



Department for
Business, Energy
& Industrial Strategy

Energy Security Bill Policy Statement

Independent System Operator and Planner

August 2022



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Summary

The Energy Bill was introduced into Parliament on 6 July 2022. This Bill will deliver a cleaner, more affordable and more secure energy system for the long term. It builds on the ambitious commitments in the Prime Minister's Ten Point Plan and the British Energy Security Strategy to invest in homegrown energy and maintain the diversity and resilience of the UK's energy supply.

The Government committed, in the British Energy Security Strategy and Future Systems Operator consultation response 2022¹, to update the governance of the energy system to drive our energy ambitions. There are many plausible paths to a resilient, affordable, decarbonised system and each of them require significant investment in infrastructure and innovation. This creates an ever-greater requirement for expert and co-ordinated strategic advice and recommendations.

This Bill makes provision for the establishment of the Independent System Operator and Planner (ISOP) as a public body with operational independence from Government, with responsibilities for planning the development of the electricity and gas transmission systems and operation of the electricity transmission system. This body will also take on a range of additional net zero focused roles, helping drive a more open, flexible and efficient system, and is expected to result in a net saving on energy bills.

The ISOP will be founded on the existing capabilities and functions of National Grid Electricity System Operator (ESO) and, where appropriate, National Grid Gas (NGG). This will require transactions between government and National Grid Plc (NG) and any other relevant parties, with the parties being appropriately compensated for the elements of their businesses that are transferred into the ISOP.

National Grid have been engaged continuously through this process. Government, Ofgem, National Grid Plc and the Electricity System Operator have agreed a joint statement which sets out a commitment to work together to create the ISOP as an expert, impartial body with responsibilities across both the electricity and gas systems.²

¹ <https://www.gov.uk/government/consultations/proposals-for-a-future-system-operator-role>

² <https://www.gov.uk/government/consultations/proposals-for-a-future-system-operator-role/outcome/joint-statement-on-the-future-system-operator>

Transfer Scheme - Compensation

To facilitate the required transactions, the Bill includes powers for the Secretary of State to make transfer schemes (Schedule 6) with various associated powers, which will help ensure that the transfers include all the relevant capabilities needed by the ISOP to perform its proposed functions.

These powers include the ability to make regulations for the purpose of establishing a process to be followed to determine the appropriate compensation to NG and any other relevant parties whose businesses are transferred, in case this is not agreed between the parties themselves.

Transfer schemes are a common mechanism for facilitating transfers of businesses where government is involved and have been used under previous legislation such as the Postal Services Act 2011, Communications Act 2003, Transport Act 2000 and the Railways Act 1993. They have, for example, been used frequently and recently to transfer passenger rail businesses (including to the public sector) when franchises terminate and have been used in the energy industry for many years.

The government will consult the transferor (expected to be National Grid Plc in the instance of the Electricity System Operator transfer) where the transfer scheme power is expected to be used as is provided in Schedule 6, Paragraph 2.

High level principles

The regulations are expected as a statutory instrument made (using the negative procedure) after Royal Assent to provide clarity to all parties on the process for agreeing and paying compensation and the mechanisms for resolution in the absence of any agreement.

The compensation within scope of the regulations will include compensation for the business(es) transferred to the ISOP.

There is a separate power in Schedule 6, Paragraph 14(2) for the Secretary of State to compensate third parties who suffer a loss as a result of the transfer (see page 8 for details on how this power may be used). While these are separate powers, it may be that the statutory instrument made will combine these two areas of compensation.

Details of the regulations regarding compensation for the transfer

As is set out on the face of the Bill (Schedule 6, Paragraph 8(2)), BEIS will seek agreement with the relevant parties on the amount of compensation payable for the relevant transfer. This will take place after Royal Assent of the Bill. In this case the transfer scheme, and any

connected agreements, will list the agreed amounts payable, and set out other agreed commercial terms (such as any warranties and indemnities, disclosure about the business etc).

However, if agreement on the compensation has not been reached, the regulations made under Part 1 of Schedule 6, Paragraph 8(5) would have set out the process that would then be followed for determining compensation in relation to the transfer.

