

# Guidance

## **RIIO-2 Electricity System Operator Price Control - Regulatory Instructions and Guidance**

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This document provides instructions and guidance to National Grid Electricity System Operator Limited to enable it to complete the reporting requirements associated with the RIIO-2 Electricity System Operator price control from 1 April 2021 to 31 March 2026.

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## Version History

| Version | Changes | Purpose   | Publication date | Release date |
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| 0.1     | n/a     | Consultation on the 'RIIO-2 Electricity System Operator – Regulatory Instructions and Guidance' | 27 August 2021   | n/a          |

## Context

This document contains the Electricity System Operator Regulatory Instructions and Guidance (RIGs).

The purpose of this document is to provide a framework to allow Ofgem to collect accurate information from National Grid Electricity System Operator Limited (NGESO).

A number of licence conditions require NGESO to provide us with this information. The main licence condition for the purposes of this document is Standard Licence Condition B15 (Regulatory Instructions and Guidance).

The RIGs will come into effect on 1 April 2022 and will apply until 31 March 2026 (or until stated otherwise).

## Associated documents

RIIO-2 Final Determinations – ESO Annex:

<https://www.ofgem.gov.uk/publications-and-updates/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

Licence conditions:

<https://www.ofgem.gov.uk/licences-industry-codes-and-standards/licences/licence-conditions>

RIIO-2 PCFM Guidance documents and revenue workbooks:

<https://www.ofgem.gov.uk/publications/riio-2-pcfm-guidance>

Pension Regulatory Instruction and Guidance Version 3.0:

<https://www.ofgem.gov.uk/publications/decision-modify-regulatory-financial-performance-reporting-rfpr-and-pension-regulatory-instructions-and-guidance-rigs-riio1>

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## 1. Introduction

### Section summary

This section sets out the purpose and structure of the Regulatory Instructions and Guidance (RIGs) which will apply to the Electricity System Operator for RIIO-2. It also sets out guidance on the process for reporting under the RIGs and our audit requirements.

## Background

- 1.1. The Regulatory Instructions and Guidance (RIGs) provide a framework which enables Ofgem to collect data from the Electricity System Operator (ESO) during the RIIO-2 period. We collect data to enable us to administer the Special Conditions<sup>1</sup> of the ESO's licence (the conditions which relate to the price control) and our price control Final Determinations. The RIGs templates provide a database of information relating to ESO performance which we will draw on to assess costs. The RIGs document informs the ESO about the information we plan to collect, guides the ESO on how to provide this information and enables the ESO to put systems in place to collect the data to the detail we require.
- 1.2. Previously, the ESO submitted this information using templates designed for Transmission Operators (TOs). As the ESO has become a separate entity from National Grid Electricity Transmission<sup>2</sup> and has its own bespoke RIIO-2 price control, we have reviewed the RIGs and reporting templates to ensure they are appropriate for the ESO and its RIIO-2 price control framework.
- 1.3. As part of the incentive process in the RIIO-2 price control framework, the ESO will be expected to provide information to enable Ofgem to assess the ESO's performance against plan delivery, metric performance, stakeholder evidence, demonstration of plan

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<sup>1</sup> National Grid Electricity System Operator – Special Conditions: <https://www.ofgem.gov.uk/energy-policy-and-regulation/industry-licensing/licences-and-licence-conditions>

<sup>2</sup> On 1 April 2019, the ESO separated from National Grid Electricity Transmission (NGET) and became a legally distinct company within the National Grid Group.

benefits, and value for money criteria.<sup>3</sup> Our intention is to avoid duplication between incentive scheme reporting and the RIGs reporting where possible. Therefore, we have tried to streamline reporting requirements wherever possible.

## Legal framework

- 1.4. For RIIIO-2, the reporting requirements have been consolidated in Standard Licence Condition B15 (Regulatory Instructions and Guidance) of the Electricity Transmission Licence (“the RIGs Licence Condition”).
- 1.5. The RIGs Licence Condition sets out the scope and governance arrangements for the RIGs.
- 1.6. In the event of any inconsistency between the licence conditions and this document, the licence conditions will take precedence.

## Components of the RIGs

### Overall structure

- 1.7. The RIGs comprise three main elements:
  - RIIIO-2 Electricity System Operator - Regulatory Instructions and Guidance (“the RIGs”). This document contains the instructions and guidance on how to report the data.
  - RIIIO-2 Electricity System Operator - Costs and Outputs Regulatory Reporting Pack Template (“C+O RRP”). This is the template for reporting cost and output data.
  - RIIIO-2 Electricity System Operator - Supporting Commentary Template (“the Supporting Commentary”). This is the template for providing commentaries against the data submitted in the C+O RRP.

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<sup>3</sup> Chapter 3, ESORI Guidance 2021-23: <https://www.ofgem.gov.uk/publications-and-updates/decisions-eso-guidance-documents-2021-23>



- 1.8. For RIIO-2, there is no longer a Revenue Regulatory Reporting Pack as the revenue elements of reporting will move into the C+O RRP and RIIO-2 ESO Price Control Financial Model (PCFM). For the 2021-22 reporting year, the ESO must complete the ESO Revenue Workbook. The ESO Revenue Workbook is an interim replacement for the RIIO-ET1 Revenue Regulatory Reporting Pack and has already been streamlined and published alongside our decision on the PCFM Guidance.<sup>4</sup> From the 2022-23 reporting year, the remaining elements of the ESO Revenue Workbook will be incorporated into the C+O RRP and the PCFM so that the ESO Revenue Workbook can be removed. For guidance on the completion of the ESO Revenue Workbook, please see the PCFM Guidance.
- 1.9. We intend to consult on updated instructions and guidance and templates for the completion of the Regulatory Financial Reporting Pack (RFPR) in early spring 2022. For instructions and guidance on the completion of the triennial Pension Pack, please see the Pension Regulatory Instructions and Guidance supplement.<sup>5</sup>

### **RIIO-2 Electricity System Operator - Regulatory Instructions and Guidance**

- 1.10. The purpose of this document is to provide instructions and guidance to enable the ESO to complete the C+O RRP and Supporting Commentary. This document provides information on:
- the systems, processes, procedures, recording and provision of the required data
  - reporting units
  - levels of accuracy (including rounding)
  - the methodology for calculating or deriving required numbers
  - the provision of the data to Ofgem (format, frequency etc)
  - any audit or examiner requirements
  - reasons for the data requirement

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<sup>4</sup> RIIO-2 PCFM Guidance: <https://www.ofgem.gov.uk/publications/decision-riio-2-pcfm-guidance>

<sup>5</sup> Pension Regulatory Instruction and Guidance Version 3.0: <https://www.ofgem.gov.uk/publications/decision-modify-regulatory-financial-performance-reporting-rfpr-and-pension-regulatory-instructions-and-guidance-rigs-riio1>

- explanations of how Ofgem will monitor, assess, and enforce compliance
- a glossary of terms used in the workbooks

1.11. For the avoidance of doubt, this document should be read in conjunction with the RIGs Licence Condition (Standard Licence Condition B15 of the Electricity Transmission Licence<sup>6</sup>). Where definitions are provided within the RIGs Licence Condition, they are not duplicated in this document.

1.12. This document is divided into sections reflecting the different component parts of the RIGs. These are as follows:

- Section 2 provides general instructions and guidance for completing the C+O RRP worksheets.
- Section 3 sets out the contents and purpose of each of the worksheets included in the C+O RRP.
- Section 4 provides instructions and guidance for the completion of the worksheets included in the C+O RRP.
- Section 5 provides instructions and guidance for the submission of the Supporting Commentary.

### **RIIO-2 Electricity System Operator - Costs and Outputs Regulatory Reporting Pack Template**

1.13. The C+O RRP has been designed to be consistent with our RIIO-2 Final Determinations and will enable us to collect the information we need to assess the ESO's performance. Where possible we have consolidated the C+O RRP with other reporting requirements (eg the ESO's Business Plan Data Template and the ESORI Guidance).

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<sup>6</sup> Electricity Transmission Standard Licence Conditions: <https://www.ofgem.gov.uk/licences-industry-codes-and-standards/licences/licence-conditions>

1.14. It also collects data on provisional totex expenditure<sup>7</sup> for use in the Annual Iteration Process and the calculation of the SOIAR term (see Appendix 1 for definition), the ESO's cost benchmark and value for money assessment, innovation expenditure, and the ESO's Electricity Market Reform (EMR) delivery function.

### **RIIO-2 Electricity System Operator - Supporting Commentary Template**

1.15. Alongside the submission of the C+O RRP, the ESO must complete the Supporting Commentary. The instructions and guidance for the Supporting Commentary are set out in Section 5. A strategic commentary is required to:

- Provide a useful executive summary, focusing attention on distilling key messages of the drivers of performance and presenting clear strategic insights at this point in the price control period.
- Give Ofgem an understanding of the key drivers of business performance in terms of expenditure, workload and outputs and the materiality of each driver.
- Provide a summary explanation of the forecast, including outputs, secondary deliverables, costs and workload.
- Provide an understanding of material variances against previous year's actuals and forecasts.
- To inform Ofgem of any organisational changes or performance improvements. This could include modifications or enhancements to allocation methodologies and/or modifications or enhancements to data capture (eg systems capturing data).

1.16. Please note that the strategic overview should be provided within the primary narrative rather than as a separate addendum.

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<sup>7</sup> Totex is provisional as it may be adjusted as a result of subsequent efficiency reviews or for the correction of any errors either after the 31 July or in subsequent years.

## Reporting under the RIGs

### Timescales for reporting

- 1.17. The reporting year for the provision of information under the RIGs is from 1 April to 31 March in the following calendar year. The RIGs included in this document will be submitted on an annual basis.
- 1.18. Except where otherwise stated, the ESO must provide the information required under the RIGs as soon as reasonably practicable and in any event not later than 31 July following the end of the reporting year to which such information relates. This is the latest date that the ESO can submit information unless Ofgem has previously agreed to an extension in writing.
- 1.19. The RIGs are linked to the value for money criterion of the ESO's incentive scheme. The ESO's End of Year Report on its performance over the business plan cycle<sup>8</sup> is published by 7 May in the final year of the incentive scheme and will set out the ESO's performance against the value for money criterion. The RIGs submission by 31 July in the same year will act as the final true up of the ESO's value for money against its cost benchmark, which will be taken into account ahead of the Authority's final decision on the incentive reward or penalty by 31 August in the final year of the incentive scheme.

