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Dear industry colleagues,

Open Letter to invite your view on the development and implementation of GB code changes resulting from legal separation of the Electricity System Operator (ESO) within the National Grid Group

We welcome and support Ofgem's response to their consultation on ESO separation which was published 3rd August 2017¹. We believe that creating a National Grid Electricity System Operator (NGESO) company that is legally separated from our National Grid Electricity Transmission owner (NGET) company within the National Grid Group will provide assurance that the right environment exists to deliver a balanced and impartial Electricity System Operator (ESO) that can realise real benefits for consumers.

As a direct consequence of creating a legally separate NGESO, industry codes will need to be modified in order to reflect this change. In the absence of primary legislation to deliver this, we will need to bring forward a coordinated and considered set of code modifications using existing governance procedures. This letter is intended to set out our thoughts on the scope of change required, how we would like to work with you to deliver these changes, and to seek feedback on our proposals.

Approach to development of code modification

As noted in Ofgem's response document, formal separation will be achieved by 1st April 2019 which means that changes to codes consequential to the formal separation will also need to be effective by this date. As such the time available to develop, agree and formalise this change is challenging.

Whilst we recognise that creating a separate NGESO and reflecting this new entity and NGET within the various codes is a significant structural change to the codes, we do not envisage any fundamental change to the current ways of working or contractual interfaces that exist with the system operator role today. As such, whilst the change in entities is significant, we expect the effect of the changes on industry parties to be minimal.

¹ <https://www.ofgem.gov.uk/publications-and-updates/future-arrangements-electricity-system-operator-response-consultation-so-separation>

We envisage playing a substantive role in leading the change, and to adopt an approach to minimise the impact and effort required of others, but we are also committed to working with stakeholders in a transparent and collaborative way. As a general approach we will prepare the legal drafting for the code changes and take forward the code modifications, working with the relevant code administrator in line with existing governance arrangements. More specifically, where National Grid does not perform the code administrator role, we will be working closely with Elexon (Balancing and Settlement Code), Electralink (Distribution Connection and Use of System Agreement) and ENA (Distribution Code) to agree the most suitable approach.

The current intention is to raise one modification application for each code covering all the required changes and to submit all code modifications at a similar time. This would enable stakeholders to consider the modifications to achieve legal separation as a package, and to provide a level of alignment in the approval stage. There might however need to be some variations to this proposed approach to allow for any transitional or implementation requirements to be better developed, and to tailor the approach to the less impacted codes such as the DCUSA and Distribution Code.

So that all parties have the opportunity to input and shape the proposals, we are intending to use an informal approach to develop the detail of the various modifications, ahead of starting the formal code modification processes.

We recognise that there will be ongoing and new code changes which may interact with separation and to assist with this, when raising the modification for each code, we will provide an initial view of changes which may overlap with the separation proposal. The established modification processes would then manage these interactions working with the appropriate code administrators and Industry Panels.

Scope of Code changes resulting from separation

The industry codes which we believe require modification to varying degrees in order to reflect a legally separate NGESO are: the Connection and Use of System Code (CUSC), the System Operator-Transmission Owner Code (STC), the Grid Code (GC), the Balancing and Settlement Code (BSC), the Distribution Connection and Use of System Agreement (DCUSA) and the Distribution Code (DCODE). The National Electricity Transmission System Security and Quality of Supply Standard (NETS SQSS) will also require modification to ensure it aligns with the changes made to NGET's licence and a new NGESO licence.

Our view is that it is the structure of the various codes rather than the intent of the codes that will be impacted most as a result of this change, and the modifications to code will be limited to the minimum required to deliver legal separation. We have considered the scope of change and feel that this can be categorised in the following way; these will apply to a varying degree dependent on each code:

- 1) Entity change – how we achieve NGESO accession to the codes and move existing NGET System Operator obligations to NGESO within each code, where relevant
- 2) Consequential change – changes throughout the code framework and/or related contractual arrangements to reflect the entity change/new relationships
- 3) Transitional/Implementation Requirements – what provisions are required ahead of 1st April 2019 for parties to be ready for separation

We have included more detail on our proposed modification principles for each code in Appendix 2 to this letter. We welcome your feedback on whether we have captured all the codes that require modification and whether the proposed principles are suitable when applied to each code.