As per Part 1 of Schedule 6, Paragraph 8(5), these regulations may make provision for:

- determining when there is an absence of agreement on the amount of compensation;
- the appointment process for an independent valuer;
- the procedure, such as a process and timeline, to be followed by an independent valuer in making a compensation determination, including rights for the independent valuer to be able to reasonably request information from the Secretary of State or the transferor to conduct its compensation determination;
- the matters to which an independent valuer must have regard and the assumptions that an independent valuer must apply in making a compensation determination;
- the specified period for which the independent valuers' compensation determination will be binding on the Secretary of State and the transferor;
- the remuneration and expenses of an independent valuer; and
- the enforcement of the requirements imposed by the regulations.

If compensation between the parties is not agreed as per section 14, once the appropriate compensation has been determined pursuant to the Bill and the regulations, the Secretary of State may make the transfer scheme(s) and pay the compensation.

Transfer Scheme - Taxation

As part of the creation of the ISOP various functions currently carried out by National Grid and its subsidiaries will be transferred to the ISOP. This will also require property, rights, assets, and liabilities, etc. currently owned by National Grid, or other energy market participants, to move into the ownership of the ISOP. The Bill includes powers for these transfers to be affected by transfer schemes made by the Secretary of State.

The bill also includes a power for the Treasury to vary any tax liability that may occur in connection with this transfer scheme (Schedule 6, Paragraph 9).

High level principles

The power in the bill allows the treasury to create a statutory instrument using the negative procedure.

Any regulations made under this power may contain provision for a tax not to apply, or to apply with modifications, or for anything transferred to be treated in a specified way for the purposes of a tax provision.

Any regulation could also either require or permit the Secretary of State to determine anything required to be determined for the purposes of any tax provision so far as relating to anything done for the purposes of, or in relation to, the transfer.

Transfer Scheme - Third Party Compensation

The primary purpose of the transfer scheme (Schedule 6) is to ensure that the property, rights and liabilities currently owned by the National Grid group that the ISOP needs in order to carry out its functions are transferred to the ISOP, and that the ISOP is owned by the Secretary of State. In order to ensure that the transfer is a smooth one, the transfer scheme is able to do things that an ordinary commercial agreement (e.g. between National Grid and the Secretary of State) would not be able to achieve. For example, it can transfer agreements with third parties that might otherwise prevent or restrict the transfer: see Paragraphs 3(2) and 6(1)(e) of Part 1 of Schedule 6.

It is therefore possible that third parties may suffer loss or damage in consequence of the Secretary of State's exercise of the various powers they have to prepare for the inception of the ISOP. Where this is the case, it may be appropriate that they should be compensated.

High level principles

This regulation will guide third parties as to how they should go about notifying the Secretary of State of their claims for compensation and establish a legal framework for considering and processing these claims.

While there is a separate power in Schedule 6, Paragraph 8(5) regarding compensation (see pages 5 and 6 for details on how this power may be used), it would not be appropriate for third parties to receive compensation under the transfer scheme, since they will not be transferors under it. The third party compensation provision is therefore freestanding rather than part of the transfer scheme itself. While these are separate powers, it may be that the statutory instrument made will combine these two areas of compensation.

In relation to these 3rd parties (i.e. parties other than a transferor under a transfer scheme) who suffer loss or damage in consequence of things done by the Secretary of State in preparation for or in connection with the designation of an ISOP, Paragraph 14(2) of Part 2 of Schedule 6 provides that the Secretary of State may make regulations providing for payment of compensation to them.

These regulations are expected to be made after Royal Assent using the negative procedure and provide for the circumstances in which compensation may be paid, how and when claims can be made and the evidence required to support them and associated procedural matters.

Pension Schemes – Participation and Amendment

As part of the transfer of functions from National Grid to the ISOP a number of employees will also transfer to the ISOP. As part of this transfer it is important to separate the pension arrangements of the ISOP and National Grid (including determining how the historic pensions liabilities should be apportioned as between ISOP & National Grid) whilst at the same time ensuring that (a) employees' and former employees' accrued pensions benefits are not adversely impacted and (b) the future service benefits of employees are broadly the same immediately after the transfer as they were before. In addition, it is important that the pensions arrangements of such employees are not unnecessarily disturbed by needing to set up new pension schemes or by requiring any third-party consents.

