

27/09/2021

## **National Grid ESO response to the Electricity System Operator's Regulatory Instructions and Guidance for RIIO-2 consultation**

**Dear Luke,**

We welcome the opportunity to respond to your consultation on the Electricity System Operator's Regulatory Instructions and Guidance (RIGs) for RIIO-2.

National Grid ESO is the Electricity System Operator for Great Britain. We move electricity around the country second by second to ensure that the right amount of electricity is where it's needed, when it's needed – always keeping supply and demand in perfect balance. As Great Britain transitions towards a low-carbon future, our mission is to enable the sustainable transformation of the energy system and ensure the delivery of reliable, affordable energy for all consumers. We use our unique perspective and independent position to facilitate market-based solutions which deliver value for consumers.

We welcome the introduction of a reporting pack and RIGs specifically designed for the reporting needs of ESO.

Our detailed response is appended to this letter, and our key messages set out below:

- We are concerned that much of the RIGs relating to cyber spend is referring to deliverables and mechanisms that are not in ESO's licence e.g. Price Control Deliverable (PCD) reporting and uncertainty mechanisms. We would welcome further discussions with Ofgem to understand what, if any additional reporting may be required with regard to cyber spend along with confirmation that any additional spend requirements would be covered under the cost assessment process.
- We have proposed some changes to ensure clarity over what costs feed into the calculation of internal Balancing and Use of System (BSUoS) revenues and what costs are funded through other revenue streams. Note that we hope to work with Ofgem over the coming weeks to develop Transmission Network Use of System (TNUoS) revenue reporting for RIIO-2 and this may require some updates to the RIGs.
- We have used best endeavours to review the tables and provide constructive feedback. However, there may still be issues we have not identified and will continue to work with Ofgem as we go through the first regulatory reporting cycle of RIIO-2 to ensure tables are updated where necessary to provide accurate and meaningful reporting.

We welcome the opportunity to further discuss the points raised within this response. Should you require any further information or would like clarity on any of the points outlined in this paper then please contact Adelle Wainwright in the first instance at [adelle.wainwright@nationalgrideso.com](mailto:adelle.wainwright@nationalgrideso.com).

Yours sincerely

Gareth Davies  
ESO Regulation & RIIO Senior Manager, National Grid ESO

## Appendix - National Grid ESO comments on Costs and Outputs Regulatory Reporting Pack Template

RIIO-2 Data Table		Comments
<b>Cover</b>		The Date of Submission should be amended to 31 July 2022.
<b>Content</b>		See comments below but we consider that tables 1.3 and 1.4 should be completed in the 2021-22 RRP and that the titles should not be greyed out and cells G18 and G19 should be input cells
<b>Finance</b>	<b>1.1 Disposals</b>	<p>This table has been copied over from the RIIO-1 reporting pack and aggregates a group total for disposals including 'ETO' and 'other' disposals. We consider that only figures for ESO would be provided in this pack since it is the only licensee in its legal entity, so columns Q to V only should be included on this worksheet.</p> <p>Para 1.10 on Page 61 of the RIGs states that cash proceeds of sales (or market value of intra-group transfers) of operational assets and cash proceeds of sale of asset as scrap will be netted off the calculated additions to RAV. Para 1.11 further adds that these deductions will be made at the end of the RIIO-2 price control.</p> <p>This treatment for disposals does not reflect Ofgem's decision as stated in the Final Determinations. Paragraph 11.32 of the Final Determinations – finance annex states 'We have decided that where a company has disposed of an asset, we will net the cash proceeds off against Totex from the year in which the proceeds occur'.</p> <p>Para 1.10 and Para 1.11 require updating to reflect the decision in the Final Determinations.</p>
	<b>1.2 Price Control Financial Model (PCFM) Inputs Summary</b>	<p><u>Actual Totex</u> The links for Actual Non-Operational Capex and Actual Controllable Opex are correct. However as noted below for 2.1 Totex Summary the underlying data is not split appropriately and therefore the inputs calculated for PCFM are not correctly categorised between Capex and Opex.</p> <p><u>Network Innovation Allowance</u> Cells H23 to M23 are currently linked to Row 34 on 7.3 NIA which is the Total NIA Expenditure (NIA<sub>t</sub>). The formula in the cells should be amended to link to worksheet 7.3 NIA, Row 52 labelled Network Innovation Allowance to be recovered (NIA<sub>r</sub>).</p> <p>The PCFM requires an input for <u>CNIA 'Carry Over Network Innovation Allowance'</u> for 2021/22. Therefore, an additional row is required to capture this value for input to the PCFM.</p> <p>The 2020/21 ESO Revenue Workbook calculates the CNIA value in line with Special Condition 4.7. The calculation could be replicated in Worksheet 7.4 CNIA.</p> <p><u>Reporting &amp; Incentive Arrangements</u> The 'Instructions for completing the C + O RRP worksheet' for this ESORI says the ESO should report on the <b>amount recovered during the reporting year</b> in question and provide a forecast for future years based on its reasonable expectations.</p>

