

# Consultation



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## Consultation on the RIIO-1 close out methodologies for the Electricity System Operator

Subject	Details
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We are consulting on the RIIO-1 close out methodologies for the Electricity System Operator.

This document outlines the scope, purpose and questions of the consultation and how you can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at [Ofgem.gov.uk/consultations](https://www.ofgem.gov.uk/consultations). If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

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## 1. Introduction

### What are we consulting on?

1.1. The RIIO-1 price control for the Electricity System Operator (ESO) ran from 1 April 2013 until 31 March 2021.<sup>1</sup> Within this framework, there were several uncertain cost areas which could only be finalised once all costs are known. Therefore, some elements need to be settled (or subject to “close out”) at the end of the RIIO-1 period, now all relevant information is available.

1.2. The RIIO-1 close out is implemented through legacy price control adjustments. The variable values  $SOLAR_t$  and  $LSORAV_t$  give effect to legacy adjustments.  $SOLAR_t$  is calculated in line with special condition (SpC) 4.8 (System Operator Legacy Adjustments) of National Grid Electricity System Operator’s (“NGESO”) transmission licence.<sup>2</sup>  $LSORAV_t$  is directed by the Authority in line with the process set out in SpC 4.9 (Legacy net RAV additions) of NGESO’s transmission licence.

1.3. Chapter 7 of the ESO Price Control Financial Handbook (PCFH) provides an overview of legacy price control adjustments relating to Regulatory Years prior to Regulatory Year 2021-22 (the “legacy period”).<sup>3</sup> Chapter 2 of this document provides an overview of our proposed approach to financial methodologies, in line with the ESO PCFH. We are consulting on our proposed approach to RIIO-1 close out financial methodologies.

1.4. We are proposing methodologies to close out three main areas of RIIO-1 for the ESO:

- Electricity Market Reform (EMR) IT funding
- Offshore Coordination Project
- Early Competition Plan Project

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<sup>1</sup> From 1 April 2013 – 31 March 2019, the ESO was part of National Grid Electricity Transmission’s (NGET) RIIO-ET1 price control framework. Following legal separation on 1 April 2019, National Grid Electricity System Operator became a separate licensee and we split NGET’s RIIO-ET1 price control settlement between the ESO and Transmission Operator (TO) companies. As a result of the separation, we need to carry out a separate close out for the ESO.

<sup>2</sup> National Grid Electricity System Operator Limited – Special Conditions:

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

<sup>3</sup> Chapter 7, ESO Price Control Financial Handbook: <https://www.ofgem.gov.uk/publications/decision-proposed-modifications-riio-2-transmission-gas-distribution-and-electricity-system-operator-licence-conditions>

1.5. The EMR IT funding element relates to the return of unspent allowances to consumers for work delayed into RIIO-2. The Offshore Coordination Project and Early Competition Plan Project elements relate to new activities that were not included in baseline RIIO-1 totex allowances. Chapters 3-5 of this document detail our proposed methodologies to close out each of these areas. Table 1 provides a summary of the proposed methodologies that we are consulting on for the ESO’s RIIO-1 close out.

**Table 1: Summary of cost areas for close out**

Area	Summary of methodology	Requested allowance adjustment (2009-10 prices)	Relevant chapter
EMR IT funding	Unspent allowances from 2019-20 and 2020-21 need to be returned to consumers in full. This is largely due to the delay of the replacement EMR IT Portal. We are assessing the efficiency of the ESO’s expenditure on EMR IT in 2019-20 and 2020-21. We will true-up allowances to reflect actual efficient costs incurred by the ESO.	£2.2m underspend across 2019-20 and 2020-21 returned to consumers in full through allowance true-up.	3
Offshore Coordination Project	We need to provide funding for efficient expenditure on this project in 2020-21 through the RIIO-1 close out. We are assessing the efficiency of the ESO’s expenditure on offshore coordination and compliance with the conditional principles of funding. We will adjust allowances to reflect actual efficient costs incurred by the ESO that comply with the conditional principles.	£0.6m additional allowance for 2020-21 for efficient spend on project.	4
Early Competition Plan Project	We need to provide the agreed ex-ante allowance for this project in 2019-20 and 2020-21 through the RIIO-1 close out. We propose to adjust allowances to reflect the ex-ante allowance, with the underspend subject to the Totex	£0.5m additional allowance for 2019-20 and £1.3m additional allowance for 2020-21 with underspend in each	5

	Incentive Mechanism (TIM) sharing factor.	year subject to TIM sharing factor.	
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1.6. In Chapter 3, we also provide an update on our approach regarding the upcoming decision on the revision of the Demand Forecasting Accuracy incentive term (DFA<sub>t</sub>) of the RIIO-1 EMR financial incentives term.