Powers in the Bill (Schedule 7, Paragraph 2) allow the Secretary of State to make provision by regulation, to enable the ISOP and associates of ISOP (including Elexon) to participate in pensions schemes which are currently in existence for the National Grid transferor entities. In addition, and in order to ensure durable pensions arrangements which take into account both the requirements of the new ISOP and also the pension benefits of the employees and former employees remaining the responsibility of National Grid, powers are required to allow the Secretary of State to make provision, by regulation, (a) for the division of the relevant pensions schemes into different sections, (b) for participation of existing and new employers in those different sections, (c) for the allocation of assets and rights between those sections (and for the valuation of assets and rights in that context), and (d) the transfer of assets and rights from the newly created sections to another pension scheme (and for the valuation of assets and rights in that context).

The Bill also includes a power (Schedule 7, Paragraph 3), for the Secretary of State to make, by regulation, amendments to the impacted pension schemes as they consider appropriate. This can include provisions regarding determining the amount of benefits payable by reference to pensionable service, transfers-in and transfers-out.

The Bill also includes protections against adverse treatment (Schedule 7, Paragraph 4) in order to protect the accrued benefits of the impacted employees and former employees as a result of the exercise of powers referred to above.

The Bill has been drafted to reflect the policy intent referred to above, and the high-level principles referred to below. Reference was also made in drafting the Bill to the approach taken in the Postal Services Act 2011 and Part 2 of the Public Service and Pensions and Judicial Offices Act 2022.

In drafting the pension regulations referred to above, the Secretary of State must consult the trustees and the principal employers of the impacted pension schemes (Schedule 7, Paragraphs 2(5) and 3(4)).

In order to enable the pension regulations to be drafted by the Secretary of State, the trustees and the employers of the impacted pension schemes need to provide all relevant information, and provided assistance which is reasonably required (Schedule 7, Paragraph 5).

High level principles

The pensions and employment arrangements regarding the creation of ISOP can only be properly determined, and the required pension regulations drafted, as part of the overall structuring of the transfer scheme and cannot be determined in advance. Provision will need to be made taking into account the detail of the National Grid pension schemes themselves (including the employees and former employees in those schemes), and the decisions on how employees and property will transfer to the ISOP as well as how the historic pension liabilities will be apportioned between ISOP and National Grid.

The detailed provision of these matters can only be made once the due diligence process associated with the transfer scheme has taken place. This due diligence can only take place once powers within the Bill are secured as government can only rely on voluntarily disclosure by the relevant parties prior to this. Further, any speculative information gathering undertaken at this stage would become out of date and therefore of limited use. Consequently, this process must wait and be carried out once legislation has passed.

It is expected that the pension regulations will be used to create one or more new ISOP sections in the existing National Grid pension schemes. ISOP employees who are active members of those schemes immediately before the transfer are expected to continue to accrue future service benefits in the relevant new ISOP sections which are broadly the same as before, and not to be otherwise adversely impacted as there will also be corresponding transfers of accrued rights to those new ISOP sections.

Elexon is a wholly owned but operationally independent subsidiary of National Grid Energy System Operator (NGESO). NGESO is expected to be transferred out of National Grid and into the ISOP and consideration of the future ownership structure of Elexon is subject to public consultation until the 22nd September 2022. It is expected when decisions on ownership structure are resolved, that these pension regulations will be used to help facilitate the change.

The Bill provides (at Schedule 7, Paragraph 4(1)) that in exercising the powers under Paragraphs 2 and 3 in Schedule 7, the Secretary of State must ensure that impacted employees and former employees are, in all material respects, no worse off in terms of their pensions provision immediately after the exercise of the powers (or, in relation to money purchased benefits, have an equivalent value). Before the powers are exercised, the relevant pension scheme trustees and principal employers must be consulted.

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