		<p>The amount recovered in a particular year may be based on a forecast and the actual value for ESORI will be known following the ESORI determination. The instructions as currently written can be interpreted as meaning that the ESORI value cannot be changed once the amount is recovered through charges. We propose that the instructions be amended to say '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 <del>report on the amount recovered during the reporting year in question and</del> provide a forecast for future years based on its reasonable expectations. Following the publication of an ESORI determination the values should be updated to reflect the determination'.</p> <p>The instructions also state that 'the ESO's expectations will be informed by feedback from Ofgem and the ESO Performance Panel received at six-monthly performance reviews'. Due to the interaction between the AIP cut-off timetable and the ESORI reporting deadlines this means that the ESO will not be able to forecast an incentive outcome until the second year of the ESORI period. We propose that this sentence be deleted and replaced with '<del>ESO will forecast an ESORI outcome informed by feedback from Ofgem and the ESO Performance Panel received at six-monthly performance reviews, if available.</del>'</p> <p><u>Tax pools</u> As noted in section 1.4 Tax Pool Totex Allocation it would be useful to have an input for opening tax pools which will need to be adjusted following the submission of final CT600 return for RIIO-1 period.</p> <p><u>Less directly remunerated services cost</u> It would be beneficial for consistency of reporting for cells H45 to L45 to be linked to Row 29 - Total Excluded Services cost in Table 7.2 DRS. We note the incorrect spelling of 'remunerated' on row 42 of this worksheet.</p>
	<p><b>1.3 Passthrough</b></p>	<p>The 'Instructions for completing the C+O RRP worksheet' for this worksheet say that for 2021-22 reporting year the worksheet will be hidden as raw data is collected in the ESO Revenue Workbook. For the 2021-22 reporting year we believe we should be filling out the actual data for 2021-22 as this should feed into the PCFM to calculate the ADJ<sub>t</sub> term in the November 2022 AIP which will inform FY24 revenues. Therefore, the instructions should be amended to reflect that we will complete the worksheet.</p> <p>It would be useful if the RIGs provided guidance as to how to fill out row 22 the Interest income accrued adjustment.</p> <p>We would appreciate guidance in the RIGs to specifically set out which costs associated with the WCF can be recovered through the WCF<sub>t</sub> term. The ESO licence SpC 4.1 Part G refers to a definition in the PCFH. The PCFH refers to PCFM Guidance which in turn refers to RIGs.</p> <p>The instructions for pass through costs (page 30 and page 31) are silent on the population of the value for EDE<sub>t</sub>. It would be useful to reference Price Control Financial Handbook Section 6.</p>
	<p><b>1.4 Tax Pools Totex allocation</b></p>	<p>On page 30, the instructions for this worksheet state that for 2021-22 reporting year the worksheet will be hidden, as raw data is collected in the ESO Revenue Workbook.</p> <p>However, updates to totex data will have consequential impact on the tax pool allocation rates. We therefore believe that there would be inputs to this worksheet for the 2021-22 reporting period. Therefore, the instructions</p>