### Form of submission

- 1.20. Instructions for the electronic submission of the workbooks will be circulated to the ESO's regulation manager in advance of each submission deadline. However, if there is any doubt about the method of submission, the ESO must contact Ofgem.
- 1.21. The submission must be accompanied by a letter signed by a director on behalf of the ESO confirming that the data is accurate and has been provided in accordance with the RIGs.

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<sup>8</sup> The business plan cycle is the period for which the business plan is applicable. The first business plan cycle (BP1) covers the incentive scheme starting on 1 April 2021 and ending on 31 March 2023.

## **Resubmissions**

- 1.22. The ESO is required to seek the agreement of Ofgem or a person nominated by Ofgem before resubmitting any information provided in accordance with these RIGs.
- 1.23. In any such instance the report concerned must be resubmitted in full (unless agreed otherwise). The resubmission must only be accompanied by a letter signed by a director where significant changes have been made and where Ofgem and/or the ESO decide such a letter is required. The volume of supporting information the ESO will be required to submit to support any resubmission will be dependent on the nature of any required resubmission.
- 1.24. For each resubmission a detailed explanation must be provided in the Changes Log in the C+O RRP listing every cell that has been amended. The explanation must include sufficient commentary to explain the reasons for the resubmission.

## **Review**

- 1.25. Once the ESO has submitted the information to Ofgem, Ofgem or a person nominated by it ('a reviewer') will undertake a detailed review of the information. A review may include a visit to the ESO for discussion of the information submitted. Such visits will be agreed with the ESO in advance.
- 1.26. Where a reviewer has been nominated, the reviewer will enter into an agreement with the ESO to maintain confidentiality on reasonable terms.

## **Appointing an examiner**

- 1.27. In accordance with the RIGs Licence Condition, the ESO must permit a person nominated by Ofgem to examine:
- the systems, processes and procedures for measuring the specified information
  - the specified information collected by the ESO
  - the extent to which the systems, process and procedures and the specified information complies with the RIGs
  - any further information relevant to the RRP submissions

### **Audit requirements in relation to revenue reporting**

- 1.28. In accordance with the RIGs Licence Condition, Ofgem will identify the specified information which is to be subject to audit, the terms on which an auditor is to be appointed by the ESO for that purpose and the nature of the audit to be carried out by that person. We will issue an Agreed Upon Audit Procedure (AUP) for use by an appropriate auditor by 31 March of the year of submission.

### **Publication and sharing of templates**

- 1.29. Ofgem may publish any further information contained in the templates but will notify the ESO in advance of any intention to do so and will make any necessary redactions.

## 2. General instructions for completing C+O RRP worksheets

### Section summary

The purpose of this section is to provide general instructions for completing the C+O RRP worksheets. This is to enable Ofgem to effectively monitor the performance of the ESO in relation to the cost benchmark set as part of our RIIO-2 Final Determinations and against previous years' submitted actuals and forecasts.

### Overview

- 2.1. The C+O RRP consists of a series of tables in MS Excel. The purpose of the C+O RRP is to facilitate the submission of uniform and comparable information from the ESO over the RIIO-2 period. This enables comparison with our Final Determinations and previous years' performance and comparative regulation on a consistent basis throughout the RIIO-2 period.
- 2.2. The ESO should submit accurate, and where instructed, audited figures of its costs and revenues for the relevant period.
- 2.3. The C+O RRP has been designed to have single data entry where possible in order to avoid duplication and to facilitate reconciliations and balance checks.
- 2.4. The key points to note in completing the C+O RRP tables are:
  - The ESO must take all reasonable steps to validate and check that the specified information provided under the RIGs is complete, reliable and meets the standards prescribed by the RIGs. The ESO must notify Ofgem of the possibility of any significant revisions to improve data quality. This notification must be issued to Ofgem as soon as it becomes evident to the ESO that a reasonable likelihood exists of significant inaccuracies in any of its previously submitted data.
  - Where a table contains multiple years of data (historical and/or forecast) that was reported in a previous RIGs template, the ESO should report, unless otherwise stated in the specific table guidance, data for all years that is to the best of its knowledge up to date and accurate. The ESO is required to explain any material data revisions in its accompanying narrative.

- The C+O RRP tables are colour coded to reflect the action required, as shown in Table 1 below and on the Cover worksheet of the C+O RRP.

**Table 1: C+O RRP Cell format key**

| <b>Cell format</b> | <b>Cell type</b>         |
|--------------------|--------------------------|
|                    | Cell intentionally blank |
| Value              | Input cell               |
| Value              | Imported value           |
| Value              | Calculation cell         |
| Value              | Output cell              |
| Value              | Ex-ante value            |
| Value              | Error checking cell      |
| <i>Value</i>       | Annotation cell          |

- Unless otherwise stated, all financial values should be input in the price of the year to which the RIGs relate, ie 2020-21 data should be in 2020-21 prices. Values that feed into the PCFM are either required to be stated in 2018-19 prices or are converted into 2018-19 prices within the RRP.
- Unless otherwise indicated in the RIGs or templates, actual financial values should be provided in £ million to a minimum of three decimal places, and displayed at one decimal place, with financial values reconciling with the audited regulatory accounts. However, the ESO is required to provide all actual financial data to the highest reasonable level of accuracy available from its source systems, and commensurate with the purpose for which such data is intended taking into consideration the appropriate allocations that are necessary to complete the tables.
- Workload units and outputs should be reported at the highest level of accuracy from the source systems and commensurate with the purpose for which such data is intended, taking into consideration the appropriate allocations that are necessary to complete the tables, unless stated otherwise in the Electricity Transmission Licence or elsewhere in this document. Workload and outputs should be entered in the unit of measurement set out in the RIGs or templates.
- Unless otherwise indicated in the RIGs or templates, financial values should be input as positive values.
- Where a reportable value is zero or not applicable to the ESO then a zero must be input rather than the cell being left blank.



## Accounting policies

- 2.5. All costs are to be entered on a cash basis. A cash basis means exclusive of provisions and accruals and prepayments that are not incurred as part of the ordinary level of business. The ESO should use the same accounting policies as in the preparation of the regulatory financial statements, in accordance with UK GAAP or IFRS unless otherwise stated.
- 2.6. In the event that the accounting policies applied to prepare the template differ from those used in the regulatory financial statements (for some or all years) the ESO must include appropriate details including quantification of the difference.
- 2.7. A new international accounting standard, IFRS16, was issued during RIIO-ET1. Where the ESO reports under IFRS in its statutory accounts, this means that all leases are now reported on the balance sheet as liabilities, along with an asset reflecting the right to use the asset over the lease term. The income statement now only reports the associated depreciation and interest expenses. Previously some leases would have been reported as operating leases with “in year” lease costs (eg rent and service charges) recognised in the income statement, with no impact on the balance sheet. To avoid issues with restatement, asset recognition and different statutory accounting policies, all costs should continue to be reported in the RIGs as they were prior to the adoption of IFRS16. This means that lease charges incurred during the year (those previously reported as operating leases) should continue to be reported as operating costs in the C+O RRP, and any element of interest cost in lease payments reported on a statutory basis under IFRS16 is excluded from interest reported in the RFPR. The arising difference between statutory accounts and the RIGs will be reported as a reconciling item within table R3 in the RFPR (“Totex Reconciliation”).

## Structure of the C+O RRP

- 2.8. The C+O RRP has been separated into the following sections:
  1. Finance
  2. Totex
  3. Opex
  4. Business Support Costs (BSC)

5. Capex
6. Other Price Control Costs
7. Non-Price Control Costs
8. Additional Data

### **Data entry**

- 2.9. As the C+O RRP is a series of tables in MS Excel, links and formulae have been included to limit, where possible, the amount of manual data entry required. The tables have not been “locked”, **but the ESO is not to change any formulae or formats (including insertion or deletion of rows or columns, moving any cells, or altering any text, figures, or formulae in any cells not shaded yellow) without instruction from Ofgem first.** If a change is necessary (to correct an error, for example), Ofgem will notify the ESO of the correction to be made.

### **Definitions**

- 2.10. Detailed definitions are included in the specific instructions for the tables unless they affect more than one table. The ESO must ensure that the definitions are clearly understood and are complied with when entering any data into the template. Where there is doubt or uncertainty, please refer to Ofgem for clarification. This is to ensure consistency.
- 2.11. The Regulatory Asset Value (RAV) is a key building block of the RIIO-2 price control. RAV represents the value upon which the ESO earns a return in accordance with the regulatory cost of capital and receives a depreciation allowance. Additions to the RAV are calculated as a set percentage based on capitalized share of totex. The definition of totex is detailed in Appendix 2.

### **Use of Estimates and Allocations**

- 2.12. Apportionments should be avoided wherever possible. However, where the ESO (and any affiliate or related undertaking of the ESO) has to do this to complete the tables, the basis of apportionment must be provided. Changes in apportionments should also be highlighted.

#### Provision of forecast data

- 2.13. There will be a requirement to forecast costs, workload and outputs for the remaining years of the RIIO-2 price control period in the reporting templates.
- 2.14. Where the ESO is required to provide forecasts then the forecasts shall represent the ESO's best view following its best endeavours to take account of all relevant internal and external factors.

#### Provision of Indirect Allocation Methodology

- 2.15. The ESO must provide its methodology for allocating indirect costs as part of its reporting for the relevant reporting year and subsequently inform Ofgem of any changes to this methodology annually.

#### **Additional information**

- 2.16. If the ESO considers additional information beyond that requested is necessary to develop a complete understanding of the information presented in the tables then such information should be included in an appendix to the submission.

#### **Template errors**

- 2.17. Where errors in a worksheet are identified then Ofgem should be notified as soon as possible. Ofgem will make the necessary corrections, log them in the Changes Log and notify the ESO.