1.7. We are also consulting on our minded-to position to exclude the following areas from the ESO’s RIIO-1 close out, which are covered in Chapter 6 of this document:

- CMP345<sup>4</sup> sunk IT costs and COVID-19 adjustments; and
- Withdrawal from Project TERRE.<sup>5</sup>

1.8. We consider that the overall monetary impact of additional allowances for CMP345 sunk IT costs and the recovery of costs due to COVID-19 adjustments will be negligible. Therefore, our minded-to position is to exclude these items from the RIIO-1 close out.

1.9. We consider that any rebate as a result of withdrawal from Project TERRE should be passed back to consumers in full. Our minded-to position is that it would be simpler to implement a totex adjustment in RIIO-2 to return any rebate received by the ESO to consumers in full rather than to include this area in the RIIO-1 close out.

1.10. Lastly, we are also asking stakeholders whether there are any other areas that should be considered for the ESO’s RIIO-1 close out.

1.11. We have worked with the ESO to develop the proposed approaches. We welcome views from all stakeholders on our suggested approaches outlined in Chapters 2 to 6 by 8 March 2022.

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<sup>4</sup> CMP345 is a modification to the Connection and Use of System Code (CUSC) that deferred the additional Balancing Services Use of System (BSUoS) costs arising from COVID-19 that were incurred in 2020-21 to 2021-22.

<sup>5</sup> TERRE is the Trans-European Replacement Reserves Exchange.

## Related publications

1.12. Please see below for a list of related publications:

- National Grid Electricity System Operator Limited – Special Conditions: <https://www.ofgem.gov.uk/industry-licensing/licences-and-licence-conditions>
- ESO Price Control Financial Handbook: <https://www.ofgem.gov.uk/publications/decision-proposed-modifications-riio-2-transmission-gas-distribution-and-electricity-system-operator-licence-conditions>
- RIIO-2 ESO PCFM Guidance: <https://www.ofgem.gov.uk/publications/decision-riio-2-pcfm-guidance>

## Consultation stages

1.13. This consultation will run from 8 February 2022 and will close on 8 March 2022.

1.14. We will then assess the relevant information for each close out area and determine the appropriate adjustments for the November 2022 Annual Iteration Process (AIP).

1.15. Our intention is to publish a decision on the RIIO-1 close out methodologies for the ESO in April 2022.

## How to respond

1.16. We want to hear from anyone interested in this consultation. Please send your response to the person or team named on this document's front page.

1.17. We've asked for your feedback in each of the questions throughout. Please respond to each one as fully as you can.

1.18. We will publish non-confidential responses on our website at [www.ofgem.gov.uk/consultations](http://www.ofgem.gov.uk/consultations).

## Your response, data and confidentiality

1.19. You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If

you do want us to keep your response confidential, please clearly mark this on your response and explain why.

1.20. If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.

1.21. If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in domestic law following the UK's withdrawal from the European Union ("UK GDPR"), the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 2.

1.22. If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

## General feedback

1.23. We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?

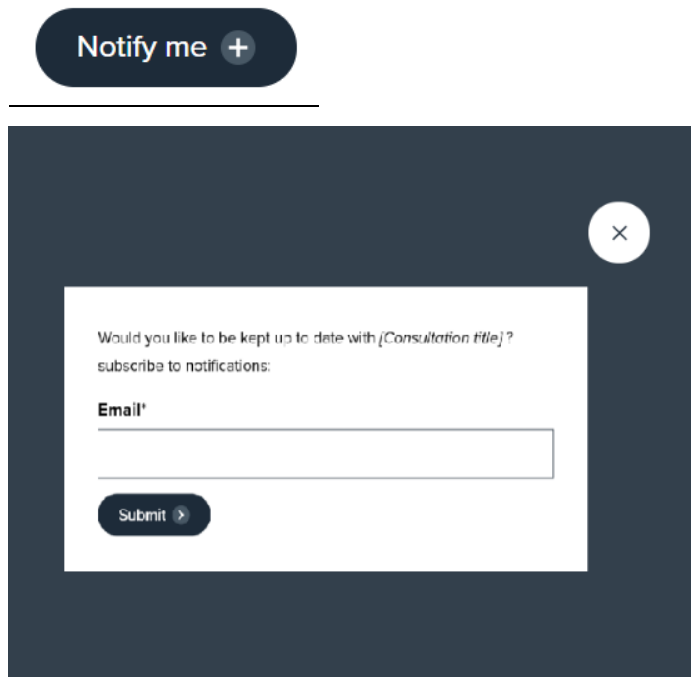
Please send any general feedback comments to [stakeholders@ofgem.gov.uk](mailto:stakeholders@ofgem.gov.uk)



