

Guidance

ESO Business Plan: Guidance Document

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As part of the RII0-2 price control, the Electricity System Operator (ESO) will need to submit a Business Plan for its second business plan cycle, commencing on 1 April 2023. This document provides updated guidance on the information that should be included in the Business Plan.

This Guidance Document outlines the dates for the submission of and determinations for the Business Plan; the contents of the Business Plan; how the Authority will assess the Business Plan; and the duration of the business plan cycle.

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Version history

Version	Changes	Purpose	Publication date	Go Live
1.0	n/a	To provide guidance on the ESO's second Business Plan for the period 1 April 2023 to 31 March 2025.	3 September 2021	29 November 2021

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1. Introduction

1.1. This chapter sets out the purpose of this Guidance Document and its status from a compliance perspective.

1.2. The ESO has a central role in our energy system. It performs several important functions from the real time operation of the system, through to market development, managing connections, and advising on network investment. The ESO's delivery of its Business Plan, across the spectrum of its roles, can unlock substantial benefits for consumers by helping to shape the best pathway to a Net Zero energy system.

1.3. The ESO's five-year RIIO-2 price control contains a default two-year business plan cycle. The ESO's first business plan cycle ("BP1") runs from the 1 April 2021 to March 2023. The ESO will publish a second Business Plan for the second business plan cycle ("BP2"), which will start on 1 April 2023.

1.4. In 2019, we set out Business Plan Guidance¹ directed at electricity and gas network companies and their stakeholders. This provided an update on the information that should be included in companies' Business Plans for RIIO-2.

1.5. This Guidance Document builds on the previous guidance issued, to provide the ESO with specific detailed guidance for BP2. This Guidance Document sets out the governance and process by which the ESO must submit the second Business Plan to the Gas and Electricity Markets Authority ("the Authority") and the governance and process by which the Authority and the ESO Performance Panel ("the Performance Panel") will assess the Business Plan.

1.6. The ESO Business Plan Guidance Document is issued by the Authority under Part B of Special Condition 4.3 (Electricity System Operator Reporting and Incentive Arrangements) of the ESO's licence. As set out in Special Condition 4.3.10, the Authority may make appropriate provision about or impose requirements in the ESO Business Plan Guidance Document, which may include, but will not be limited to:

¹ RIIO-2 Business Plan Guidance: https://www.ofgem.gov.uk/sites/default/files/docs/2019/10/riio-2_business_plans_guidance_october_2019.pdf

- (a) the dates for the submission of and determinations for the Business Plan;
- (b) the contents of the Business Plan;
- (c) how the Authority will assess the Business Plan; and
- (d) the duration of the business plan cycle.

1.7. This document may be revised and reissued in accordance with Part B of Special Condition 4.3.

1.8. Before issuing new or amending the ESO Business Plan Guidance Document, the Authority will publish on the Authority's Website:

- (a) the text of the proposed ESO Business Plan Guidance Document;
- (b) the date on which the Authority intends the ESO Business Plan Guidance Document to come into effect; and
- (c) a period during which representations may be made on the content of the ESO Business Plan Guidance Document, which will not be less than 28 days.

Compliance

1.9. Where provisions of this Guidance Document require the compliance of the licensee, the licensee must comply with those provisions as if the Guidance Document were part of Special Condition 4.3.

1.10. For the avoidance of doubt, this document is subordinate to the licence. This document does not change any definitions or obligations contained within the licence and in the event of any ambiguity over the Guidance Document, the licence will take precedence.

1.11. The content of this Guidance Document does not alter or supplement the ESO's compliance with its wider obligations under legislation, its licence or industry codes. References to 'baseline expectations' within this document are for the purposes of the ESO

Business Plan Guidance Document and the Electricity System Operator Reporting and Incentives (ESORI) Arrangements² only.

² Electricity System Operator Reporting and Incentives (ESORI) Guidance 2021-23:
<https://www.ofgem.gov.uk/publications/decisions-eso-guidance-documents-2021-23>

2. The Business Plan process

This chapter provides an overview of the Business Plan process. It provides guidance on the steps, processes and timings involved in the ESO's second business plan cycle.

Duration of the business plan cycle

2.1. The ESO's RIIO-2 price control runs from 1 April 2021 to 31 March 2026. We will continue with the default two-year business plan cycle for the ESO. The ESO's second business plan cycle (BP2) will cover the period between 1 April 2023 to 31 March 2025.

2.2. The ESO is expected to deliver its business plan and adhere to the incentive scheme's timing, in the absence of any changes or further updates from Ofgem. If any changes to the ESO's wider governance arrangements³ are confirmed and anticipated to come into effect during BP2, then we will provide an update on how this will be managed and, if necessary, we will update the ESO's guidance documents accordingly. In doing so, we will consult with the impacted parties, including the ESO, to ensure the regulatory framework remains fit for purpose.

2.3. We expect to make a decision about the time period and regulatory arrangements for the third and final business plan cycle (BP3) under RIIO-2 by Q3 2023. At this point, we should have greater clarity and certainty about the existence of, or timings for, changes to the ESO's wider governance arrangements.

