those provisions as if the ESORI Guidance Document were part of this condition.

4M.13 Before issuing or issuing any material revision of the ESORI Guidance Document under this condition, the Authority will consult with the licensee.

Part E: Within Year reporting, Mid-Year Report and End of Year Report

4M.14 The licensee shall publish information on its performance in relation to the Principles and the Forward Plan on a regular basis, in line with the requirements in ESORI Guidance Document.

4M.15 The licensee shall, on or before the 15th working day in October in Relevant Year t, prepare and publish a report on its website (the “Mid-Year Report”), containing the latest available information specified in paragraphs 4M.16 (a) to (c) in respect of that Relevant Year t.

4M.16 The licensee shall, on or before 7 May in Relevant Year t prepare, publish and submit a report to the Authority (the “End of Year Report”) setting out how the licensee has performed during the Relevant Year t-1, including:

- (a) information on the progress it has made against the Deliverables;
- (b) a summary of the licensee’s performance against the Performance Metrics, including the explanations and justifications for its performance; and
- (c) any evidence of benefits to consumers that have been, or will be, delivered during that Relevant Year, or in the following Relevant Years, as a result of the actions taken by the licensee during that Relevant Year.

4M.17 The licensee shall ensure to the best of its knowledge that the information provided in respect of paragraphs 4.14 to 4M.16, including any explanations and justifications for its performance, is accurate and correct.

4M18 Where the licensee identifies that the information provided in respect Part E of this condition is not accurate or correct, the licensee must notify the Authority and publish or resubmit corrected information as soon practicably possible.

Part F: Incentive payments

4M.19 The Authority will direct by 31 July, or such later date that it considers appropriate, the value of IncPayExt_t, in respect of Relevant Year t-1 as determined under this condition and the ESORI Guidance Document.

4M.20 For each Relevant Year, the value of IncPayExt_t will be no greater than a maximum value of £30m and not less than a minimum value of (minus) -£30m unless otherwise directed by the Authority.

Part G: Definitions:

<u>Deliverables</u>	<u>means the steps the licensee intends to take during a Relevant Year to meet the Long Term Vision as set out in 4M.3(b);</u>
<u>ESO Performance Panel</u>	<u>means a panel established by the Authority to make recommendations to the Authority on the performance of the licensee in a Relevant Year;</u>
<u>ESORI Guidance Document</u>	<u>means a document developed and published by the Authority in accordance with Part D of this condition;</u>
<u>ESORI Scheme</u>	<u>means the arrangements established in respect of special condition 4M;</u>
<u>Formal Opinion</u>	<u>means an opinion published by the Authority on the licensee's Forward Plan in accordance with condition 4M.9;</u>
<u>Forward Plan</u>	<u>means the plan established and published under Part C of this condition;</u>
<u>Long Term Vision</u>	<u>means the changes the licensee intends to make to the way it performs its role as the System Operator in accordance with 4M.3(a);</u>
<u>Performance Metrics</u>	<u>means, in relation to each of the Principles, the information used to measure the licensee's performance against the Long Term Vision and Deliverables as set out in 4M.3(c);</u> <u>and</u>
<u>Principles</u>	<u>means the principles set out in the document issued by the Authority entitled 'ESO Roles and Principles Guidance' (as amended from time to time).</u>