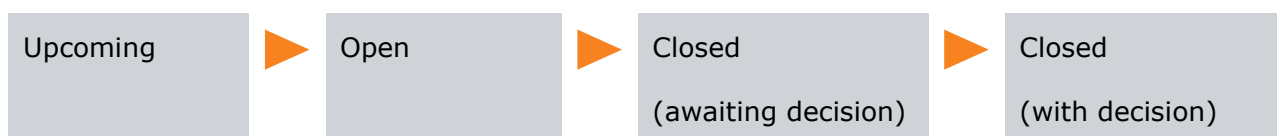
### How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website.

[Ofgem.gov.uk/consultations.](https://www.ofgem.gov.uk/consultations)



Once subscribed to the notifications for a particular consultation, you will receive an email to notify you when it has changed status. Our consultation stages are:



## 2. Approach to financial methodologies

This section describes the process which the Authority proposes to follow in determining any revisions to the ESO's RIIO-2 RAV balances and revenue for the ESO RIIO-2 price control period.

The section employs the following terms:

- **AIP:** Annual Iteration Process
- **RAV:** Regulated Asset Value
- **Revenue RRP:** the extended ESO RIIO-1 Revenue Regulatory Reporting Pack
- **The Legacy PCFM:** the ESO RIIO-1 Price Control Financial Model
- **The RIIO-2 PCFM:** the ESO RIIO-2 Price Control Financial Model

### Questions

**Question 1: Do you agree with our proposed approach to financial methodologies, including the phasing of the impact?**

**Question 2: What are your views on what should, or should not, be finally incorporated into the financial handbook?**

## Background

2.1. To close out the ESO's RIIO-1 price control, the ESO's RIIO-1 licence contains "legacy" adjustments:

- Legacy Adjustments to Revenue allowances –  $SOLAR_t$ ; and
- Legacy Adjustments to RIIO-1 RAV additions –  $LSORAV_t$ .

2.2. The legacy revenue adjustment (SOLAR) term is derived in accordance with the formula in Part A of SpC 4.8 (System Operator Legacy Adjustments). SOLAR is the sum of the pre-existing true-up mechanisms introduced in RIIO-1, which have been extended into RIIO-2 to cover the close-out of RIIO-1, as set out in Table 2.

**Table 2: Legacy adjustment to revenue allowances (SOLAR<sub>t</sub>)**

<b>SOLAR<sub>t</sub> components</b>	<b>Description</b>	<b>SpC</b>
LSOMOD <sub>t</sub>	System Operator Legacy MOD term.	SpC 4.8, Part B
LSOTRU <sub>t</sub>	System Operator TRU term.	SpC 4.8, Part C
LSOEMRINC <sub>t</sub>	System Operator Financial Incentives on EMR term.	SpC 4.8, Part D

2.3. The legacy RAV adjustment (LSORAV) term is derived in accordance with SpC 4.9 (Legacy net RAV additions). LSORAV is calculated in accordance with the ESO Price Control Financial Handbook. LSORAV refers to the “outturn” (or ex-post) RAV additions in RIIO-1, which we propose to import into the RIIO-2 ESO PCFM.

2.4. One component of the SOLAR term is “SOMOD”, which is calculated by the RIIO-1 PCFM on an annual basis. The SOMOD term calculates an appropriate revenue adjustment for a future year, given a set of changes in historical years. SOMOD has been calculated annually as part of the AIP, and we continue to calculate it until the close-out of RIIO-1 is completed.