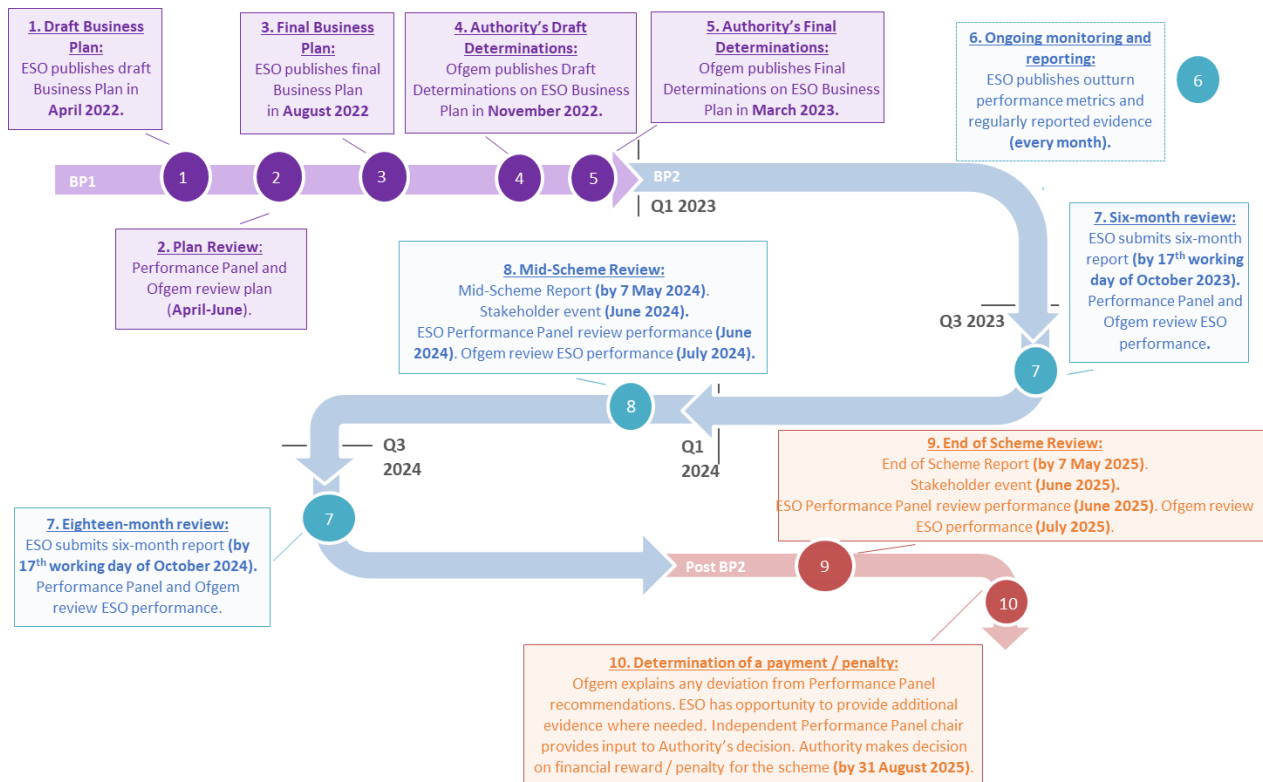
Stages in the second business plan cycle (BP2)

2.4. Figure 1 provides an overview of the key stages and timings in the reporting and incentives process for the ESO's BP2. We provide guidance on stages 1-5 of the business plan cycle in the sections below.

³ Energy Future System Operator consultation:
<https://www.gov.uk/government/consultations/proposals-for-a-future-system-operator-role>

2.5. The full details expected for stages 6-10 are included in the ESORI Guidance.⁴ We do not expect these stages to change for BP2, however we will update the ESORI Guidance to include the timings outlined below, as well as the performance measures from stage 5, before the start of the BP2.

Figure 1: Regulatory process for second business plan cycle (BP2)



Steps 1 to 5: The ESO Business Plan

Step 1) The draft Business Plan

2.6. The ESO should engage with stakeholders to inform and publish a draft version of the Business Plan by 30 April 2022, in the year before the start of BP2. This deadline will be the last date for publishing the draft Business Plan and starting a 'formal' consultation period on its contents.

⁴ Chapter 2, Electricity System Operator Reporting and Incentives (ESORI) Guidance 2021-23: <https://www.ofgem.gov.uk/publications/decisions-eso-guidance-documents-2021-23>

2.7. The draft version of the Business Plan should reflect stakeholder views and feedback provided to the ESO throughout the duration of the previous business plan cycle. The draft Business Plan must clearly demonstrate how these views have been taken into account.

2.8. The Business Plan should outline the details of the ESO's costs, activities, and deliverables for delivering its RIIO-2 strategy over BP2. The updated Delivery Schedule and the content required for BP2 is outlined in Chapter 3.

2.9. The ESO Roles Guidance⁵ also provides guidance on what the ESO should seek to achieve with its second Business Plan from April 2023. We will engage with the ESO on any new expectations or anticipated changes to existing expectations by the end of 2021. If required, we will publish a new version of the Roles Guidance, following consultation, in advance of the start of BP2.

Step 2) The Plan Review

2.10. The formal Business Plan consultation period should be at least six weeks long. The ESO should ensure it engages with a wide spectrum of stakeholders, including but not limited to potential new electricity industry parties; the Authority; and any other interested parties, including consumer representatives and academics.

2.11. The draft Business Plan will be reviewed by the Performance Panel.⁶ Ofgem will arrange a meeting for the Performance Panel to review the draft Business Plan following its publication. The Performance Panel will comment on the quality, ambition and value for money of the two-year business plan proposal. The Performance Panel will record its feedback on the Business Plan in a report, which will be published on Ofgem's website. This report will be published during the ESO's draft Business Plan consultation period, in time for the ESO to take on board the Performance Panel's feedback before producing its final Business Plan.

⁵ ESO Roles Guidance: <https://www.ofgem.gov.uk/publications/decisions-eso-guidance-documents-2021-23>

⁶ For BP1, the Business Plan review was carried out by the 'RIIO-2 Challenge Panel' and ESO RIIO-2 Stakeholder Group (ERSG). For BP2, the ESO Performance Panel will perform this task. We do not intend to set a role for the ERSG and it will be for the ESO and the ERSG to agree whether, and if so what role they have for BP2. Consequently, any role set out for the ERSG in the 'Enhanced Engagement Guidance' will no longer be applicable.

Step 3) The final Business Plan

2.12. The ESO must publish a final version of its Business Plan by 31 August 2022. This deadline is the last date for publishing the final Business Plan. The ESO should ensure that it engages actively with stakeholders on the contents of its Business Plan well before this deadline. The final Business Plan should demonstrate how the ESO has incorporated the views of stakeholders, Ofgem and the Performance Panel. This should include an explanation of the reasons why points raised by stakeholders may not have been factored into the final Business Plan.

2.13. The Business Plan should also clearly demonstrate how the ESO has actively sought and considered stakeholder views throughout the previous business plan cycle.

Step 4) The Authority's Draft Determination

2.14. We will provide a 'Draft Determination' on the final Business Plan by November 2022. This will follow our review of the final Business Plan, the stakeholder responses received by the ESO and the Performance Panel's report on the draft Business Plan.

2.15. Before issuing the Draft Determination, we may seek further clarifications from the ESO around its Business Plan (for example, if any unclear or ambiguous points remain). The ESO should respond to these requests promptly and in line with the general guidance in Chapter 5 of the ESORI Guidance.

2.16. In our Draft Determination we will set out for consultation our proposals for:

- our grading of the ESO's two-year Delivery Schedule;
- our value for money assessment and proposals for a two-year cost benchmark for the ESO;
- key performance measures for the ESO; and
- any other aspects of the ESO's price control which are being reviewed for BP2.