#### **Re-openers**

- 2.18. Our evaluative approach to incentives on costs and outputs, combined with shorter Business Plans, means the price control is designed to accommodate uncertainty and the influence of external factors. We therefore do not have any volume drivers, mechanistic cost re-openers, or totex indexation measures for the ESO. We will review the cost benchmark as part of the cyber resilience IT re-opener at the start of RIIO-2,

which is discussed further in Chapter 7 of the Core Document of our Final Determinations.<sup>9</sup>

- 2.19. In relation to re-openers, where the ESO expects its application to be successful and reports forecast expenditure, the ESO should also ensure they report the corresponding forecast allowance.

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<sup>9</sup> Final Determinations Core Document: <https://www.ofgem.gov.uk/publications-and-updates/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

### 3. Purpose of C+O RRP worksheets

#### Section summary

The purpose of this section is to illustrate the contents of the C+O RRP and to set out the purpose of each worksheet within the C+O RRP.

#### Introduction

3.1. The purpose of these worksheets is to facilitate the submission of uniform and comparable financial, costs, workload and outputs information from the ESO over the RIIO-2 period. This enables comparison with business plans, comparison with prior years and comparative regulation on a consistent basis throughout the RIIO-2 period.

#### Overview of worksheets

3.2. The purpose of each worksheet in the C+O RRP is outlined in Table 2.

**Table 2: Purpose of each worksheet in the C+O RRP**

| Worksheet      | Purpose and use by Ofgem   |
|----------------|--|
| Cover          | The purpose of this worksheet is to capture the submission date and version number. It also provides a key to the colour coding convention used throughout the workbook. |
| Contents       | The purpose of this worksheet is to provide a summary of the data table names contained within the template and quick reference links.                                   |
| Changes Log    | The purpose of this table is to track the status of change proposals (and the action taken) and the correction of errors within the template.                            |
| Universal Data | The purpose of this worksheet is to capture data used throughout the workbook, such as reporting year and indexation data.   |

| <b>Finance</b>  |  |
|---|--|
| 1.1 Disposals   | The purpose of this table is to collect information relating to fixed asset disposals.   |
| 1.2 Price Control Financial Model (PCFM) Inputs Summary | The purpose of this table is to capture all PCFM inputs calculated within the workbook for use in the Annual Iteration Process of the PCFM. Where required, this worksheet converts reporting year prices into 2018-19 prices using conversions on the Universal Data worksheet.   |
| 1.3 Pass Through  | The purpose of this table is to record information on certain elements of allowed revenue that are treated as pass through items in the PCFM.  |
| 1.4 Tax Pools Totex Allocations                         | The purpose of this table is to collect information on the percentage allocation of totex categories to tax pools for the PCFM.  |
| <b>Totex</b>  |  |
| 2.1 Totex Summary                                       | <p>The purpose of this table is to collect a summary of ESO Opex, Business Support Costs (BSC), Other Price Control Costs and Capex data for the actual reporting year and high-level forecasts for the whole of the price control period. This enables a comparison with previous years and the cost benchmark.</p> <p>This table uses data in reporting year prices to calculate ESO Totex.</p>  |
| 2.2 Cost Benchmark Summary                              | <p>The purpose of this table is to record the final audited annual figures for the ESO’s BP1 value for money assessment against the cost benchmarks. This table will also act as a record of the up-to-date cost benchmarks.</p> <p>The ESORI Guidance 2021-23 states that where the differences in outturn and projected spend are greater than <math>\pm 10\%</math> of the cost benchmark for each of the ESO’s roles, the ESO should provide evidence-based detail on the specific drivers of the deviations, linked clearly to specific deliverables. Therefore, this table highlights where the percentage difference in outturn and projected spend is <math>\pm 10\%</math> of the cost benchmark for each role.</p> |

|   |   |
|---|---|
| 2.3 Related Party Transactions                    | The purpose of this table is to record information on the turnover and margin % for all affiliates and calculates (if any) the related party margin to be disallowed in the PCFM.   |
| <b>Opex</b>                                       |   |
| 3.1 Opex Summary                                  | The purpose of this table is to report expenditure on Direct Opex and Supporting Operational Costs for each of the ESO’s operational activities. These figures will be used in the value for money assessment. We will use this information to assess the economic efficiency and appropriateness of any direct and supporting expenditure.   |
| 3.2 Salary and Full Time Equivalent (FTE) Numbers | The purpose of this table is to collect information on ESO staff salaries and FTEs. This will provide a cost per FTE for comparisons of total transmission employment costs.  |
| 3.3 Provisions                                    | The purpose of this table is to collect details of the provisions that have affected the results so that Ofgem can understand any significant events happening in the year.   |
| <b>Business Support Costs (BSC)</b>               |   |
| 4.1 Business Support Costs (BSC)                  | <p>The purpose of this table is to collect cost information on the Business Support activities listed below, which in most cases are related to general support activities necessary in the running of the ESO.</p> <p><u>BSC</u></p> <p>Collectively includes the activities of:</p> <ul style="list-style-type: none"> <li>• IT &amp; Telecoms (Business Support)</li> <li>• Property Management (Business Support)</li> <li>• HR &amp; Non-operational Training</li> <li>• Finance, Audit &amp; Regulation</li> <li>• Insurance</li> <li>• Procurement</li> <li>• CEO &amp; Group Management</li> </ul> <p>These figures will be used in the value for money assessment. We will use this information to assess the economic efficiency and appropriateness of any expenditure relating to these support activities.</p> |

|   |   |
|---|---|
| 4.2 Business Support Costs (BSC) Allocation | The purpose of this table is to provide Ofgem with visibility of BSC incurred at a Group level and their subsequent attribution across the Group legal entity structure. This will be used to ensure that allocation methodologies applied are fair and consistent and do not attempt to unfairly apportion these costs to a licensee.  |
| <b>Capex</b>                                |   |
| 5.1 Capex Summary                           | The purpose of this table is to report expenditure on non-operational capex. These figures will be used in the value for money assessment. We will use this information to assess the economic efficiency and appropriateness of any non-operational capital expenditure.   |
| <b>Other Price Control Costs</b>            |   |
| 6.1 Cyber Resilience IT Costs               | <p>The detailed reporting for cyber resilience IT will be contained in the six-monthly PCD reporting templates that the ESO is required to fill in in accordance with the licence condition.</p> <p>To avoid any unnecessary duplication in reporting, and as cyber resilience IT activities are strictly confidential, the intention for the RRP reporting is for aggregated totals only that feed into the PCFM.</p> <p>These figures will be used in the value for money assessment.</p> |
| 6.2 Pension Administration Costs            | The purpose of this table is to collect cost information on pension scheme costs, including Pension Scheme Administration Costs, Pension Protection Levy Fund costs, and any other relevant categories of cost related to the ESO’s expenditure on pensions. These figures will be used in the value for money assessment.  |
| <b>Non-Price Control Costs</b>              |   |
| 7.1 Non-Activity Based Costs                | The purpose of this table to collect information on certain elements of allowed revenue that are treated as pass through items and are not captured in table 1.3 (Pass Through) or 6.2 (Pension Administration Costs).  |
| 7.2 Directly Remunerated Services (DRS)     | The purpose of this table is to collect information relating to for each category of DRS as set out in Special Condition 2.9 (Services treated as Directly Remunerated Services).   |



|   |  |
|---|--|
| 7.3 Network Innovation Allowance (NIA) Expenditure                    | The purpose of this table is to report the ESO’s expenditure under the RIIO-2 Network Innovation Allowance (NIA). The NIA is a set allowance that the ESO can use to spend on innovation projects which comply with the RIIO-2 NIA Governance Document.  |
| 7.4 RIIO-1 Carry-over Network Innovation Allowance (CNIA) Expenditure | The purpose of this table is to report the ESO’s expenditure under the carryover of the RIIO-1 NIA (CNIA). The CNIA allows the ESO to spend and recover any remaining unspent funds from the 2020-21 RIIO-1 NIA, providing that projects were started before 31 March 2021 and comply with the RIIO-1 NIA Governance Document. The table only includes reporting for 2021-22 because this is the only year that CNIA can be recovered. |
| 7.5 Network Innovation Competition (NIC) Expenditure                  | The purpose of this table is to report funding for NIC projects that the ESO received funding for in RIIO-1 and remain in-flight during the RIIO-2 price control. Additionally, the table also seeks to capture other categories of NIC funding that will be relevant if the ESO has to return any funds on these projects.  |
| 7.6 Strategic Innovation Fund (SIF) Expenditure                       | The purpose of this table is to report funding for SIF projects that the ESO will receive funding for in RIIO-2. Additionally, the table also seeks to capture other categories of SIF funding that will be relevant if the ESO has to return any funds on these projects.   |
| <b>Additional Data</b>  |  |
| 8.1 System Operator (SO) Electricity Market Reform (EMR) Data         | The purpose of this table is to collect data relating to the NGESO EMR delivery function. It will be used by Ofgem to understand the amount of data NGESO is processing relating to EMR and how effective it is performing the role.   |

## 4. Instructions for completing the C+O RRP worksheets

### Section summary

The purpose of this section is to inform the completion of the C+O RRP worksheets.

### Introduction

- 4.1. The ESO should submit accurate (and where instructed) audited figures of its costs and revenues for the relevant period.
- 4.2. All costs are to be entered on a cash controllable basis. This means exclusive of all provisions and all accruals and prepayments that are not incurred as part of the ordinary level of business.
- 4.3. The ESO should submit numbers in £ million correct to three decimal places.
- 4.4. The ESO must only fill in the yellow input cells, as shown in Table 1 in this document and on the Cover worksheet of the C+O RRP.

### Overview of worksheets

- 4.5. The instructions for completing each worksheet in the C+O RRP are outlined in Table 3.