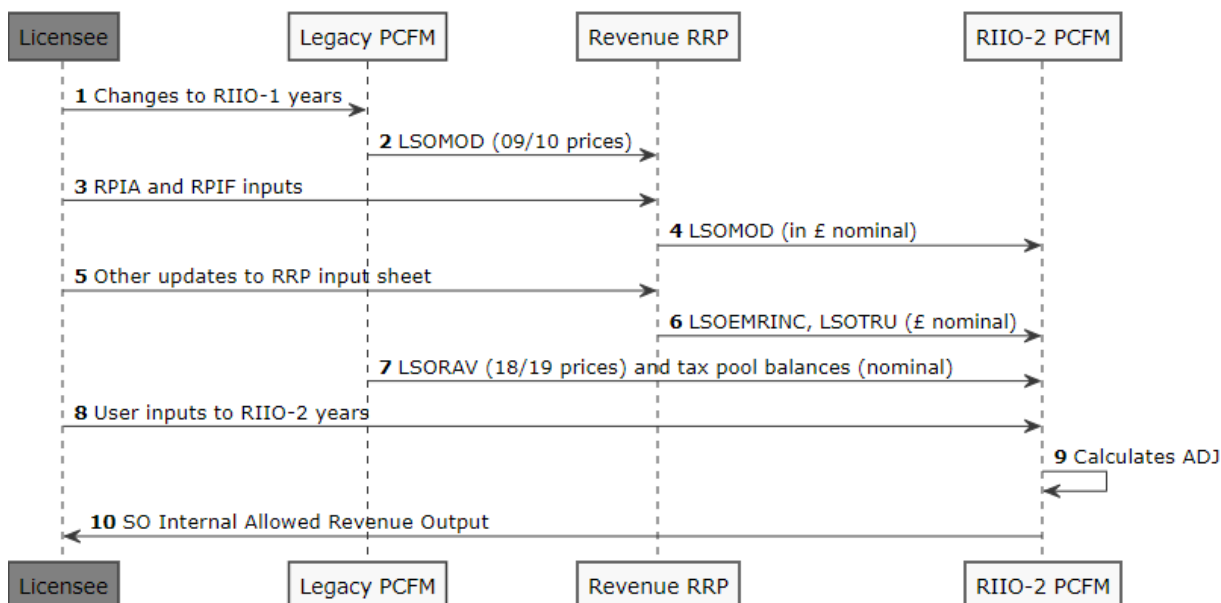
2.5. In the typical RIIO-1 process, SOMOD only reflects changes to pre-defined “variable values” in the PCFM, and other values remain fixed through the price control. However, we propose to broaden the scope of historical changes we implement in the RIIO-1 PCFM, and thus extend the function of SOMOD to capture the effect of the ESO RIIO-1 close out.

2.6. Figure 1 illustrates how the Legacy PCFM, Revenue RRP and RIIO-2 PCFM interact and produce an allowed revenue value for the next regulatory year. Figure 1 should be read from top to bottom (the steps are numbered). The arrows show where components come from and feed into.

2.7. For example, steps 2 to 4 show LSOMOD is calculated in the Legacy PCFM, converted to nominal prices in the Revenue RRP, and input into the RIIO-2 PCFM. Step 7 shows LSORAV inputs come from the Legacy PCFM directly.

2.8. This process is set out in the ESO PCFH and the special conditions of the ESO’s electricity transmission licence.

**Figure 1: Sequence diagram of the RIIO-2 AIP with legacy adjustments**



## Proposed approach to close out

2.9. We propose to implement close out methodologies via the Legacy PCFM by revising “yellow box” (non-variable) values as well as variable values or modifying the Legacy PCFM as necessary.<sup>6</sup> This provides the greatest transparency about the nature of the ex-post adjustment, a reliable way of calculating the impact of changes, and provides a useful data source for the final RIIO-1 performance in the future.

2.10. We propose to implement the ESO RIIO-1 close out methodologies in the November 2022 AIP. We note that corrections can be made in subsequent AIPs if necessary. We have also given the ESO the option to reflect a provisional closing position for RIIO-1 through the November 2021 AIP. Any adjustments made through the November 2021 AIP are subject to our close out methodologies and further true-up.<sup>7</sup>

<sup>6</sup> The PCFM contains two types of inputs: Variable Value inputs, which can be changed through each AIP and fixed or “yellow-box” inputs, which are not variable through an AIP and require a separate consultation to be modified.

<sup>7</sup> In the interim period between the beginning of RIIO-1 and the completion of the close out process, we use provisional, estimated values for the RIIO-2 PCFM that are subject to “true-up” following the final decision on our close out methodologies.

2.11. We note that the ESO RIIO-2 Price Control Financial Handbook already posits adjusting the Legacy PCFM to accommodate close out methodologies. However, we welcome views on what should or should not be finally incorporated into the handbook.

**Phasing of the impact of close out**

2.12. In the current AIP process, the cumulative impact of all changes is included in the next SOMOD value. However, we propose to smooth the impact of the November 2022 AIP legacy adjustments over the remaining three years of RIIO-2.