Delivery Schedule grading

2.17. We will assess the ESO's two-year Delivery Schedule for each role.

2.18. The first stage of our grading will consider whether the individual deliverables meet our minimum requirements; whether they are specified, time bound, relevant, beneficial for consumers and in line with industry priorities, as specified in Chapter 3, paragraph 3.3. To inform the latter three of these requirements we will consider:

- a) how ambitious and well defined the ESO's deliverables are;
- b) whether the two-year deliverables clearly link to the long-term vision and medium-term strategy, set out in the first Business Plan, and make sufficient progress against these; and
- c) stakeholder feedback.

2.19. The second stage of our grading of the ESO's two-year Delivery Schedule will include our assessment of the extent to which the deliverables and associated activities for each role fall 'below', 'meet' or 'exceed' our baseline expectations. This will be based on the 'meet' and 'exceed' expectations included in the Roles Guidance.

2.20. This will inform an overall rating of 1 to 5 for each role's Delivery Schedule, where:

- 1 = deliverables do not meet any or very few of our expectations
- 2 = deliverables mostly do not meet our expectations
- 3 = deliverables mostly meet our expectations
- 4 = deliverables mostly exceed our expectations
- 5 = deliverables exceed all or almost all of our expectations

2.21. This 1-5 grading is consistent with the overall evaluation scoring for each role. The grading provides the ESO with a firm ex-ante expectation of our assessment of the ESO's 'plan delivery' performance if these deliverables are met. It also links to the value for money and demonstration of plan benefits criteria given the relevance of the ESO's deliverables for these criteria.

2.22. There is no mechanistic link between the first step (minimum requirements) of the grading and the second step (expectations). However, where deliverables do not meet our minimum requirements, it is unlikely we would then be able to conclude that the Delivery Schedule exceeds our expectations.

2.23. Where the Delivery Schedule is not sufficiently ambitious, we will highlight how it could be improved.

2.24. The extent to which Ofgem would be able to provide the feedback on the assessment outlined in paragraphs 2.18 to 2.23 will depend on:

- a) the clarity and level of detail provided by the ESO in its Business Plan regarding, for example, the ESO's planned activities/deliverables or the value of benefits its actions will create; and
- b) the ESO's reporting of its engagement with industry participants to validate the details and value of the planned deliverables.

Cost benchmark

2.25. We will assess the ESO's proposed internal costs and propose a cost benchmark for each role. The cost benchmark will represent Ofgem's view on the fair, value for money cost of delivering the ESO's planned outputs. This will be a point of reference for our within-scheme monitoring and value for money assessment.

2.26. We will consult on the methodology for allocating costs between roles as part of the determinations process. We will also set out how we intend to treat uncertain IT Capex costs. At this point we do not expect significant changes to the process for BP1.⁷

Performance measures

2.27. Within the Draft Determination we will outline our proposals for three types of performance measure:

- a) Performance metrics – numeric measures of performance which will have clear, ex-ante performance benchmarks for below/meets/exceeds expectations. The ESO will report on these metrics at regular, agreed intervals throughout the business plan

⁷ Chapter 4, Final Determinations – ESO Annex: <https://www.ofgem.gov.uk/publications/rrio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

cycle. These metrics should create transparency around the ESO's performance and help stakeholders track the ESO's progress against its Business Plan;

- b) Stakeholder satisfaction surveys – certain aspects of the surveys on satisfaction with the ESO, which are repeated at six-month intervals to track performance; and
- c) Regularly reported evidence (RRE) – numeric measures which are relevant evidence of the successful delivery of the ESO's Business Plan aims, but for which it is not possible to set reliable performance benchmarks and/or where the data is available too infrequently to be a useful performance metric.

Other aspects of the ESO's price control

2.28. Within the Draft Determination we will also outline our proposals for the following aspects and values of the ESO's price control, which are being reviewed for BP2:

- a) Disallowance of Demonstrably Inefficient and Wasteful Expenditure (DIWE) cap value;
- b) Additional funding;
- c) Capitalisation rates; and
- d) Network Innovation Allowance (NIA).

Step 5) The Authority's Final Determination

2.29. After publishing the Draft Determination, Ofgem will meet with the Performance Panel to discuss our provisional grading of the ESO's two-year Delivery Schedule, the proposed performance measures, and the value for money assessment and cost benchmark. The Performance Panel will provide its views, noting any disagreement with any part of our assessment and/or areas that may not have been covered by the proposed performance metrics.

2.30. Ofgem will publish a 'Final Determination' by March 2023 which will build on and finalise the decisions made in the Draft Determination. The Final Determination will consider all consultation responses received and the views of the Performance Panel.

2.31. In our Final Determination we will set out:

- our final grading of the ESO's two-year Delivery Schedule;
- our final two-year cost benchmark;
- our final key performance measures for the business plan cycle; and
- our final decision on any other aspects of the ESO's price control which are being reviewed for BP2.

2.32. The Final Determination will be considered by the Performance Panel as part of its evaluation of the ESO's performance (as described in Chapter 3 of the ESORI Guidance). The Authority will also consider the Final Determination when making its decision on an incentive reward or penalty (as described in Chapter 4 of the ESORI Guidance).

2.33. For the avoidance of doubt, the ESO's performance will be measured following the evaluation processes described in Chapters 3 and 4 of the ESORI Guidance. The Final Determination sets clear, ex-ante performance expectations if deliverables are met. It does not restrict the ESO from achieving a higher or lower incentive reward or penalty. We consider that both the original ambition of the Delivery Schedule, and the extent to which it is delivered, are important factors to consider when determining performance.

Revisions to the Business Plan

2.34. We expect the ESO to remain flexible and adaptable throughout the business plan cycle and respond to changing situations. The ESO should deviate from the plan where it identifies opportunities for greater consumer benefits. Equally, if an action in the plan turns out not to be in consumers' best interests, then the ESO should change its approach and explain why.

2.35. Whilst the Business Plan document will not be revised once published, we expect any changing context and changes from the plan to be explained through the ESO's within-year reporting throughout the rest of the business plan cycle. Any material changes to the deliverables during the year (i.e., new activities and/or deliverables) should be added clearly via an addendum to the Business Plan or within-scheme reports.

3. Contents of the Business Plan

This chapter outlines our expectations on the contents of the ESO’s Business Plan and provides specific guidance on what certain elements of the Business Plan should contain.