**Table 3: Instructions for completing each C+O RRP worksheet**

| Worksheet | Guidance on completing worksheet   |
|-----------|--|
| Cover     | The ESO should complete the reporting year, the version number and the submission date in the yellow cells.  |
| Index     | The ESO should input an X in the yellow cells between G16 and G51 for each of the worksheets that has been completed. Where a worksheet has not been completed for a reporting year, the ESO must provide a clear explanation and justification for this in the Supporting Commentary. |

|                |  |
|----------------|--|
|                | <p>The ESO should also track the version history of its C+O RRP submissions for the reporting year in the yellow cells between C55 and G57.</p> <p>If the ESO is submitting additional information with the RRP or earlier, this should be input in the yellow cells between G60 and G73.</p>  |
| Changes Log    | There is no input required in this worksheet. Any errors identified or changes required should be notified to Ofgem, who will update the template, record the changes and issue a revision.  |
| Universal Data | The ESO should complete the reporting year in the yellow cell.   |
| <b>Finance</b> |  |
| 1.1 Disposals  | <p>Rows 12 to 17: Enter details of disposals in the regulatory year by asset type for the company and individual licensees in the yellow cells. For the avoidance of doubt, disposals should include assets transferred from the ESO to a company within the same group (ie a property company).</p> <p>Rows 22 to 28: Insert details of any adjustments or reclassifications relating to disposals in the yellow cells.</p> <p>Row 16: Property and land disposal income - various sites – these cells are linked to the sub-table below the main table. All yellow areas of the sub-table must be completed. The property and associated land include in-whole or part of any operational site and in-whole or part of any non-operational site (eg office buildings).</p> |

|  |  |
|--|--|
| <p>1.2 Price Control<br/>Financial Model (PCFM)<br/>Inputs Summary</p> | <p>The ESO is required to input information on the <math>ESORI_t</math>, <math>DRSR_t</math> and <math>DRSC_t</math> terms on this worksheet. The rest of this table draws information from Tables 1.3 (Pass Through), 1.4 (Tax Pools Totex Allocation), 2.1 (Totex Summary) and 7.3 (NIA Expenditure).</p> <p><b>Additional Funding – Other:</b></p> <p>This is a pre-determined fixed allowance of £4.8m per year for BP1 as set out at paragraph 5.28 of our Final Determinations.<sup>10</sup></p> <p>This value does not need to be updated by the ESO, however it may be updated by the Authority during the RIIO-2 price control period in line with our Final Determinations for BP2 and any licence modifications.</p> <p><b>Reporting &amp; Incentive Arrangements:</b></p> <p>The Reporting and Incentive Arrangements term (<math>ESORI_t</math>) is the financial incentive to reward or penalise the ESO for its performance. The value of <math>ESORI_t</math> will be determined by Ofgem at the end of each business plan cycle. For BP1, this will be by 31 August 2023. The <math>ESORI_t</math> term is defined in Part D of Special Condition 4.1 (System Operator Internal Revenue Restriction).</p> <p>The value of <math>ESORI_t</math> will be no greater than a maximum value of £30m, in aggregate, across each two-year period of the business plan cycle and not less than a minimum value of negative £12m, in aggregate across each two-year period of the business plan cycle, as determined under Special Condition 4.3 (Electricity System Operator Reporting and Incentive Arrangements) and the ESORI Guidance.</p> <p>For the values in row 28, actual data for the reporting period in question should be input directly into the yellow input cells. The ESO should report on the amount recovered during the reporting</p> |
|--|--|

<sup>10</sup> Chapter 5, RIIO-2 Final Determinations – ESO annex:  
[https://www.ofgem.gov.uk/system/files/docs/2021/02/final\\_determinations\\_-\\_eso\\_annex\\_revised.pdf](https://www.ofgem.gov.uk/system/files/docs/2021/02/final_determinations_-_eso_annex_revised.pdf)

|                         |  |
|-------------------------|--|
|                         | <p>year in question and provide a forecast for future years based on its reasonable expectations. The ESO’s expectations will be informed by feedback from Ofgem and the ESO Performance Panel received at six-monthly performance reviews. The data should be input in 2018-19 prices.</p> <p><b>Directly Remunerated Services:</b></p> <p>The ESO should input actual and forecast data for the reporting period in question in the yellow input cells in rows 44 and 45 for the DRSRt and DRSCt respectively. The data should be input in 2018-19 prices.</p> <p>These licence terms are defined in Part D of Special Condition 4.1 (System Operator Internal Revenue Restriction).</p>   |
| <p>1.3 Pass Through</p> | <p><b>2021-22 reporting year:</b></p> <p>For 2021-22, this worksheet will be hidden as the data will be collected in the ESO Revenue Workbook. The ESO should include the 2021-22 data when completing this worksheet in future RIIO-2 years.</p> <p><b>Reporting years from 2022-23:</b></p> <p>Actual data for the reporting period in question should be input directly into the yellow input cells of this worksheet, which should be used to populate the PCFM. The licence terms are defined in Parts G and I of Special Condition 4.1 (System Operator Internal Revenue Restriction).</p> <p><u>Forecasting</u></p> <p>Forecasts for future regulatory periods should be input directly into this worksheet, which should be used to populate the PCFM.</p> <p><u>SO Bad Debt</u></p> <p>SO Bad Debt costs relate to any amounts that are incurred (or forecast) by the ESO due to network charges owed to it by one or more Defaulting Connection and Use of System Code Party and are treated as pass through under Special Condition 4.1 (System Operator Internal Revenue Restriction).</p> |

|                                       |  |
|---------------------------------------|--|
|                                       | <p>Values should be input into the yellow input cells of the bad debt section of this worksheet. This data is then picked up in worksheet 1.2 (Price Control Financial Model (PCFM) Inputs Summary), which should be used to populate the PCFM.</p> <p>The 'Provisional Bad Debt cost' in row 20 should include the SO Bad Debt costs that ESO expects to incur including any RIIO-1 SO Bad Debt. This row contains forecasts only and should not include any actual costs, which should be input in row 21 below labelled 'Actual Bad Debt cost incurred'.</p> <p>The 'Recovered SO Bad Debt' value should be input in row 24 as a positive value and should include the aggregate value of any bad debt recovered (including RIIO-1 SO Bad Debt), where the costs have previously been recovered via the BDA term.</p> <p>All values should be exclusive of VAT.</p> |
| <p>1.4 Tax Pools Totex Allocation</p> | <p><b>2021-22 reporting year:</b></p> <p>For 2021-22, this worksheet will be hidden as the data will be collected in the ESO Revenue Workbook. The ESO should include the 2021-22 data when completing this worksheet in future RIIO-2 years.</p> <p><b>Reporting years from 2022-23:</b></p> <p>Allocation percentages of totex categories to tax pools should be input by the ESO in the yellow input rows based on their best estimate of the allocation rates at the time of updating the inputs. These rates will then be used to derive capital allowance allocation rates used by the PCFM.</p> <p>Allocation rates should not be retrospectively updated for a year where the ADJR* value has already been published and charges have already been set.</p>  |

| <b>Totex</b>                                      |   |
|---|---|
| 2.1 Totex Summary                                 | <p>The ESO should input the adjustment for IAS 19 pension accrual (including post cut off deficit payment) as a negative value in the yellow cells in row 16.</p> <p>The rest of this worksheet is auto-populated with information from Tables 3.1 (Opex Summary), 4.1 (BSC), 5.1 (Capex Summary), 6.1 (Cyber Resilience IT Costs), and 6.2 (Pension Administration Costs).</p>   |
| 2.2 Cost Benchmark                                | <p>There is no input required in this worksheet. This worksheet is auto-populated with information from Tables 3.1 (Opex Summary), 4.1 (BSC), 5.1 (Capex Summary), 6.1 (Cyber Resilience IT Costs), and 6.2 (Pension Administration Costs).</p>   |
| 2.3 Related Party Transactions                    | <p>The ESO should fill in the boxes shaded in yellow:</p> <ul style="list-style-type: none"> <li>• Margin by related party (columns A and K:O)</li> <li>• Turnover by related party (columns A and K:O)</li> <li>• Related Party Margin by Cost Category (columns AC:AJ and column AL)</li> <li>• Costs before allocations: Outside Price Control (column AO)</li> <li>• Costs before allocations: Total Related Party Margin (column AP)</li> </ul> <p>This input is required to be repeated for each reporting year.</p> <p>Related party margin is defined in Appendix 1. Whether a related party margin is allowed or not is defined in Appendix 2.</p> |
| <b>Opex</b>                                       |   |
| 3.1 Opex Summary                                  | <p>The ESO should input outturn and forecast data for each ESO activity as required in the yellow cells.</p>  |
| 3.2 Salary and Full Time Equivalent (FTE) Numbers | <p>The ESO should fill in total gross staff costs by activity, and FTEs and average salaries as indicated by the boxes shaded in yellow.</p> <p>Where FTEs are allocated, the basis of allocation should be stated in the narrative accompanying the tables.</p>  |

|   |  |
|---|--|
|   | <p><u>Specific definitions for this worksheet (see Appendix 1 for full definitions):</u></p> <ul style="list-style-type: none"> <li>• Full Time Equivalent (FTE) Employee</li> <li>• Labour</li> <li>• Pension</li> </ul>  |
| 3.3 Provisions                              | Data should be input as required in the yellow shaded cells. A description of each provision should be input in the yellow cells in column C. Costs should be input in the yellow cells in columns S:W as positive or negative values as appropriate. Provisions are those defined under standard accounting terminology.  |
| <b>Business Support Costs (BSC)</b>         |  |
| 4.1 Business Support Costs (BSC)            | <p>Costs associated with each of the Business Support activities (see Appendix 1 for full definitions) should be reported in the yellow cells in rows 13:22 in this table.</p> <p>'Insurance – Claims paid out to SO' and 'Other Income' should be input as negative values.</p> <p>The ESO should input costs for each category of IT &amp; Telecoms in the yellow cells in rows 27:33 of the memo table.</p> <p>For the avoidance of doubt, the data requirements are relevant to the ESO and not Group level.</p> |
| 4.2 Business Support Costs (BSC) Allocation | Please input the ESO's allocation of BSC in the yellow cells for each of the Business Support activities (See Appendix 1 for full definitions).  |
| <b>Capex</b>                                |  |
| 5.1 Capex Summary                           | <p>Non-operational capex has been categorised into the following expenditure types: IT &amp; Telecoms (Non-operational); Vehicles; Non-operational Property; and Small Tools, Equipment, Plant &amp; Machinery. Definitions for each of these can be found in Appendix 1.</p> <p>For IT &amp; Telecoms, the table requires the ESO to list specific IT systems / projects where the total expenditure is £1m or more in</p>  |



|   |  |
|---|--|
|   | <p>rows 31:130. Full project details, not just expenditure in the year, should be entered as indicated by the column headings.</p> <p>Expenditure on all other IT assets less than £1m should be entered in total in row 26. Where the total spend on a project is more than £1m but the expenditure within a particular year is less than £1m, this should be shown as an individual project and not included in the 'Other IT expenditure' category.</p> <p>The ESO must also provide the role allocation for each IT system / project where the total expenditure is £1m or more in column I. This allocation should follow the non-role specific cost allocation set out in the ESORI Guidance.<sup>11</sup></p> <p>For all other categories of Non-operational capex, the ESO should input outturn and forecast expenditure in rows 12:14.</p>          |
| <p><b>Other Price Control Costs</b></p> |  |
| <p>6.1 Cyber Resilience IT Costs</p>    | <p>The ESO is to report its annual cyber resilience IT capex and opex costs, and the totex will populate automatically with the cell formulas in rows 13 and 19.</p> <p>The ESO is to report expenditure of baseline allowances in the yellow input cells in rows 11 and 12, and report expenditure of uncertainty mechanism allowances in the yellow input cells in rows 17 and 18.</p> <p>The annual capex and opex costs should align with the capex and opex costs recorded in the 'Overview' tab of the Cyber PCD reporting packs (we have consulted on the reporting templates already and intend to issue these in Q3 2021). If the ESO incurs additional cyber resilience IT costs that are not included within the PCD reporting, and therefore the RRP data is not consistent with the data in the Cyber PCD reporting packs, these additional</p> |