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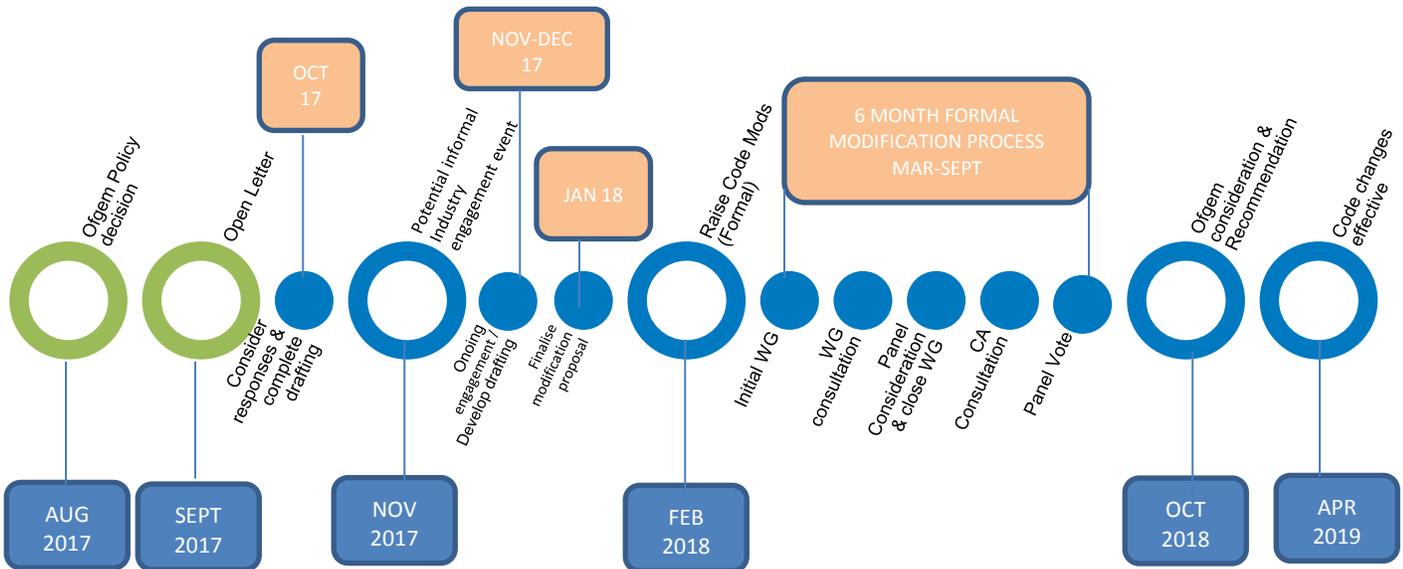
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Page 2 of 7

Proposed timeline

Given that formal separation is planned to take place on 1st April 2019, it will be necessary for all code changes to be approved ahead of this date. We are working to achieve this, recognising that any changes will need to be approved by Ofgem, in October 2018. With this in mind we expect to start the formal code modification process in February 2018 and the legal text will accompany the proposal. To aid that process we will be looking to engage with you to develop and communicate the detailed modification proposals prior to the formal submission.

Our plan is to share initial draft modification proposals for all codes with you later this year. We have no fixed view of the best forums to explain our work to date, so would welcome your views on what would best meet your needs/expectations. Below is a summary of our indicative timeline:



Next steps

To help us to gather industry's feedback and suggestions, we have proposed five questions in Appendix 1. We encourage you to respond to the questions and send your response to Box.ELSP@nationalgrid.com by 6th October 2017.

In the meantime, should you have any queries or concerns about proposed code changes, implementation approach or legal separation in general, please contact us at Box.ELSP@nationalgrid.com

We look forward to receiving your feedback and to working with you and other key stakeholders to implement code changes to enable a more independent ESO.

Yours sincerely

Lloyd Griffiths

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APPENDIX 1 – Open letter questions

Q1: Have we captured all the codes which are required for modification to reflect a legally separate NGENSO within the National Grid group? If not, what other codes do we need to consider?

Q2: Are the proposed modification principles appropriate for each code? If not, please provide your view.

Q3: Would you support an approach that included cross code coordination to progress changes efficiently where modifications impact multiple codes?

Q4: How would you like to be engaged throughout the process?

Q5: Do you have any concerns about legal separation in general? If so, please provide contact details of the person within your organisation that we should contact in relation to these matters.

APPENDIX 2 – Further detail on our proposed modification principles

CUSC

Our expectation is that there will be minimal change required to the current terms or processes provided for in CUSC given this currently relates to NGET acting in its SO role today.

In terms of the modification proposals, the key change will be to introduce NGESO as a party to the CUSC framework agreement in place of NGET. Given that the code is created through a framework agreement our current thinking is to introduce the ability in CUSC for NGET to novate the framework agreement (and underlying CUSC contracts) from NGET to NGESO, using the modification process. This approach would reduce the effort required by ourselves and industry in addressing the various contracts supplemental to CUSC.

As a result of the entity change, there will be some consequential changes required to the CUSC (for example, governance arrangements) and references in the underlying CUSC contracts (for example, the construction agreements) which will need to acknowledge the legally separate NGET. We will look to achieve this through code provisions where we can but some bilateral discussion may be required.

We will also need to provide for certain transitional arrangements to be put in place ahead of 1st April 2019; for example the security required under CUSC construction agreements will need to be provided in the name of new ESO entity at 1st April 2019. We will also need to consider and manage ongoing processes that span the formal separation date, such as connection offers made but not accepted/to be made pre 1 April 2019 and disputes.