Overview

3.1. We are providing specific guidance on several elements of the ESO’s second Business Plan. Table 1 sets out a high-level overview of our expectations on the contents of the ESO’s second Business plan and how this differs from the first Business Plan.

Table 1: Summary of changes to our Business Plan content expectations for BP2

Element of Business Plan		Expectations for BP2	Expectations for BP1
Outputs	Delivery Schedule	The ESO should provide an update on its deliverables during BP2. This should include an updated Delivery Schedule from BP1.	Set out deliverables assigned to each activity and sub-activity for the RIIO-2 period.
	Performance measures	We expect the ESO to set out updated proposals for stakeholder survey parameters. The ESO will not need to set out performance metrics or RRE.	Work with stakeholders to develop a set of stretching performance measures.
Internal costs	Cost benchmark	The ESO should provide an update on internal costs in a consistent format to the information and supporting data tables for BP1. New or updated cost benefit analyses (CBAs) should only be provided for new activities	Provide costs broken down by activity, historical costs and comparable benchmarks, as well as proportionate CBA to justify key spending.

		or where there have been material changes to the anticipated costs or benefits of existing activities.	
	IT investments	Specific guidance to be provided by the end of 2021.	Provide sufficient information on IT investments to enable Ofgem to provide a robust, ex-ante view on costs.
	Shared services	Where there are material changes to shared costs or the shared services allocation, we expect the ESO to explain these changes and how its cost drivers, used to determine the percentage allocation of shared costs, are fair and reflective of the ESO's consumption of shared services.	Provide separate reporting of business support costs, with a clear description of how these have been allocated from the wider National Grid group.
	Cap on demonstrably inefficient and wasteful expenditure (DIWE)	The ESO should clearly justify any proposed change to the DIWE cap and why this is in consumers' interests.	The DIWE cap was set at 2.5% RAV per year for BP1.
Finance	Additional funding, including pass through allowance for Working Capital Facility (WCF)	The ESO should clearly justify any proposed changes to the level of additional funding and why this is in consumers' interests.	Additional funding was set at £4.8m per year for BP1, including a pass-through allowance for the WCF.

Innovation	Network Innovation Allowance (NIA)	The ESO should justify any proposed changes to the level of NIA funding for BP2, including details of progress made on NIA projects in BP1; plans for innovation activities; and how these activities will build upon wider activities within the Business Plan (where appropriate).	NIA funding was set at £4.5m per year for RIIO-2.
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Outputs

Delivery Schedule

3.2. For BP2, the Business Plan should set out, in relation to each of the roles, the deliverables during the two-year Business Plan cycle to deliver the ESO’s RIIO-2 medium-term strategy and long-term vision for the energy system. The Delivery Schedule for each role should be set out to show how the deliverables meet and/or exceed our expectations, as listed in the latest version of the Roles Guidance.

The Deliverables

3.3. In general, we consider that the deliverables should be:

- Specified – they should be clear what is being delivered in practice in order for successful delivery to be measured;
- Time bound – they should contain clear dates and milestones;
- Relevant – they should be justified against the delivery of the long-term vision;
- Beneficial for consumers – they should be intended to deliver consumer benefits and the ESO should clearly articulate and/or quantify the expected consumer benefit and what type of measurable outcome/benefit is associated with successful delivery; and

- In line with industry priorities – it should be clear why deliverables have been prioritised and how industry feedback has been responded to.

The Delivery Schedule

3.4. The BP2 Delivery Schedule should be an update of the BP1 Delivery Schedule provided in April 2021.⁸

3.5. The ESO should use the Excel template (the “BP2 Delivery Schedule template”) published alongside this Guidance Document to submit the BP2 Delivery Schedule. The BP2 Delivery Schedule template has been provided to ensure that, if filled in correctly, the contents of the BP2 Delivery Schedule meet our minimum requirements and our baseline expectations as outlined above.

3.6. Any new or updated deliverables should be clearly identified and outlined from BP1 to BP2. The unique ID/number for each deliverable set out in the BP1 Delivery Schedule must be retained where deliverables continue into BP2. Any new deliverables must have a new unique ID/number that was not used in the BP1 Delivery Schedule.

Abridged Delivery Schedule

3.7. The ESO should present an abridged version of the full BP2 Delivery Schedule in its second Business Plan. The abridged version should be considered as a more accessible and streamlined summary of the full BP2 Delivery Schedule for stakeholders, however, the ESO must provide clear references to the full BP2 Delivery Schedule.

3.8. A template for the abridged BP2 Delivery Schedule is provided in Annex 2. The contents of each column in the abridged version should be consistent with the full BP2 Delivery Schedule.

⁸ ESO RIIIO-2 Updated Delivery Schedule:
<https://www.nationalgrideso.com/document/189126/download>

3.9. For the avoidance of doubt, Ofgem will only consider the full BP2 Delivery Schedule when grading the Delivery Schedule at the Draft Determination and Final Determination stages.

Performance measures

3.10. For BP1, we asked the ESO to work with its stakeholders to develop a set of stretching performance measures.

3.11. The stakeholder satisfaction surveys framework has been set for RIIO-2. For BP2, we expect the ESO to set out updated proposals for certain aspects of the stakeholder satisfaction surveys, including: the questions, survey method, participants and the performance benchmarks.

3.12. We do not expect the ESO to propose performance metrics or RRE. Instead, Ofgem will propose these performance measures at the Draft Determination stage. We will work with the ESO and other stakeholders to develop these measures, or suggest alternatives, before and during the consultation process for our Draft Determination.

Internal costs

Cost benchmark

Costs

3.13. In the first business plan, the ESO set out its proposed costs for the whole RIIO-2 period through the Business Plan Data Template (BPDT), the BPDT Strategic Narrative and cost-benefit analyses (CBAs) for its transformational activities.

3.14. We expect the ESO to provide an update on its costs for BP2. This should be in a consistent format to the information and supporting data tables in the Business Plan for BP1. There should be a full/complete articulation of all updated costs in at least one single location within the Business Plan.

3.15. The future of system operation may evolve significantly, and decisions may be made within the next two years which overlap the ESO's work to finalise its Business Plan and Ofgem's work to finalise its Determinations. Without prejudging any outcome, active

planning for uncertainty can strengthen preparedness and improve transparency and allow any implications for core planning to be recognised.