<sup>11</sup> ESORI Guidance 2021-23: <https://www.ofgem.gov.uk/publications-and-updates/decisions-eso-guidance-documents-2021-23>

|  |  |
|--|--|
|  | costs need to be explained in the Supporting Commentary within the RIGs submission.  |
| 6.2 Pensions Administration Costs                  | <p>Outturn and forecast data should be input as required into the yellow cells between S11:W12 for each year of RIIO-2 for the Pension Scheme Administration Costs and the Pension Protection Levy Fund categories.</p> <p>For all other relevant categories of ESO pension administration costs, the ESO should input a clear description of the cost category in column D, as well as outturn and forecast data as required in the yellow cells between S15:W30.</p>                               |
| <b>Non-Price Control Costs</b>                     |  |
| 7.1 Non-Activity Based Costs                       | <p>Outturn and forecast data should be input as required into the yellow cells in row 11 for each year of RIIO-2 for the Licence Fee Payments category.</p> <p>For all other relevant categories of ESO pass through costs that have not been captured in table 1.3 (Pass Through) or table 6.2 (Pension Administration Costs), the ESO should input a clear description of the cost category in column D, as well as outturn and forecast data as required in the yellow cells between S14:W31.</p> |
| 7.2 Directly Remunerated Services (DRS)            | <p>Costs should be input as positive values for each category of DRS as set out in Special Condition 2.9 (Services treated as Directly Remunerated Services).</p> <p>It may be that some services have no identifiable costs.</p> <p>If De Minimis services are reported outside of the ESO business, please do not complete the information but state this in the Supporting Commentary.</p>  |
| 7.3 Network Innovation Allowance (NIA) Expenditure | The ESO should input details of each RIIO-2 NIA activity / project in the yellow cells in cells D11:F28 as required and provide the outturn and forecast expenditure in the yellow cells V11:Z28.  |

|   |   |
|---|---|
|   | <p>The ESO should populate actual data from 1 April 2021 up to and including the current reporting year, and forecast data for the remaining RIIO-2 period, ie all five years of RIIO-2.</p> <p>The ESO should input details of any expenditure has been declared Unrecoverable NIA Expenditure by Ofgem in the yellow cell D38:F39 as required and provide the outturn and forecast expenditure in the yellow cells V38:Z39.</p> <p>Additionally, the ESO should also report how much of their Total NIA Expenditure has been spent on internal resources in the yellow cells V46:Z46.</p> |
| 7.4 RIIO-1 Carry-over Network Innovation Allowance (CNIA) Expenditure | <p>The ESO should input details of each CNIA activity / project in the yellow cells in columns D:F as required and provide the outturn expenditure in the yellow cells in column U.</p> <p>The ESO should input the total of any third party income or contributions towards projects into the yellow cell U41.</p>   |
| 7.5 Network Innovation Competition (NIC) Expenditure                  | <p>The ESO should input details of each NIC project it received funding for in RIIO-1 in the yellow cells in columns D:F as required and provide the outturn and forecast expenditure in the yellow cells in columns U:AG.</p>  |
| 7.6 Strategic Innovation Fund (SIF) Expenditure                       | <p>The ESO should input details of each SIF project it receives funding for in the yellow cells in columns D:F as required, and provide the outturn and forecast expenditure in the yellow cells in columns U:Y.</p>  |
| <b>Additional Data</b>  |   |
| 8.1 System Operator (SO) Electricity Market Reform (EMR) Data         | <p>This worksheet should be submitted separately from the rest of the C+O RRP.</p> <p>The ESO should complete the yellow cells with the appropriate data.</p> <p>Rows 14:15 and 17:24 should show absolute numbers for all capacity market (CM) prequalification activities during the reporting period.</p>  |

Rows 28:33 should show absolute numbers for all contracts for difference (CfD) application and qualification activities during the reporting period.

Rows 37:41 should show absolute numbers for demand side response prequalification activities during the reporting period.

Row 42 should show the total volume, in gigawatts to three decimal places of demand side response capacity prequalified during the reporting period.

Row 46 should show the actual peak national demand (as defined in the Grid Code) for the reporting period.

Row 47 should show the forecast peak national demand (as defined in the Grid Code) for the reporting period made 1 year before the reporting period.

Row 48 should show the forecast peak national demand (as defined in the Grid Code) for the reporting period made 4 years before the reporting period.

Rows 52 & 54 should show the absolute number of responses to the CM and CfD customer and stakeholder satisfaction surveys during the reporting period.

Rows 53 & 55 should show the average score for the specific overall satisfaction question in the CM and CfD customer and stakeholder satisfaction surveys during the reporting period.

## 5. Supporting commentary

### Section summary

This section sets out the instructions and guidance for the completion of a commentary that supports the ESO's C+O RRP.

### Overview

- 5.1. Alongside the submission of its RIGs tables, the ESO must complete the Supporting Commentary template provided. The Supporting Commentary must provide a strategic context to the overall RIIO-2 performance expected by the ESO at this point in the price control period. The commentary must therefore distil key messages of what the ESO sees as important indicators of performance, provide clear strategic insights on the expected performance over the RIIO-2 period and any areas for improvement.
- 5.2. In doing so, the narrative will identify the main reasons and drivers of actual/forecast spend for the current reporting year, a view for the entire price control period and the expected outturn position at the end of RIIO-2. Where it helps support the strategic narrative, additional detail can be provided on what has driven performance to date and what is expected to drive performance in future years. The narrative should also explain the material differences between outturn and forecast spend between last year's information and the latest information.
- 5.3. The appropriateness and materiality of the information provided should be set at a level that avoids the need for Ofgem to ask supplementary questions. Where visual representations of information (eg waterfall diagrams) may aid understanding, these should be included.
- 5.4. For the Supporting Commentary on elements of totex, the ESO may refer back to its six-monthly incentive scheme value for money reporting if necessary.
- 5.5. Additional appendices can be used to provide further detail on specific performance areas. Examples include providing an overview and timelines to mitigate any perceived

delivery risks or explaining changes in data methodologies or organisational structure and the effect that this has on reporting.

5.6. Instructions and guidance to complete each chapter in the template are as follows:

- **Executive summary:** Provide a summary of the key messages from the commentary. This should seek to distil key messages of the drivers of performance and present clear strategic insights at this point in the price control period.
- **Chapter 1- Table by table:**
  - *Allocation methodology* – This should be filled out by exception and note any issues regarding how the table was completed which Ofgem should be aware of. For example, was the table filled out differently to how instructed in the RIGs or how previously stated it would be? What was the justification for this change and what impact did it have? Were there any allocations between cost categories required that Ofgem are not already aware of?
  - *Summary views* – This is only included for certain tables and the information required is table specific. Provide summaries of all of the areas noted, quantifying assertions wherever possible and appropriate. Each numbered section will have a guide word limit specific to that table.
  - *Additional commentary* – Provide any further important information related to the relevant table if necessary.
- **Chapter 2 – Forecasting:** Some forecasting information is likely to have already been provided in the 'summary view' and 'additional commentary' within Chapter 1. This chapter should focus on the ESO's organisational approach to forecasting on issues that are relevant to multiple tables. It should also note if and how forecasting is being improved.
- **Appendices:** Any information the ESO considers important that does not fall under one of the preceding chapters should be included in the appendices.
- Information provided by the ESO in Chapter 2 and the appendices should come under sub-headings. At the end of each subsection, the ESO should reference which table(s) the information is most relevant to.

## Appendix 1 – Glossary and Definitions

- 1.1. The purpose of this appendix is to provide definitions for the terms included in these instructions and in the associated worksheets (with the exception of totex which is defined in Appendix 2).
- 1.2. This appendix provides definitions that cover more than one table and more general definitions. Any word or expressions used in the Utilities Act 2000, Electricity Act 1989, the Energy Act 2004, or standard or special licence conditions of the Electricity Transmission Licence shall have the same meaning when used in these rules, similarly for standard accounting terms, IFRS/IAS and/or UK GAAP and Companies Act 2006 definitions should be applied.
- 1.3. In the circumstance where no definition is given the ESO should include in explanatory notes details of the treatment it has applied and inform the Authority of the omission. Where a definition set out in this appendix is not the same as that applied by the ESO for other purposes, the definition set out herein must be used in the preparation of the RIGs templates.
- 1.4. Except where the context otherwise requires, any reference in this appendix or in the RIGs to a numbered standard or special condition (with or without a letter) or Schedule is a reference to the standard or special condition (with or without a letter) or Schedule bearing that number in the Electricity Transmission Licence, and any reference to a numbered paragraph (with or without a letter) within such a standard or special condition is a reference to the paragraph bearing that number in the standard or special condition or Schedule of the Electricity Transmission Licence in which the reference occurs, and reference to a Section is a reference to that Section in the standard or special conditions of the Electricity Transmission Licence.
- 1.5. Where terms are defined within the licence conditions (standard or special) or other documents approved by the Authority (such as the RIIO-2 NIA Governance Document), they are not replicated here and the user should refer to the licence condition or such other document for these definitions.