We envisage our focus to be based on the following high level activities:

- Engagement with Ofgem, code panel and industry on the process for change, rationale for approach and scope of modifications
- Review of code and contracts, to scope, identify and confirm legal strategy and approach to engagement and CUSC mods and general coordination of code changes
- Draft legal code text and modification proposal
- Progress through modification process with CUSC panel (including workgroup, consultation, vote and submission of Ofgem report)
- Modifications approved to enable parties to “get ready” and for the change in entity to be implemented (April 2019)

STC and STC Procedures

Changes to the STC and STC Procedures will be needed to add NGESO in the “SO” role and “change” NGET to a “TO” role, and to reflect regional differences between England & Wales (onshore) and Scotland where these are necessary. The impact on STC parties will be managed accordingly with a strong focus on engagement and a clear rationale for change including clarity and assurance around the separation of responsibilities and liabilities between the SO and TO.

In terms of the modification proposals, and at a high level, the key change will therefore be to introduce the new NGESO entity as a party to the STC framework agreement and to change NGET to a TO role. We will also need to transfer the underlying contracts (for example, Transmission Owner Construction Agreements) from NGET to NGESO.

As a consequence of the entity change, there will be some consequential changes required to the STC (for example governance arrangements) and the underlying contracts (for example, Site Responsibility Schedules) which will need to acknowledge the legally separate NGET and NGESO. We will look to achieve all the above through code provisions where we can but some bilateral discussion is likely to be required.

We will also need to provide for certain transitional arrangements to be put in place ahead of 1st April 2019 so that all parties have clarity on the documents and counterparty to be in place.

We envisage our focus to be based on the following high level activities:

- Engagement with Ofgem, code panel and other TOs on process for change, rationale for approach and scope of modifications
- Review of code and contracts, to scope, identify and confirm legal strategy and approach to engagement and STC mods and general coordination of code changes
- Share approach and changes with industry
- Draft legal text and modification proposals
- Progress through modification process with STC and STCP panels (including workgroup, consultation, vote and submission of Ofgem report)
- Modifications approved to enable parties to “get ready” and for the change in entity to be implemented (April 2019)

Grid Code

Changes to the Grid Code are expected to generally be limited to recognising the change in “SO” role in the Grid Code from NGET to NGESO and retaining NGET as an England & Wales Relevant Transmission Licensee (as with CUSC). In terms of the modification proposals, and at a high level, the key change will therefore be to introduce the new NGESO entity.

As a result, there will be some consequential changes required to the Grid Code (for example, governance arrangements) and the underlying contracts (for example, Site Responsibility Schedules) which will need to acknowledge the legally separate NGET. We will look to do this through code provisions where we can but some bilateral discussion is likely to be required.

We may also need to provide for certain transitional arrangements to be put in place ahead of 1st April 2019 so that all parties have clarity on the documents and counterparty to be in place.

We envisage our focus to be based on the following high level activities:

- Engagement with Ofgem, code panel and industry on process for change, rationale for approach and scope of modification
- Review of code and contracts, to scope, identify and confirm legal strategy and approach to engagement and STC modifications and general coordination of code changes
- Share approach and changes with industry
- Draft legal text and modification proposal
- Progress through modification process with Grid Code panel (including workgroup, consultation, vote and submission of Ofgem report)
- Modifications approved to enable parties to “get ready” and for the change in entity to be implemented (April 2019)

BSC

Changes to the BSC are expected to be limited to achieving the change from NGET to NGESO, NGET's role in the context of the BSC being solely an ESO role, as this is effectively a code between ESO and transmission system users administered by Elexon.

The BSC has procedures for novation and our expectation is to utilise this procedure to introduce the new NGESO entity.

The existing licence requirements in relation to the BSC will move to NGESO through the proposed transmission licence transfer and we need a direction from Ofgem to transfer the share in Elexon currently held by NGET to the NGESO. There are a small number of associated agreements that will also require novation or replacement (example the meter operator agent in the context of offshore transmission).

We envisage our focus to be based on the following high level activities:

- Engagement with Ofgem, Elexon and industry on process for change and rationale for approach
- Review of code and underlying contracts (eg meter operator arrangements), to scope, identify and confirm legal strategy and approach to engagement and general coordination of code/framework changes
- Share approach and changes with industry
- Support Elexon and BSC panel through novation/modification process
- Implement change (April 2019)

Distribution Code and DCUSA

NGET is a party to the DCUSA in its role as SO in the context of embedded offshore transmission so we will need to replace NGET with NGESO. It is not considered likely but we will also need to consider any consequential changes to the DCUSA and the DCode to reflect the change in entity and to novate the small number of underlying bilateral agreements between NGET and the respective DNOs.

We envisage our focus to be based on the following high level activities:

- Engagement with Ofgem, Electralink, ENA and industry on process for change and rationale for approach
- Review of code and underlying contracts, to scope, identify and confirm legal strategy and approach to engagement and general coordination of code/framework changes
- Support counterparties through novation/modification process
- Implement change (April 2019)