3.16. The ESO should include an indicative plan for the transformational activities it would have to undertake should there be a decision to change its governance arrangements. This indicative plan should outline any trigger points and milestones that the ESO must achieve during the transformational process (e.g., in setting up new autonomous service provision). The activities and milestones should have associated dates and timeframes, as well as including any costs in achieving them. The transformational costs⁹ included in the ESO's business plan should be kept separate from core business activity costs. The ESO's indicative plan and costing should address transformation for the ESO; we recognise this does not capture any wider activities and their associated costs.

3.17. We emphasise that the information the ESO submits on its transformational activities and costs will be considered as indicative until there is greater clarity and certainty about the existence of, or timings for, changes to the ESO's wider governance arrangements. Once there is greater clarity on the ESO's wider governance arrangements, the ESO will be able to update its milestones, activities and costs for further consideration.

BPDT and BPDT Strategic Narrative

3.18. The ESO is required to submit an updated BPDT and BPDT Strategic Narrative alongside the second Business Plan. The ESO should use the template published alongside this Guidance Document to submit the BP2 BPDT.

3.19. The BP2 BPDT submission should include the ESO's outturn costs since the submission of the first Business Plan, as well as forecast costs for the remainder of RIIO-2. The ESO should focus its BPDT Strategic Narrative on the key drivers of any material changes in costs compared to the forecasts set out in the first BPDT submission for RIIO-2.

3.20. Further detailed guidance on the BPDT and BPDT Strategic Narrative is included in Annex 3.

⁹ Transformational costs are considered to be the internal costs to the ESO of the change to a Future System Operator. For the avoidance of doubt, these costs are separate from transaction costs (i.e., costs to the relevant entities involved in transacting the sale/purchase of the ESO).

CBAs

3.21. For BP2, the ESO should confirm whether the CBAs have materially changed from the original CBAs. Where they have materially changed, we require the ESO to provide justification for any material changes from the original CBAs provided in its first Business Plan.

3.22. We will also require new CBAs for any new activities that the ESO plans to undertake in BP2 that have not already been subject to a CBA. Ofgem will work with the ESO to agree the scope of the new activities that require a separate CBA.

3.23. The ESO should refer to our previous RIIO-2 Cost Benefit Analysis Guidance¹⁰ when developing its CBAs. For the avoidance of doubt, the CBAs should identify benefits and clearly articulate how the activities in question lead to those benefits; clearly justify any assumptions that are made; and clearly set out how anticipated costs and benefits are measured. Where financial benefits are identified, these should be either directly measurable or measurable through a proxy that has a direct cost associated with it. For benefits that cannot be easily measured, the ESO should include these in the narrative rather than the CBA financial benefits.

IT investments

3.24. IT investments form a significant part of the ESO's proposals over the RIIO-2 period. Therefore, it is essential that Ofgem is provided with sufficient information to conduct a rigorous assessment of these IT investments.

3.25. For the first Business Plan, we assessed IT&T (IT and telecoms) costs with the input of external experts.¹¹ The approach assessed each Capex project against four criteria (project justification, definition, cost assurity and resource) and applied a Red Amber Green (RAG) assessment to identify the recommended level of costs.

¹⁰ RIIO-2 Cost Benefit Analysis Guidance: <https://www.ofgem.gov.uk/publications/riio-2-final-data-templates-and-associated-instructions-and-guidance>

¹¹ Chapter 4, RIIO-2 Final Determinations – ESO Annex: <https://www.ofgem.gov.uk/publications/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

3.26. For BP2, we plan to provide further detailed guidance on the information we require from the ESO in order to assess its IT investments. We will provide this detailed guidance by the end of 2021, before the ESO submits its draft Business Plan for BP2.

Shared services

3.27. For RIIO-2, the ESO is allocated costs that are shared across National Grid Group using the Unified Cost Allocation Methodology (UCAM) approach agreed with Ofgem. Alongside the first Business Plan, the ESO provided details¹² on how costs shared across National Grid Group are allocated to the ESO.

3.28. We recognise that the shared services submission is prepared at a Group level, with the methodology and allocation agreed for each sector for the RIIO-2 period. Therefore, if the ESO expects there to be no material changes to its shared costs for BP2, the ESO's projected RIIO-2 costs in its original Business Plan may be resubmitted for BP2. The ESO should confirm this as part of its Business Plan submission.

3.29. We expect the ESO to provide the most up-to-date version of the arrangements on the governance of IT investments and terms of reference for the governance organisations for BP2, even if the ESO expects there to be no material changes to its shared costs for BP2.

3.30. If there are material changes to the ESO's shared costs for BP2, we expect to see a greater level of detail on shared services to ensure that we have a full understanding of how the cost drivers used to determine the ESO's allocation of costs were calculated. If there are material changes, we expect the ESO to provide details on:

- the UCAM principles;
- cost drivers used to determine the ESO's allocation of costs;
- cost tables showing how the drivers have been used; and

¹² ESO RIIO-2 Business Plan – Annex 8 Shared Services:
<https://www.nationalgrideso.com/document/158591/download>

- governance of IT investments and terms of reference for the governance organisations.

3.31. For the cost drivers, we expect the ESO to set out:

- the relevant cost drivers for each cost item;
- how and when each cost driver has been measured;
- for cost items with more than one cost driver, the weighting of each driver and how this has been calculated;
- the rationale behind the allocation methodology used for each cost item; and
- the total percentage ESO share of National Grid Group costs for each cost item.

3.32. The ESO must notify Ofgem of any changes to cost allocation drivers (including the creation of new cost centres/drivers), explaining the reason for the change and the forecast financial implications for each National Grid Group regulated licensee, as per our Final Determination.¹³

Cap on disallowance of DIWE

3.33. Our Final Determination for BP1 limited the amount of demonstrably inefficient and wasteful expenditure (DIWE) that Ofgem can disallow each year at 2.5% RAV per year.¹⁴

3.34. We stated that we would keep this cap under review, based on the ESO's track record of delivery and any Ofgem use of disallowance powers, and that we would consider adjusting the value of the cap at the start of BP2 if this would be in consumers' interests.

¹³ Page 63, RIIO-2 Final Determinations – ESO Annex: <https://www.ofgem.gov.uk/publications/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

¹⁴ Chapter 4, RIIO-2 Final Determinations – ESO Annex: <https://www.ofgem.gov.uk/publications/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

3.35. If the ESO believes that the DIWE cap should be adjusted for BP2, it must clearly justify the reasons for this as part of its second business plan, setting out what it believes to be the appropriate cap level and why this change would be in consumers' interests.