## A

### Accounting Costs

Costs as per statutory or regulatory accounts before any adjustments for non-controllable costs and atypical, provisions etc.

### Accounting Standards

The term encompasses Financial Reporting Standards ("FRS") 100, 101, 102 and 103 (known as the new UK GAAP) effective from 1 January 2015 and International Financial Reporting Standards and International Accounting Standards (together "IAS") and the International Financial Reporting Interpretations Committee ("IFRIC") interpretations.

### Accruals and Prepayments

For the purpose of determining what amounts should be excluded as non-cash items. These are only those items that are not incurred as part of the ordinary level of business activities and would be atypical. Normal business activities include normal trade accruals and prepayments and holiday pay provisions.

### Annual iteration Process

The Annual Iteration Process is the process of annually updating the variable (blue box) values in the price control financial model and running the model in order to determine the value of the term  $SOIAR_t$ , as defined in Part B of Special Condition 4.1 (System Operator Internal Revenue Restriction).

## B

### Business Support Costs (BSC)

Collectively includes the activities, which are all separately defined in this Glossary, of:

- IT & Telecoms (Business Support)
- Property Management (Business Support)
- HR & Non-operational Training
- Finance, Audit & Regulation
- Insurance
- Procurement
- CEO & Group Management



## C

### Cash Basis

All costs incurred and paid in cash or normally paid in cash, subject to short timing differences, as part of the ordinary level of business.

#### Includes:

- All provisions, accruals and prepayments that are incurred as part of ordinary level of business activities, these include holiday pay provisions, normal trade accruals and prepayments, and which are expected to be paid within the entity's standard terms of business.
- Exceptional events that do not meet the Severe Weather 1-in-20 event definition.
- The cost of assets acquired under a finance lease excluding finance interest.
- Cash payments for the utilisation of a provision.

#### Excludes:

- All provisions relating to atypical events.
- The cost or transfer value of assets acquired from a Related Party which have been previously used in or by the ESO.
- All accruals and prepayments that relate to atypical events.
- Atypical cash costs.

### Cash Controllable Costs

The normal ongoing cash operating costs, excluding non-recurring / one off costs that are controllable by the licensee.

### CEO and group management

#### Includes:

- Communications - communication within the UK businesses, internal communications, external communications, media relations, issues management, regional communications, community relations, community awareness, branding, events management.
- Group Strategy- function has the responsibility of evaluating the strategic options of the Group.

- Legal / Risk and Compliance/ Company Secretary – legal department, the management corporate governance for all companies to ensure they comply with legislation, regulations and best practice.
- Corporate Responsibility and investor relations – corporate responsibility and interaction with institutional equity investors and market analysts, management of rating agencies also advertising, charity and sponsorship arrangements.
- Board Members and Other – staff and other costs of Board members and other corporate costs not fitting into other categories.
- Non-executive & group directors' labour costs (where they are not carrying out specific departmental duties) and Board meeting costs.

Excludes:

- Insurance management.
- Legal advice relating to way leaves/servitudes/easements.
- Group costs relating to specific activities eg HR, Finance, Audit, Regulation, Taxation, HSE, Insurance, etc (include under the specific cost category).

### Contractors

For the purposes of the RRP, this is a Cost Type. It represents costs incurred by contracting with organisations for the provision of services.

Includes:

- Professional Services - services provided on a consultancy basis, typically items such as legal services, audit fees, taxation services.
- Subcontractor - an organisation that performs part or all of the obligations of another's contract.

Excludes:

- Charges for materials provided by the contractor where the cost of such materials has been separately identified by the contractor (include in Materials).
- Ex principal Related Party (include in Related Party).

### Customer / Capital contributions

Financial contribution received from / repaid to a customer in respect of the provision of a new connection to the transmission network.

## D

### De Minimis

The activity of conducting de minimis business, ie non-transmission activities, which are subject to the limitation provided for in Standard Licence Condition B6 (Restriction on Activity and Financial Ring Fencing) Paragraph 4.

### Direct Opex

Direct Opex consists of operating costs that the ESO incurs to deliver its outputs under its three roles. Direct Opex costs are predominantly staff and external contractor costs. ESO Opex consists of Direct Opex plus Supporting Operational Costs.

## E

### Enhancement

A change to an existing IT system that adds to the capabilities of the system.

### ESO Opex

ESO Opex consists of Direct Opex plus Supporting Operational Costs.

## F

### Finance, Audit and Regulation

Performing the statutory, regulatory and internal management cost and performance reporting requirements and customary financial and regulatory compliance activities for the ESO.

Includes:

- Process of payments and receipts
- Time sheet evaluation where not part of the payroll process
- Financial & risk management - eg credit & exposure management
- Financial planning, forecasting & strategy

- Financial accounting
- Management accounting
- Investment accounting
- Treasury management
- Transportation income accounting
- Pricing
- Statutory & regulatory reporting
- Tax compliance & management
- Internal audit & management of the relationship with external audit function
- External audit fees
- Cost of regulatory department

Excludes:

- Insurance costs (include under Insurance).
- Any of the IT systems associated with finance, audit and regulation (include under IT & Telecoms).

#### Fines and Penalties

Any fines or penalties paid by the ESO that do not fall within the categories of:

- Notice Penalties
- Inspection Penalties (part of Investigatory Inspections and Penalties)
- Overstay Fines
- Permit Penalties

Includes all tax penalties, fines and interest.

#### Full Time Equivalent (FTE) Employee

The number of normal hours worked by an employee divided by the normal hours of a full-time member of staff in an equivalent role according to his or her contract of employment.

## G

### Group

A Group consists of a parent company and its participating interests, where participating interests has the meaning as defined in the Electricity Transmission Licence.

## H

### HR & Non-operational Training

#### HR (Human Resources)

This would include provisions of the HR function ie the full range of professional activity for an individual's career path from recruitment to retirement and post retirement where applicable, eg management and administration of pension payments (NB PPF scheme administration costs are excluded) and from related professional advice to directly resolving grievances for staff.

Includes:

- Costs of payroll and pension's management and operation.
- Facilitating staff performance, development and reviews.
- Industrial and employee relations including HR strategy, policies and procedures.
- Monitoring equal employment opportunities.
- HR advice to management, succession planning and also retentions and rewards.

Excludes:

- Pension Scheme Administration and PPF levy costs.
- Pension deficit repair payments relating to the "established deficit" and for the avoidance of doubt, all unfunded early retirement deficiency costs (ERDC) post 1 April 2004.

#### Non-operational Training

Facilitating and operating training courses of a non-technical nature for office-based staff.

Includes:

- Staff who organise and provide non-operational training and maintain employees training records.

- Cost of running the non-operational training costs eg course fees.
- Leadership development training.

Excludes:

- Any operational training costs.
- Non-operational costs associated with formal training and apprentice programmes (included under operational training).
- Time of employees attending training (include as labour costs under the relevant activity for non-operational).
- HSE costs (include under Closely Associated Indirect costs).
- IT systems associated with HR & Payroll (include under IT & Telecoms).
- IT & Property management costs associated with Non-operational Training (include under IT & Property costs respectively).

## I

### Insurance

Support and expertise to develop the business risk profile, managing the claims process and provision of information and understanding to the business in relation to insurable and uninsurable risks.

Includes:

- Insurance premiums
- Insurance premium tax
- Insurance contract negotiating and monitoring
- Insurance claim processing
- Insurance risk management
- Payments relating to uninsured claims
- Costs of in-house insurance team
- Brokers fees

### IT & Telecoms (Business Support)

Provision of IT services for the day-to-day service delivery.

#### Includes:

- The purchase, development, installation and maintenance of non-operational computer and telecommunications systems and applications.
- Provision of IT services for the day-to-day service delivery and includes the cost of Help Desk, data centres, IT application development, maintenance and support; establishing and maintaining IS infrastructure projects (IT Network Provision, Network Maintenance, Servers support/services).
- Voice and data telecoms (eg WAN, landline rental and call charges, ISDN data and costs/rental of mobiles except where costs are charged directly to user departments).
- Developing new software for non-operational IT assets including the costs of maintaining an internal software development resource or contracting external software developers. This will include any cost of software licences to use the product where those costs cover more than one year.
- Installing new or upgrading software, other than where it is. This does not include upgrading of software that is included within the costs of annual maintenance contracts for the software.
- Maintenance and all the operating costs of the IT infrastructure and management costs and Applications cost. This includes any annual fee for the maintenance of software licences, whether or not they include the right for standard upgrades or 'patches' to the software as they become available.
- IT applications maintenance and running costs.
- IT new applications software and upgrade costs.

#### Excludes:

- IT equipment which is used exclusively in the management of network assets, but which does not form part of those network assets.
- Any of the property costs associated with IT & Telecoms (include under Property Management), except where the cost of specific IT environmental control systems can be distinguished from other property costs.

### IT & Telecoms (Non-operational)

Expenditure on new and replacement IT assets which are not system assets. These include Hardware and Infrastructure and Application Software Development.

#### Hardware and Infrastructure Costs

Includes:

- Purchase of IT equipment that is either located away from network assets or does not directly relate to the control of those assets.
- Purchase and installation of new hardware systems (eg servers, firewalls, switches & ISDXs).
- Purchase of equipment for the physical IT environment (ie air conditioning, fire and flood prevention and detection), where these can be differentiated from property costs.
- Purchase of Client equipment (eg desktops, laptops, monitors, printers, plotters).
- Purchase of Telecoms equipment (eg staff mobile devices) where not used exclusively in the real time management of network assets.
- Hardware that is purchased as part of an IT software project.

Excludes:

- Software development and upgrade costs (report under Application Software Development).
- Any of the property costs associated with IT & Telecoms (include under Property Management), except where the cost of specific IT environmental control systems can be distinguished from other property costs.

#### Application Software Development Costs

Includes:

- IT software upgrade costs: New and upgraded software licences where the benefit is received over more than one year.
- Cost of software development staff employed directly by the ESO or contracted to undertake development work during the reporting year.
- Purchase and installation of new application software and their license fees.



Excludes:

- Hardware that is purchased as part of an IT software project (include in Hardware and Infrastructure Costs).
- Annual maintenance charges whether or not they include standard upgrades to the software (include in IT & Telecoms (Business Support)).
- Ongoing or renewal software licence and licensing fees.
- Any of the property costs associated with IT & Telecoms (include under Property Management), except where the cost of specific IT environmental control systems can be distinguished from other property costs.