		<p>should be amended to reflect that this worksheet will be completed for 2021/22.</p> <p>The instructions also state that allocation rates should not be updated retrospectively for a year where the ADJR* value has already been published.</p> <p>Currently cell H52 to L58 are recalculated to take account of the latest view of totex. To maintain the allocation rates for the year where ADJR* has been published and ensure they are not adjusted retrospectively Ofgem should update the worksheet to reflect the PCFM tax pool allocation rate and change the cell shading to grey. For the 2021/22 RIGs template this approach will apply to cells H52 to H58.</p> <p>At Final Determinations following the introduction of the intangible tax pool for RIIO-2, ESO submitted an estimated value for its opening tax pool balances. It was understood that the balances would be updated to reflect the actual opening pool balances following the submission of the final CT600 return for the RIIO-1 period. We believe to facilitate this change to the PCFM it would be useful to have additional inputs for the opening tax pools to enable this update to occur.</p>
<b>Totex</b>	<b>2.1 Totex Summary</b>	<p>We note the intent in this table to split totex costs into capex and opex costs. However, the 'Other Price Control Costs' feeding in from table 6.1 contain a mixture of capex and opex costs. This could be amended by amending the formulae or through the addition of an additional capex category and sub-total.</p> <p>We consider it necessary to be able to reflect the exclusion of any related party margins or disallowed costs from totex. This could be achieved through the additional of lines in the Totex Summary (separate lines for capex and opex).</p> <p>We note that Appendix 2- Definition of Totex para 1.5 (page 60) states that 'the unfunded costs for NIA Expenditure and the Network Innovation Competition can be included in Totex.' Currently the Cost &amp; Outputs template does not capture this information.</p> <p>We propose that a separate worksheet '6.4 Unfunded Innovation costs' be included in the template. The table should summarise the unfunded costs for the innovation expenditure detailed on worksheets 7.3 NIA, 7.5 NIC and 7.6 SIF. As the worksheets do not contain a calculation for the unfunded expenditure the worksheets would have to be amended to calculate that information.</p> <p>The total on the new worksheet '6.4 Unfunded Innovation costs' should be added to the row 15 Other Price Control costs.</p> <p>An amendment is also required to Table 4 (page 59) 'Other Price Control Costs'. The details column should be amended to 'Other costs that do not fall into the above categories, including pension and unfunded innovation costs <del>admin fees, and cyber resilience IT</del>'</p>
	<b>2.2 Cost Benchmark Summary</b>	<p>The directly attributable costs by role include only the ESO Direct Opex plus the Directly Attributable costs from table 5.1. However, per table 5 in the ESORI guidance document IT opex project costs should be attributed to roles. The benchmark costs populated in the table currently recognise this split (albeit categorised as Indirectly Attributable), but the auto population of the table pulls a third of the total BSC opex from table 4.1 into table 2.2. To achieve the split per the ESORI guidance the IT Telecoms &amp; Memo section</p>

		<p>of table 4.1 could be further categorised to provide opex project costs by role which could feed directly into table 2.2. We consider it most appropriate to feed this into the Directly Attributable costs section of table 2.2, probably as a separate line.</p> <p>We consider that it would be useful to incorporate a tracker in the RRP to track any changes to benchmark costs. This would provide transparency and clarity as to the benchmark cost.</p>
	<b>2.3 Related Party Transactions</b>	<p>We note an updated format for the capture of related party transactions from the RIIO-1 reporting packs. We consider that more detailed instructions on how to fill out the template would be useful, in particular the details required for each related party e.g. rows 30 to 56.</p> <p>We note the new requirement to split the related party by cost category. It would be useful to update the table purpose on page 23 in the RIGs to note this.</p> <p>The split of margin by cost category could be more clearly set out. For example, we do not recognise the cost category 'System Operating Costs'. It might also be useful to have a separate category for capex costs.</p> <p>For the split by cost category, it is not clear that row 14 is linked to the related party detailed on row 11, column A of the summary table. It would be helpful to have a description of the related party in column AB.</p> <p>There appears to be a check in cell AK30, AK53 etc. which does not have a formula to do the required check.</p> <p>If the disallowed related party margin is linked to the PCFM, it would be useful to link this through to the PCFM inputs tab in the workbook so that all PCFM inputs are in one place. We recommend this is done through adding a line for disallowed related party costs in the 2.1 Totex Summary worksheet, which would then feed into the PCFM inputs for totex.</p> <p>RIGs Para 1.23: For clarity, as the intent is for the captive insurance company to carry the insurance risk, we ask that para 1.23 be amended as follows: 'We will not allow any <b>excess</b> losses relating to these captive insurers (to the extent that they are covered by captive insurers) to be funded by customer <b>nor will profits relating these captive insurers be returned to customers.</b>'</p> <p>We note the updated and expanded definition of related party costs in the RIGs and the inclusion of the additional cost allocations disclosure as outlined in the Final Determinations. However, we think this guidance should not be included in the definition of related party costs (para 1.20) but would better sit in chapter 2 under the Provision of Indirect Allocation Methodology on page 19 (para. 2.15).</p>
<b>Opex</b>	<b>3.1 Opex Summary</b>	<p>We note that the ESO supporting costs include the cost of the regulatory team, which is consistent with the presentation of costs in the RIIO-2 BPDT. However, this is contrary to the definition of BSC costs in appendix 1 of the RIGs, whereby these costs are included in the Finance, Audit and Regulation (FAR) costs. We would prefer that these costs be reported as ESO costs since regulatory support is no longer delivered through a shared central regulatory team following legal separation in 2019. If this is the case the definition of FAR costs would need to be updated in the RIGs (page 44).</p>