Finance

Additional funding, including WCF

3.36. Our Final Determination for BP1 set 'Additional Funding – Other' at £4.8m per year (nominal prices) and 'Additional Funding – Working Capital Facility (WCF)' as a pass-through arrangement to fund the efficient and observable costs for the WCF. The WCF was estimated at £0.7m - £0.9m in nominal prices.¹⁵

3.37. We stated that these additional funding decisions could be reviewed for BP2 due to the uncertainty of the underlying estimates, the changing nature of the ESO's role and the lack of precedent for the underlying risks. We will consider potential changes to revenue collection cashflow risks and whether experience with the new price control could change the level of perceived asymmetric risk the ESO is credibly exposed to.¹⁶

3.38. The ESO should consider both upward and downward drivers that could change the level of additional funding required in BP2 compared to BP1. If the ESO believes changes to the level of additional funding is required for BP2, it must clearly justify why any change is required, setting out what it believes to be the appropriate level of additional funding. It should clearly show which individual drivers have impacted any new level of proposed funding and by how much.

¹⁵ Chapter 5, RIIIO-2 Final Determinations – ESO Annex: <https://www.ofgem.gov.uk/publications/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

¹⁶ Chapter 7, RIIIO-2 Final Determinations – ESO Annex: <https://www.ofgem.gov.uk/publications/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

Innovation

Network Innovation Allowance

3.39. Our Final Determination for BP1 set out the level of Network Innovation Allowance (NIA) for the ESO at £20.7m for the RIIO-2 period.¹⁷ We set out that the ESO could request additional funding for years 3-5 at BP2, with more details of planned innovation activity in those years and more evidence of how these activities will build upon wider activities in the RIIO-2 Business Plan.

3.40. If the ESO believes additional NIA funding is needed for years 3-5 of RIIO-2, it should justify any proposed changes, providing as much detail as possible on the following:

- details of progress on business as usual (BAU) and NIA-funded innovation in BP1, including spend-rate to date against forecast spend rate;
- plans for new projects/activities the ESO plans to take forward with NIA, including how such projects/activities build upon and link to past and future projects being taken forward by itself and others, considering lessons learned from these past projects;
- details of how planned NIA projects/activities will build upon wider 'BAU innovation' activities within BP2 (where appropriate); and
- an explanation as to why the planned NIA projects/activities cannot be funded via other funding, such as via the ESO's cost-pass through arrangements or shareholder funds.

3.41. NIA funding remains conditional on ESO-led NIA projects involving partnership with other network companies, third party innovators and/or academics. We expect to see, for example, evidence of interactions with Distribution Network Operators (DNOs) and their

¹⁷ Chapter 6, RIIO-2 Final Determinations – ESO Annex: <https://www.ofgem.gov.uk/publications/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

RIIO-ED2 Business Plans included in any justification for increased NIA funding by the ESO.

3.42. We do not require the ESO to set out its Innovation Framework¹⁸ again for BP2. However, we expect the ESO to set out how it is building on the framework and how it is accounting for lessons learned throughout BP1.

¹⁸ Chapter 2, RIIO-2 Business Plan Guidance: <https://www.ofgem.gov.uk/publications/riio-2-business-plans-guidance-document>

4. Presentation and structure of the Business Plan

Presentation

- 4.1. The ESO's Business Plan should be concise and clearly written (avoiding small font sizes). The core narrative should contain all information relevant to Ofgem's assessment of the plan. The ESO should balance keeping this core narrative as short as possible, whilst also presenting proportionate evidence and justification for the proposed expenditure and outputs.
- 4.2. Where the ESO needs to provide further information, it should use annexes. Annexes should be clearly signposted and referenced within the core Business Plan text.
- 4.3. More technical information may also be provided in the annexes. The annexes should be as clear and readable as the rest of the Business Plan.

Structure

- 4.4. Though Ofgem does not prescribe a particular structure that Business Plans must follow, it is important to ensure that we can easily identify material contained in the Business Plan that will be relevant to our assessment. Therefore, the Business Plan should cover each of the sections set out in Chapter 3 of this document. These should be clearly labelled so that we are able to access all of the information that we require.
- 4.5. The ESO should try to ensure that the information relevant to each assessment area is presented in its relevant chapter or section (rather than spread throughout the Business Plan, for example).
- 4.6. Where it is not possible to include all information relevant to an assessment area within its own single chapter or section (for example where a supplementary annex is required), the ESO will need to clearly identify where in the Business Plan the relevant material is located. Therefore, the Business Plan should include a table that maps information on these key areas to relevant parts of the Business Plan.

Cross-referencing

- 4.7. In order to successfully navigate the Business Plan, the ESO should effectively cross-reference between different sections, using hyperlinks where possible (for example,

when referencing any of the data tables, annexes or any further detail which is explored elsewhere in the Business Plan).

4.8. It is important to have clear links between the data tables and the core narrative sections. Data tables should be clearly numbered and any data in the narrative should be clearly linked to the relevant data table number (and include a hyperlink wherever possible). For each data table, there should also be a link to where in the main narrative this data is discussed. For some data tables this may be more than one part of the Business Plan that describes the data.

Annex 1: Glossary

Table 2: Glossary of key terms used in the ESO Business Plan Guidance Document

Element	Description
Activity	A subset of responsibilities within a role with specific expectations and deliverables attached to it.
Business Plan	Details the ESO's costs, activities, deliverables and performance metrics for delivering its strategy over a business plan cycle of the RIIO-2 period.
Business plan cycle	Each business plan cycle runs for a two-year period. The first business plan cycle (BP1) covers the incentives scheme starting on 1 April 2021 and ending on 31 March 2023. The following business plan cycle (BP2) will start on 1 April 2023 and end on 31 March 2025.
Deliverable	A specific delivered output within an activity which has associated delivery dates and success measures.
Delivery Schedule	A grouping of deliverables for either a role or the Business Plan.
Delivery Schedule grading	Ofgem's grading of the Delivery Schedule for each role, designed to set a clear reference point and align expectations in the incentives process.
ESO Performance Panel	A mix of independent experts and industry representatives that are responsible for reviewing the ESO's plans and performance, as well as performing an End of Scheme evaluation of the ESO's performance.
Incentives scheme	The process over a two-year business plan cycle to assess the ESO's performance against five key criteria, resulting in the award of a £m reward or penalty.
Long-term vision	The long-term vision covers the period from the start of RIIO-2 to 2030.
Medium-term strategy	The medium-term strategy is the five-year strategy covering the RIIO-2 period.
Performance benchmarks	Describes ex-ante what outturn performance is below, meets and exceeds expectations for each performance metric.
Performance measure	A measure of the ESO's performance, including performance metrics, stakeholder satisfaction and other regularly reported evidence.
Performance metric	A numerical measure of ESO performance which can be produced regularly, has a pre-defined methodology and has clear performance benchmarks.