**L**

**Labour**

For the purposes of the RRP, this is a Cost Type. Labour costs include any form of payment, consideration or other benefit, paid or due to or in respect of employees, including the costs of temporary or Agency Staff.

Includes:

- Gross salaries and wages of all employees, including payments resulting from bonus and profit-related payment schemes.
- Employer's national insurance contributions.
- Salary sacrifice payments.
- Sick pay.
- Sickness benefits.
- Private health insurance.
- (Non-pension related) retirement awards.
- Death in service benefits.
- Paid leave.
- Company cars or payments in lieu thereof.
- Standby costs – are the costs incurred when employees are on standby to be called upon if required in the event of a specified occurrence in accordance with their terms of employment.

- Agency Staff.
- Subsistence.
- Travel.
- Entertainment expenses.
- Share options (including employee share purchase plans, employee share option plans).
- Medical insurance costs.
- Childcare assistance.
- Protective clothing.
- Welfare costs.

Excludes:

- Professional services.
- Contractors.
- Company vehicles take home over night, other than company cars (include under Labour costs).
- Small tools and equipment (include under non-operational new assets and replacement).
- Pension costs (employer only).
- Pension Deficit Repair Payments.

For all activities except operational training excludes time spent on operational training courses (include in labour under operational training).

## **N**

### **New IT System**

A new IT system that is additional to or replaces an existing IT system.

### Non-operational Capex

Expenditure on new and replacement Non-operational Assets which are not system assets.

Includes:

- IT & Telecoms (Non-operational)
- Non-operational Property
- Non-operational Vehicles
- Small Tools, Equipment, Plant and Machinery

### Non-operational Property

Expenditure on new and replacement property assets which are not system or operational assets.

Includes:

- Premises used by people (eg stores, depots and offices) which are not operational premises (eg substations).
- Office equipment.

## **P**

### Pass Through Costs

Costs for which companies can vary their annual revenue in line with the actual cost.

### Pensions

For the purposes of the RRP, this is a Cost Type.

Includes (Pensions includes licensee payments on a cash basis for the following):

- Ongoing normal service contributions to Defined Benefit Pension Schemes.
- Ongoing normal service contributions to Defined Contribution Pension Schemes.
- Ongoing normal service contributions to stakeholder and/or personal pension plans.
- (From 31 March 2015) payments in respect of Pension Scheme Incremental Deficit repair payments.
- Payments in respect of the PPF levy (whether paid directly by the distribution business or within ongoing contribution rates).

- Payments in respect of pension scheme administration costs (whether paid directly by the distribution business or as part of ongoing contribution rates).

Excludes:

- (From 31 March 2015) payments in respect of Pension Scheme Established Deficit repair payments (report in Pension Administration Costs).
- Payments in respect of pension related severance costs.
- Payments in respect of augmentation of benefits.

### Pension Deficit Repair Payments

The cash costs paid, directly or indirectly, by the licensee to reduce a shortfall in a pension scheme's assets compared with its liabilities as set out in the deficit recovery plan agreed between the licensee and the pension scheme trustees, reported to the Pensions Regulator and certified by the pension scheme actuary, in accordance with the pension scheme rules.

From 1 April 2015 these are split into:

- Payments in respect of Pension Scheme Incremental Deficit repair payments, which are part of Pensions, which are payments relating to funding the incremental deficit.
- Payments in respect of Pension Scheme Established Deficit repair payments, which are payments related to funding the established deficit.

### Pension Deficit Payments relating to Established Deficit

Established deficit means the difference between the assets and liabilities, determined at any point in time, attributable to pensionable service up to 31 March 2012 and relating to regulated business activities under our second Pension Principle. The term applies equally if there is a subsequent surplus.

### Pension Scheme Administration Costs

The administrative costs for the operation of a pension scheme by the scheme trustees (excluding interest and taxation) including salaries and on costs of pension scheme administrators and all other associated costs of administering the pension scheme, whether borne by the scheme directly or the employer(s) and not recovered from the scheme.

Includes:

- Actuarial consultancy fees
- Administration and investment management fees where not remunerated by deduction from investment returns
- Third party administration fees
- Electricity Pensions Services Limited costs
- Pensions administration system licence and support costs
- Legal advisers' fees
- Recruitment costs
- Pension secretariat
- Policy and strategy
- Administration consultancy
- Auditors' fees
- Custodian fees
- Communication consultancy fees
- General office costs (eg printing, IT support, publications etc)
- Investment consultancy fees
- Tracing agency fees
- Member communication costs
- Trustee remuneration
- Trustee training costs

Excludes:

- Administration and investment management fees where remunerated by deduction from investment returns.
- Costs incurred by the licensee/distribution business in managing its ongoing and contributions and deficit repair payments to pension schemes.
- Costs of actuaries appointed by the scheme sponsors to advice on the scheme valuations and recovery plans.

- Costs incurred by the licensee/distribution business, directly or indirectly, in managing its relationship with the Pension Scheme and scheme trustees or actuaries.

### Procurement

Responsible for the procurement of goods & services in the support of the business operations, through the management of procurement contracts with suppliers.

Includes:

- The cost of carrying out market analysis.
- Identifying potential suppliers, undertaking background review, negotiating contracts, purchase order fulfilment & monitoring supplier performance.
- Setting up and maintaining vendor accounts within the accounting system and maintaining e-procurement channels.
- Setting procurement guidelines and monitor adherence to the guidelines.

Excludes:

- Any of the IT systems associated with procurement (include under IT & Telecoms).

### Property Management (Business Support)

The activity of managing, providing and maintaining non-operational premises, ie premises used by people such as stores, offices and depots. This should include costs such as rent, rates (business), and utilities costs including electricity, gas and water, maintenance/repair costs of premises and also should include the provision of the facilities / property services such as reception, security, access, catering, and mailroom, cleaning and booking conferences. The costs of property surveyors should also be included here.

Includes:

- Stores, depots, offices (including training centre buildings & grounds)
- Rent paid on non-operational premises
- Rates and taxes payable on non-operational premises
- Utilities including electricity, gas and water (supply and sewerage)
- Inspection and maintenance costs of non-operational premises
- Facilities management costs including security and reception

- Training centre buildings & grounds
- Control rooms and data centres

Excludes:

- Any IT systems associated with property management (include under IT & Telecoms)
- Depreciation and profit/loss on Fixed Assets Relocation costs to or from non-operational premises
- Network rates

## **R**

### **RAV**

Regulatory Asset Value (RAV) represents the value upon which the ESO earns a return in accordance with the regulatory cost of capital and receives a depreciation allowance.

### **Refresh**

A change to the software or hardware of the system due to an upgrade from the supplier.

### **Regulatory Instructions and Guidance (RIGs)**

The collection of documents issued by Ofgem to the ESO to enable it to complete the reporting requirements associated with the RIIO-2 price control arrangements. It includes Excel reporting packs, instructions and guidance and supporting commentaries.

### **Regulatory Year**

Has the meaning given in the ESO's licence.

### **Related Party**

Is an affiliate, a joint venture of the licensee or of an affiliate or an associate of the licensee or of an affiliate or a relevant associate of the licensee.

### **Related Party Margins**

The profit or loss recorded on a transaction with an affiliate being the excess or deficit on actual direct costs and indirect costs (including financing costs) fairly attributable to the transaction or the charge and the cost of providing that transaction.

### Related Party Transaction

A transaction that occurs where one party provides goods, works, supplies or services to a Related Party.

## S

### Salary / Staff Costs

Includes: salaries and wages, national insurance contributions, overtime standby and other allowances, all ongoing pension costs and incremental deficit repair payments, share based schemes, and sick pay and sickness benefits.

### SOIAR<sub>t</sub>

The System Operator Internal Allowed Revenue (SOIAR) term is derived from the formula set out in set out in Special Condition 4.1 (System Operator Internal Revenue Restriction) of the Electricity Transmission Licence. The ESO must use best endeavours to ensure that the revenue collected from Balancing Services Activity associated with internal costs does not exceed SO Internal Allowed Revenue. The value of SOIAR<sub>t</sub> is calculated through the annual iteration of the ESO Price Control Financial Model and is specified in a direction given by the Authority by 30 November in each Relevant Year.

### Small Tools, Equipment, Plant and Machinery (Non-operational)

Small tools, equipment, plant and machinery which are used to work on, assist work on or test system assets. They are not system assets and are not permanently attached to one system asset at one location, irrespective of when they were bought or for what purpose.

Typically includes:

- Hand and power tools
- Instruments and testing equipment, eg
  - Partial discharge monitors
  - Voltage recorder
  - Load monitors
- Power quality monitoring equipment
- Ladders (used at substations and transported on vehicles)
- Lifting and handling gear
- Street Works signing and guarding equipment



- Non-wheel- mounted winches and winching equipment
- Cable drum equipment, eg drum stands
- Workshop equipment, eg pedestal drills, grinding wheels and reciprocating saws
- Misc. Equipment, eg cable spiking guns, pumps, gas hoses and fittings
- Inspection costs for recertification and recalibration associated with STEP

Excludes:

- Harness, climbing belts and fall arrest equipment (include as labour cost under the relevant activity of that employee)

### Supporting Operational Costs

Costs of teams that support the ESO's three roles, such as ESO regulation, stakeholder engagement, innovation and business change. ESO Opex consists of Direct Opex plus Supporting Operational Costs.

**T**

Totex

**See Appendix 2.**

## Appendix 2 – Definition of totex

### Introduction

1.1. The Regulatory Asset Value (RAV) is a key building block of the RIIO-2 price control. RAV represents the value upon which the ESO earns a return in accordance with the regulatory cost of capital and receives a depreciation allowance. Additions to the RAV are calculated as a set percentage based on a capitalized share of totex. Totex is dealt with as follows:

- an agreed percentage of totex (see below) will be funded as slow money (ie as an addition to RAV)
- the remainder will be funded as fast money (ie which is expensed and funded in the year of expenditure)

1.2. At the end of each year of the price control, as part of the Annual Iteration Process, we will publish an updated RIIO-2 PCFM which will give an indicative updated RAV for the ESO. In ascertaining these values, it is important that the treatment of expenditure that the ESO incurs in this period is consistent with the principles and specific issues set out in our Final Determinations – that is, the same constituents of costs are included as totex. We add all costs on a normal accruals basis. This excludes provisions, except for the actual cash utilisation thereof.