	<b>3.2 Salary and Full Time Equivalent (FTE) Numbers</b>	<p>We note that the RIGs definition of labour in appendix 1 includes gross salaries and that the salary definition includes pensions. Since pensions is a separate input to the table that would result in pensions costs being input twice. We consider that pensions should be excluded from the definition of salaries to ensure that pension costs are only input once.</p> <p>The definition of pension costs includes pension administration costs which are categorised as other price control costs and do not map into ESO costs. We have assumed that the breakdown on this worksheet related to ESO ongoing benefit costs so would exclude pension administration charges. If so, this should be made clear in the RIGs.</p>
	<b>3.3 Provisions</b>	The sum in row 17 for total net movement incorrectly includes in the sum the closing balance.
<b>Business Support Costs</b>	<b>4.1 Business Support Costs (BSC)</b>	<p>We note the definition of IT&amp; Telecoms (Business Support) costs in appendix 1. We consider it would be appropriate to note the specific exclusion of costs relating to Cyber Resilience.</p> <p>As noted in our feedback on table 2.2, it would be appropriate to have a split of opex projects by role in table 4.1.</p> <p>‘Insurance - Claims paid out to SO’ is not defined in the RIGs. For clarification of items to include in this line can an additional definition be added under I. ‘Insurance - Claims paid out to SO –insurance proceeds received and retained by ESO.’</p>
	<b>4.2 Business Support Costs (BSC) Allocation</b>	<p>We note the intent for Ofgem to collect a consolidated view of business support costs for National Grid Group. However we believe the ESO costs could be auto-populated by linking to table 4.1.</p> <p>We note the omission of CEO &amp; group management costs from table 4.2 but consider that it should be included.</p>
<b>Capex</b>	<b>5.1 Capex Summary</b>	<p>We note the definition of IT&amp; Telecoms (Non-operational) costs in appendix 1. We consider it would be appropriate to note the specific exclusion of costs relating to Cyber Resilience.</p> <p>We note the continuation of the categorisation of projects as ‘New/Enhancement/Refresh’ as in the RIIO-1 tables, but we are not sure whether this continues to add value to the reader, as we did not include this in our RIIO-2 tables.</p> <p>We note the exclusion of smaller projects from the need to provide full details and mapping in rows 31:130. It would be beneficial to update the RIGs on page 33 to state that where costs for a project are ‘<b>expected</b> to be more than £1m’, then it should be recorded as an individual project, which would ensure all projects even in start-up phase are correctly recorded.</p>
<b>Other Price Control Costs</b>	<b>6.1 Cyber Resilience IT Costs</b>	We note Ofgem’s expectation in the RIGs that ESO will complete six-monthly PCD reporting templates in accordance with the licence (page 24). We have no such licence obligation. Furthermore, the narrative on page 33 of the RIGs refers to baseline allowances and uncertainty mechanism allowances. We have no concept of allowances in our RIIO-2 framework and there are no uncertainty mechanisms in our licence. We note that the consultation on PCD reporting templates referred to on page 33 of the RIGs was addressed to the RIIO-2 network companies and not ESO since ESO has no special conditions relating to reporting of PCDs.

		<p>We also note the reference to Re-openers and allowances in para 2.18/2.19 in the RIGs. This should be updated to recognise that ESO does not have re-openers or allowances in RIIO-2 but can collect revenues based on forecast costs.</p> <p>We consider that it would be helpful to add a definition of Cyber Resilience costs to appendix 1 to be clear which costs should be included.</p>
	<b>6.2 Pension Administration Costs</b>	We have no comments on this table.
<b>Non-Price Control Costs</b>	<b>7.1 Non-Activity Based Costs</b>	<p>The accompanying RIGS explain the purpose of the table is to record costs for certain elements of allowed revenue that are treated as pass-through and are not captured in table 1.3 or 6.2.</p> <p>We believe this definition to be vague and could lead to incorrect treatment for revenue recovery as the majority of ESO costs are Pass Through (using the definition on Page 51).</p> <p>We consider that there are two types of costs itemised below that could be captured in a non-activity based costs table</p> <ul style="list-style-type: none"> <li>i. TNUoS passthrough costs These costs should be captured separately as they will feed into ESO's allowed passthrough costs for TNUoS charges (e.g. licence fees and cross border trading). We expect these costs will also be included in a TNUoS worksheet in the PCFM which we will develop with Ofgem over the next few months. They will also feed into the RFPR reconciliation of totex to statutory accounts expenditure.</li> <li>ii. Non-totex expenditure Items which are not categorised as totex (e.g. Rebranding Company Assets and Fines and Penalties) and which cannot be fed into the PCFM to be recovered through revenues. It is important to capture these costs as they will form part of the totex to statutory accounts expenditure reconciliation in the RFPR.</li> </ul> <p>Therefore, we propose the purpose of the worksheet is amended <b>'to record costs for which are not included in calculating SOIAR and are not captured elsewhere in the Cost and Outputs table.'</b></p> <p>We consider other items currently included in this table should be treated as follows:</p> <ul style="list-style-type: none"> <li>iii. Offshore and Early Competition The costs for these new activities should be included within the relevant roles (role 3) through addition of rows to table 3.1. If costs are not added to table 3.1 they will not flow through to the PCFM totex numbers to be recovered through revenues.</li> <li>iv. SO review (FSO) costs These costs cannot be recovered unless they are included in Totex. We would suggest addition of a table 6.3 to capture another category of 'Other price control costs' (split between opex and capex) which would feed into the 2.1 Totex summary table (and hence PCFM Totex inputs).</li> </ul>