Regularly reported evidence	Evidence that should be regularly reported by the ESO to inform the evidence of benefits criterion in the evaluation criteria.
RIIO-2 period	RIIO-2 covers the period starting 1 April 2021 and ending on 31 March 2026.
Role	One of the three roles in the Roles Framework, defined below
Roles Framework	Sets out our expectations for how the ESO should comply with its obligations, and for RIIO-2, meet and exceed our incentives expectations under three roles: control centre operations; market development and procurement; and system insight, planning and network development.

Annex 2: Abridged BP2 Delivery Schedule template

Table 3: Abridged BP2 Delivery Schedule template

Sub-activity #	Deliverable #	Name	What does success look like on delivery?	Delivery date	Changes from BP1 Delivery Schedule
Please include the sub-activity reference number only.	Please include the deliverable reference number only.	Please provide the name associated with the deliverable reference number listed in the previous column.	Please describe what success is expected to look like upon completion of this deliverable. What will be achieved?	For deliverables with defined project timescales, please input a single final delivery quarter and year for this deliverable. If the deliverable is an ongoing activity throughout BP2, please input 'Continuous'.	Please explain what changes have been made to this deliverable from the BP1 Delivery Schedule, as finalised in April 2021.

Annex 3: Detailed guidance on updated BPDT for BP2

Introduction

The BPDT provides a framework which enables Ofgem to collect quantitative data from the ESO on its proposed operations and investment plans during the RIIO-2 period. The BPDT is part of a wider suite of information provided to Ofgem to enable informed price control cost benchmarks to be set for the ESO.

This annex builds on the previous RIIO-2 ESO BPDT Guidance¹⁹ (“the ESO BPDT Guidance”) issued, to provide the ESO with specific detailed guidance for BP2. Where this annex does not provide any additional instructions or guidance on how to complete the BPDT, the ESO BPDT Guidance should be followed.

The ESO should refer to the RIIO-2 Electricity System Operator - Regulatory Instructions and Guidance document²⁰ for the most up-to-date accounting definitions to be used when completing the BP2 BPDT and BPDT Strategic Narrative.

BPDT Strategic Narrative

Alongside the submission of the BP2 BPDT, the ESO must provide a summary explanation of the information provided in each data worksheet through an additional BPDT Strategic Narrative. The ESO should follow the guidance set out in the ESO BPDT Guidance to complete the BPDT Strategic Narrative update, except where changes are outlined below.

For the avoidance of doubt, the updated requirements d), e) and f) below replace requirements d), e) and f) in the ESO BPDT Guidance.

For BP2, we expect to see an update on the BPDT Strategic Narrative to also include:

¹⁹ RIIO-2 Electricity System Operator Price Control – Guidance on Business Plan Data Templates: Version 1.2: <https://www.ofgem.gov.uk/publications/riio-2-final-data-templates-and-associated-instructions-and-guidance>

²⁰ RIIO-2 Electricity System Operator – Regulatory Instructions and Guidance: <https://www.ofgem.gov.uk/publications/consultation-electricity-system-operators-regulatory-instructions-and-guidance-riio-2>

- d) A finance overview of what the activity is, why the ESO is doing it, what has changed from the RIIO-2 forecast set out in the BP1 BPDT (costs and headcount), what the outputs and measurable deliverables are;
- e) Compare the current forecast across the RIIO-2 period and the previous forecast across the RIIO-2 period from BP1. The ESO should explain the material differences between them, the reason for any material step change or difference. Information should be included in terms of trends, unit costs, run rates²¹ (or other established metrics); and
- f) Summarise and explain the profile for any changes to the RIIO-2 information.

For BP2, the BPDT Strategic Narrative is not applicable to the worksheets previously exempted, nor the RIIO-1 years of E2.1 Cost Matrix.

BPDT expenditure worksheets

For BP2, any previous references to price control allowances or revenue allowances from BP1 should now be considered to relate to the ESO's RIIO-2 price control cost benchmarks.

The ESO should populate historic actual data covering from 1 April 2014 up to and including the current reporting year and forecast data for the remaining RIIO-2 period (i.e., all eight years of RIIO-1 and all five years of RIIO-2). For the avoidance of doubt, all tables requiring annual historical data must be fully reconcilable to the latest published Regulatory Year. The ESO should also populate, where available, any projected expenditure beyond RIIO-2 for any categories listed on the worksheet.

For BP2, the following worksheets are no longer required: E1 (Totex), E3.1 (Pass Through), E3.4 (RPEs), E3.5 (BCF), E4.1 (Master Data), E4.4 (Risk and Contingency, E4.7 (System Characteristics and Activity), and E4.9 (Cyber Security OT). Worksheets E4.3 and E4.11 have

²¹ Run rates use the current information as a predictor of future performance. The run rate assumes that current conditions will continue; it is a forecast based on extrapolating current results into future periods (in this case RIIO-T1 period and extrapolating into the RIIO-T2 period). Run rates can be applied to costs, financial and operational metrics to approximate future results.

been renamed as Directly Remunerated Services (DRS) and Network Innovation Allowance (NIA) respectively.

For BP2, the updated instructions and guidance for specific worksheets are below:

Updated tables

E1.1 Totex AP

<p>Purpose and Use by Ofgem</p>	<p>This tables summarises costs attributable to 'price control' and 'non price control' categories for the ESO.</p> <p>'Price control costs' is further separated into the following cost categories:</p> <ul style="list-style-type: none"> • Short Term Operations, • Market Development & Procurement, • Long Term Network Development & Planning, • Supporting Operational Costs, • Business Support Costs, • Capex, and • Other Price Control Costs. <p>'Non price control costs' is further separated into the following cost categories:</p> <ul style="list-style-type: none"> • Non-Activity Based Costs, and • Directly Remunerated Services.
<p>Instructions for Completion</p>	<p>There is no input required in this worksheet.</p>

E1.5 Universal Data

<p>Purpose and Use by Ofgem</p>	<p>The purpose of this worksheet is to capture data used throughout the workbook, such as reporting year and indexation data.</p>
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Instructions for Completion	There is no input required in this worksheet.
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E3.1 Non-Activity Based Costs

Purpose and Use by Ofgem	The purpose of these tables is to record information on certain elements of allowed revenue that are treated as pass through items and are not related to pension administration costs, which are captured in E3.5 (Pension Admin Costs).
Instructions for Completion	The licensee should fill in the boxes shaded in yellow.