### Definition of totex

1.3. There are four main categories of costs that the ESO incurs as part of its totex and which are included in the cost benchmark. These are outlined in Table 4.

**Table 4: ESO Totex categories**

| <b>Cost category</b>             | <b>Sub-categories</b>           | <b>Details</b>   | <b>Shared service?</b> |
|----------------------------------|---------------------------------|--|------------------------|
| ESO Operational Costs (ESO Opex) | Role 1                          | Operating costs that the ESO incurs to deliver its outputs under its three roles. Predominantly staff and external contractor costs.   | No                     |
|                                  | Role 2                          |  |                        |
|                                  | Role 3                          |  |                        |
|                                  | Supporting Operational Costs    | Costs of teams that support the three roles, such as ESO regulation, stakeholder engagement, innovation and business change.           |                        |
| Capital Expenditure (Capex)      | IT and Telecoms (IT&T)          | Predominantly the cost of the ESO's control centre architecture and market platforms.  | Yes                    |
|                                  | Property                        | Building costs associated with the ESO's Wokingham control centre and share of the National Grid Warwick office.                       |                        |
| Business Support Costs (BSC)     | IT&T                            | Costs for services provided by National Grid Group to support the ESO's general business activities. Predominantly IT operating costs. | Yes                    |
|                                  | Property management             |  |                        |
|                                  | HR and Non-operational Training |  |                        |
|                                  | Finance, Audit and Regulation   |  |                        |
|                                  | Insurance                       |  |                        |
|                                  | Procurement                     |  |                        |
|                                  | CEO and Group Management        |  |                        |
| Other Price Control Costs        | n/a                             | Other costs that do not fall into the above categories, including pension admin fees and cyber resilience IT.                          | Yes                    |

1.4. The ESO shares certain functions with other National Grid Group companies, including IT, Human Resources (HR), Finance, Legal and Procurement. The costs associated with these functions are allocated to the ESO by National Grid Group. Some of these costs

are allocated on an indirect basis, based on a methodology to reflect the ESO's approximate usage. Others are allocated to the ESO directly (eg costs for ESO-specific property or IT investments).

1.5. The annual net additions to RAV will be calculated as a set percentage based on a capitalised share of totex. Totex consists of all the expenditure relating to the ESO's regulated activities with the exception of:

- All costs relating to de minimis activities.
- All costs relating to directly remunerated services (with the exception of capex relating to sole use exit connections).
- Pension deficit repair payments relating to the established deficit and for the avoidance of doubt, all unfunded early retirement deficiency costs (ERDC) post 1 April 2004.
- Costs associated with the Network Innovation Competition and Network Innovation costs funded by the Innovation allowance. (For the avoidance of doubt, the unfunded costs for NIA Expenditure and the Network Innovation Competition can be included in totex).
- All statutory or regulatory depreciation and amortisation.
- Profit margins from related parties (except where permitted as defined below).
- Costs relating to rebranding a company's assets or vehicles following a name or logo change.
- Fines and penalties incurred by the ESO (including all tax penalties, fines and interest) except if, exceptionally Traffic Management Act costs can be shown to be efficient.
- Any costs relating to the NGESO for external purposes (ie balancing services activity).
- Compensation payments made in relation to standards of performance.
- Bad debt costs and receipts (subject to an ex-post adjustment to allowed revenues).
- Any cost reporting which is not on a normal accruals basis as referred to in paragraph 1.2 above (for the avoidance of doubt, accruals to recognise the present value obligation to the defined benefit pension scheme (in accordance with International Accounting Standard 19) are excluded from totex).
- Costs in relation to pass through items, including business rates (except for business rates on non-operational buildings).

- Interest, other financing and tax costs (except for business rates on non-operational buildings and stamp duty land tax).
- 1.6. It should also be noted that pension deficit repair payments relating to any incremental deficit (ie not part of the established deficit) are considered to be part of the ESO's labour costs and as such are part of totex.
- 1.7. For avoidance of doubt, in each case normal ongoing pension service costs will follow employment costs in each activity to RAV.
- 1.8. Costs added to RAV are all intended to refer to costs incurred by the ESO or a related party of the ESO undertaking regulated business activities. Where those costs are recharged to the ESO, they should not include any internal profit margins of the ESO or related party, except where permitted. The treatment of related party margins is set out in paragraphs 1.22 to 1.27 below.
- 1.9. For the avoidance of doubt, costs that are eligible for a re-opener mechanism will follow the totex treatment as set out above at the time they are incurred.

## **Deductions from RAV**

- 1.10. The following items are not included in the costs added to the RAV but are netted off additions to the relevant cost categories in carrying out the RAV roll forward calculation:
- Cash proceeds of sale (or market value of intra-group transfer) of operational assets – by netting off the proceeds from the calculated additions to RAV.
  - Cash proceeds of sale of assets as scrap – by netting off the proceeds from the calculated additions to RAV.
- 1.11. These deductions from RAV will be made (on an NPV neutral basis) at the end of the RIIO-2 price control.

## Other RAV requirements

### Efficient costs

- 1.12. Ofgem reserves the option to disallow costs from the RAV for any of the totex expenditure if they do not relate to the regulated business or are demonstrably inefficient or wasteful. For the first business plan cycle (BP1), we have set a cap on disallowance of demonstrably inefficient or wasteful expenditure of 2.5% RAV per year. We will consider adjusting the value of the cap at the start of the second business plan cycle (BP2).
- 1.13. We will specifically review all costs in relation to restructuring of a company's business or operations in relation to corporate transactions, including the associated redundancy costs to satisfy ourselves that these costs are efficient and will deliver future savings for the benefit of the consumer.

### Restated costs

- 1.14. For all costs, in whatever category, activity or exclusion, where a company makes any restatement of costs, we will apply these in the year in which they were originally incurred rather than in the year of the restatement.

### Related party costs

- 1.15. Related party costs are only included within totex to the extent they represent the cost of services required by the ESO's business. Costs for services recharged to the ESO by a related party will only be admissible if the ESO would otherwise have needed to carry out the service itself or procure it from a third party. We expect these services and associated costs to be itemised and justified. Such costs are only included to the extent that they satisfy the criteria regarding the prohibition on cross-subsidy in the relevant standard or standard special licence condition unless the ESO already holds derogations.
- 1.16. All companies and related parties charging the ESO should be able to demonstrate they have a robust and transparent framework governing the attribution, allocation and inter-business recharging of revenues, expenses, assets and liabilities. There should be

documented procedures to demonstrate compliance with EU Procurement directives and implementing national legislation where these apply.

- 1.17. We expect the network company to be able to justify the charge by reference to external benchmarking, or by reference to market-related testing, or tendering. We expect related parties to be able to support their charges by either service level agreements or contracts; and that such contracts would be finalised on a timely basis and not remain in draft for an unreasonable period.
- 1.18. The attribution of costs relating to shared services must be on a demonstrably objective basis, not unduly benefiting the regulated company or any other company or organisation and be based on the levels of service or activity consumed by each entity. We expect the ESO to document the basis on which it approves these at board level and provide evidence of this together with details of how the continuing assessment and challenge, annually takes place.
- 1.19. The basis should be consistent from year to year and where there are changes the ESO should both document and justify them.
- 1.20. The ESO must notify Ofgem of any changes to cost allocation drivers (including the creation of new cost centres/drivers) in the Supporting Commentary to the C+O RRP submission, explaining the reason for the change and the forecast financial implications for each National Grid Group regulated licensee. The ESO must ensure that the ESO board notifies Ofgem in a letter alongside the C+O RRP submission whether it is satisfied that any changes to the allocation drivers (including the creation of new cost centres/drivers) are fair and reflective of the ESO's consumption of shared services.<sup>12</sup>
- 1.21. The method used to attribute costs from the related party to the ESO and to activities should be transparent and the revenues, costs, profits, assets and liabilities separately distinguishable from each other.

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<sup>12</sup> For more guidance on these policies, please see paragraphs 4.57-4.62 of our Final Determinations – ESO Annex: <https://www.ofgem.gov.uk/publications/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

## Related party margins

- 1.22. We will exclude related party profit margins from costs added to RAV unless the related party concerned earns at least 75 per cent of its turnover from sources other than related parties and charges to the licensed entity are consistent with charges to external customers. For this purpose, we consider an entity to be a related party if it is an affiliate or related undertaking or if that entity and the network company have any other form of common ownership. A key indicator of entities being in common ownership is that they are affiliates of the ultimate controller (or controllers where there is more than one).
- 1.23. Where network operators utilise captive insurance companies, these shall be excluded from the related party exclusion. We will not allow any excess losses relating to these captive insurers (to the extent that they are covered by captive insurers) to be funded by customer.
- 1.24. When an entity ceases to be a related party, for example on a change in ultimate controller, then from the time it ceases to be a related party its margins will be allowable, if it meets the following requirement. There must be an unambiguous demonstration that its charges to the transmission business (in the original or amended contract) remain competitive and are in line with market rates, or the contract was re-tendered and that there was more than one bidder.
- 1.25. Whilst not precluding other demonstrations of competitiveness, we consider that an open competitive tender is likely to be the clearest indicator. In the absence of an open competitive tendering exercise, we will seek strong evidence that the terms of any contract are competitive.
- 1.26. Irrespective of whether the network company demonstrates competition and they no longer disallow margins, the ESO must arrange to comply with the requirements of the relevant standard or standard special licence condition (on the maintenance and provision of information). It must continue to report the former related party's costs and margins as if it were still a related party for the remainder of the price control period. The data is required in order for us to be able to monitor performance against the price control and carry out cost analysis to inform future reviews.
- 1.27. Where a principal related party resource provider ceases to be a related party during a price control period, for example on the restructuring of a group, we shall continue to



treat them as a related party until the end of that price control period and we will continue to disallow the margins charged. At the next price control period the margins will be allowed provided that there is unambiguous demonstration that the charges to the regulated business (in the original or amended contract) remain competitive and are in line with market rates, or that the contract is re-tendered and that there is more than one bidder.