	<b>7.2 Directly Remunerated Services (DRS)</b>	We have no comments on this table.
	<b>7.3 Network Innovation Allowance (NIA) Expenditure</b>	To enable inclusion of unfunded innovation cost in Totex (see comments relating to worksheet 2.1 Totex Summary we propose that an extra line labelled 'Unfunded Network Innovation costs' is added to this table. This row would calculate the difference between Row 34 Total NIA Expenditure (NIAEt) and Row 52 Network Innovation Allowance to be recovered (NIAt).
	<b>7.4 RIIO-1 Carryover Network Innovation Allowance (CNIA) Expenditure</b>	The PCFM requires an input for CNIA 'for 2021/22. We propose that this worksheet is expanded to include the calculation of 'Carry Over Network Innovation Allowance' in line with Special Condition 4.7. The calculation was included in the ESO Revenue Workbook.
	<b>7.5 Network Innovation Competition (NIC) Expenditure</b>	To enable inclusion of unfunded innovation cost in Totex (see comments relating to worksheet 2.1 Totex Summary we propose that an extra line labelled 'Unfunded Network Innovation costs' is added to this table.
	<b>7.6 Strategic Innovation Fund (SIF) Expenditure</b>	<p>We note that there are limited project lines for NIC and SIF in tables 7.5 and 7.6. We are expecting a significant number of SIF innovation projects, requiring additional lines in the tables.</p> <p>We also note that SIF projects are not distinguished by competition type and believe distinction should be included between Research/Alpha/Beta.</p> <p>We request that definitions are provided for all the different SIF categories, such as the SIF Directly Attributed Costs.</p> <p>To enable inclusion of unfunded innovation cost in Totex (see comments relating to worksheet 2.1 Totex Summary we propose that an extra line labelled 'Unfunded Network Innovation costs' is added to this table.</p>
<b>Additional Data</b>	<b>8.1 System Operator (SO) Electricity Market Reform (EMR) Data</b>	<p>We propose the following amendments relating to the EMR Data table:</p> <p>Cell D19: <i>No. of <b>CM pre-qualification decision themes</b> overturned by Ofgem</i></p> <p>Cell D33: <i>No. of <b>CfD qualification decision themes</b> overturned by Ofgem</i></p> <p>Cell D52: <i>No. of responses to <b>CM customer <del>and</del> satisfaction surveys</b></i></p> <p>Cell D54: <i>No. of responses to <b>CfD customer <del>and</del> satisfaction surveys</b></i></p>
	<b>Table Commentary</b>	<p>We note the requirement to provide comment on systems used to populate worksheet. We are not sure of the benefit of providing this information since we have not provided this in the past.</p> <p>We note that the commentary template only includes table narrative (chapter 1). It may be useful to expand to include the other required sections.</p>



	<p><b>Other comments</b></p>	<p>Page 56 Definition of SOIAR – we propose that the sentence ‘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’ is deleted as it is an licence obligation specified in the licence and not required to define the term.</p> <p>We note that the RIGs refer to regulatory accounts in several places e.g. page 16 para 3. There is currently no obligation to produce regulatory accounts for the ESO.</p> <p>Page 60 Para 1.5 the bullet point needs to be amended to include Strategic Innovation Competition:  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 <del>and</del> the Network Innovation Competition <b>and Strategic Innovation Competition</b> can be included in totex).</p>
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