E3.2 Related Party Margin

Purpose and Use by Ofgem	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.
Instructions for Completion	<p>The licensee should fill in the boxes shaded in yellow:</p> <p>Margin by related party Turnover by related party Related Party Margin by Cost Category (columns AB:AI and column AK). Costs before allocations: Outside Price Control Costs before allocations: Total Related Party Margin</p> <p>This input is required to be repeated for each reporting year.</p>

E3.5 Pension Admin Costs

Purpose and Use by Ofgem	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.
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<p>Instructions for Completion</p>	<p>The licensee should fill in the boxes shaded in yellow between cells M13:Y14 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 the yellow cells in column A, as well as outturn and forecast data as required in the yellow cells between M16:Y31.</p>
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E4.2 Scheme Summary

<p>Purpose and use by Ofgem</p>	<p>The purpose of this table is to indicate the expected expenditure profile for a scheme from the RIIO-1 period to beyond the RIIO-2 period.</p>
<p>Instructions for Completion</p>	<p>The licensee should fill in the boxes shaded in yellow for each activity with a CBA.</p>

E4.3 Directly Remunerated Services (DRS)

<p>Purpose and use by Ofgem</p>	<p>The purpose of this table is to collect information relating to each category of DRS as set out in Special Condition 2.9 (Services treated as Directly Remunerated Services).</p>
<p>Guidance on completing this worksheet</p>	<p>Costs should be input as positive values for each category of DRS 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 narrative.</p>

E4.5 ESO Capex

<p>Purpose and use by Ofgem</p>	<p>The purpose of this table is to report expenditure on ESO Capex. We will use this information to assess the economic efficiency and appropriateness of any capital expenditure.</p>
<p>Guidance on completing this worksheet</p>	<p>ESO Capex has been categorised into the following expenditure types: IT & Telecoms; Vehicles; Property; and Small Tools, Equipment, Plant & Machinery. Definitions for each of these can be found in the RIIO-2 ESO Regulatory Instructions and Guidance document.</p> <p>For IT & Telecoms, the table requires the ESO to insert the name of specific IT systems/projects where the total expenditure is £1m or more in rows 45:344. 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 39. Where the total spent 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 IT expenditure <£1m category.</p> <p>The ESO must also provide the role allocation for each IT system/project where the total expenditure is £1m or more. This allocation should follow the non-role specific cost allocation set out in the ESORI Guidance 2021-23.</p> <p>For all other categories of ESO Capex, the ESO should input outturn and forecast expenditure in the yellow cells in rows 27:29.</p>

E4.6 Business Support Costs (BSC)

<p>Purpose and use by Ofgem</p>	<p>The purpose of this table is to collect cost information on the Business Support Activities listed below, which in most cases</p>
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	<p>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"> • IT & telecoms (Business Support) • Property management (Business Support) • HR & non-operational training • Finance, audit & regulation • Insurance • Procurement • CEO & group management <p>We will use this information to assess the economic efficiency and appropriateness of any expenditure relating to these support activities.</p>
<p>Guidance on completing this worksheet</p>	<p>Costs associated with each of the Business Support activities should be reported in the yellow cells in this table.</p> <p>'Insurance – Claims paid out to SO' and 'Other Income' should be input as negative values.</p> <p>For the avoidance of doubt, the data requirements are relevant to the ESO and not Group level.</p>

E4.6b Business Support Allocation

<p>Purpose and use by Ofgem</p>	<p>The purpose of this table is to provide Ofgem with visibility of Business Support Costs 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.</p>
<p>Guidance on completing this worksheet</p>	<p>Please input the ESO's allocation of Business Support Costs in the yellow cells in the rows relevant to the ESO for each of the business support activities.</p>

E4.8 Salary and FTE numbers

Purpose and Use by Ofgem	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.
Instructions for Completion	<p>The licensee should fill in the boxes shaded in yellow across each of the cost categories:</p> <ul style="list-style-type: none"> • Labour • Pensions • Average Staff Numbers • Average Salary per FTE £'k

E4.11 Network Innovation Allowance (NIA)

Purpose and Use by Ofgem	The purpose of this table is to record information directly applicable to the Network Innovation Allowance.
Instructions for Completion	<p>The ESO should break down NIA funding by project/theme, providing a description of what these themes entail and why funding is needed, and include reference to any corresponding paragraph in the business plan.</p> <p>As per paragraph 6.6 of our RIIO-2 Final Determinations – ESO Annex, the ESO can request additional NIA funding for 2023/24, 2024/25, and 2025/26. If the ESO seeks to request this additional funding, it should break down what additional NIA funding it is requesting by theme, providing a description of what these themes entail and why funding is needed, and include reference to any corresponding paragraph in the business plan.</p>

E5.01 – E5.23 ESO Operational Activity Categories

Purpose and use by Ofgem	The purpose of these tables is to provide a summary of costs incurred across the RIIO-1/2/beyond RIIO-2 periods, for each of ESO operational activities. This will allow Ofgem to have a
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	<p>more granular understanding of the proposed costs in each of the operational cost activities and facilitate its cost assessment process.</p>
<p>Guidance on completing this worksheet</p>	<p>Annual cost profile information is required for the price control period.</p> <p>Updates to existing cost Categories and new cost categories are listed below:</p> <p><u>E5.04 - National Control & Day Team</u></p> <ul style="list-style-type: none"> • Operate the GB electricity transmission system in real-time: rotating teams balance the system and economically optimise system operations (e.g., manage constraints) • Conducts PPAT Market Surveillance <p><u>E5.21 – Offshore Transmission</u></p> <ul style="list-style-type: none"> • This information will be provided in an update to our Roles Guidance at a later date. <p><u>E5.22 – Early Competition</u></p> <ul style="list-style-type: none"> • This information will be provided in an update to our Roles Guidance at a later date. <p><u>E5.23 – Future System Operator (FSO)</u></p> <ul style="list-style-type: none"> • This information will be provided in an update to our Roles Guidance at a later date.