### 3. Electricity Market Reform IT funding

This section explains our proposed methodology for closing out Electricity Market Reform (EMR) IT funding. It also sets out an update on our approach regarding the upcoming decision on the revision of the Demand Forecasting Accuracy incentive term (DFA<sub>t</sub>).

#### Questions

**Question 3: Do you agree with our proposed methodology for EMR IT funding for the ESO?**

### Background

3.1. In August 2014, the Government appointed National Grid Electricity System Operator Limited as EMR Delivery Body (DB). The EMR DB is responsible for delivering the Capacity Market and Contracts for Difference regimes. During RIIO-1, the EMR DB had specific and separate business planning, allowances and funding re-opener arrangements.

3.2. The EMR DB had a single re-opener in RIIO-1, on which we made our decision on 30 September 2019.<sup>8</sup> This decision adjusted allowances for the EMR DB over the period April 2016 to March 2021. We allowed additional allowances of £9.81m (2014-15 prices) for the EMR DB for the period April 2016 to March 2021. Of this, £7.81m was provided for justifiable and efficient historical investment in the existing IT administration system (“the Portal”). The remaining £2m was provided to allow the EMR DB to develop a replacement Portal by April 2021. We note that this replacement Portal has been delayed and will now be released in phases over 2022-23. Table 3 sets out the additional allowances granted following our re-opener decision in September 2019.

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<sup>8</sup> Decision on Adjustments to the Electricity Market Reform Delivery Body Allowances: <https://www.ofgem.gov.uk/publications/decision-adjustments-electricity-market-reform-delivery-body-allowances>

**Table 3: Total adjusted EMR DB allowances following 2019 re-opener decision**

All figures in £m 2014-15 prices	2017	2018	2019	2020	2021	Total
Allowances	7.15	6.80	6.68	6.66	6.41	33.70
Decision on adjustment to allowances	2.39	2.26	1.06	2.10	2.00	9.81
Adjusted allowances	9.54	9.06	7.74	8.76	8.41	43.51

3.3. We decided that further allowance adjustments over the period October 2019 to March 2021 would be determined through the RIIO-1 close out.

3.4. The ESO proposes to return an underspend of £2.68m (2014-15 prices) below allowances across 2019-20 and 2020-21 through the RIIO-1 close out.

## Proposed methodology

3.5. As part of the close out process, we will request additional information from the ESO regarding its expenditure against allowances on EMR IT to enable us to determine whether this expenditure is efficient.

3.6. We intend to assess the efficiency of the ESO’s expenditure on EMR IT for 2019-20 and 2020-21. Our assessment would be guided by questions including but not limited to:

1. Have the investments in the existing Portal provided the necessary functionality for its continued use in place of the replacement Portal?
2. Have the investments in the existing Portal resulted in improved customer feedback?
3. What expenditure was incurred on the development of the replacement Portal?
4. What progress was made on the development of the replacement Portal in RIIO-1?
5. Was the expenditure incurred economic and efficient?

3.7. We propose to true-up allowances for 2019-20 and 2020-21 to reflect the actual efficient costs incurred by the ESO.

3.8. This true-up would be implemented through the SOEMRES variable value in the Legacy PCFM. SOEMRES feeds into the LSORAV and LSOMOD terms, which would be trued-up following the methodology described in Chapter 2 of this document.

3.9. We welcome views on our proposed methodology to implement the legacy adjustments for EMR IT funding.

## **Update on upcoming decision on revision of DFA<sub>t</sub>**

3.10. DFA<sub>t</sub> is the Peak National Demand Forecasting Accuracy Incentive as described in paragraph 4L.2(b) of NGENSO's transmission licence as in force on 31 March 2021. DFA<sub>t</sub> is a component of SOEMRINC<sub>t</sub>. Therefore, DFA<sub>t</sub> feeds into the legacy EMR incentive term (LSOEMRINC<sub>t</sub>). LSOEMRINC<sub>t</sub> is derived using SOEMRINC<sub>t</sub> in accordance with Part D of SpC 4.8 (System Operator Legacy Adjustments) of NGENSO's current electricity transmission licence.

3.11. The ESO has formally requested that DFA<sub>t</sub> should be disappplied for the Regulatory Year 2020-21 due to the impacts on demand from COVID-19. Ofgem is currently considering this request and intends to make a decision on whether to disapply DFA<sub>t</sub> for the Regulatory Year 2020-21. This decision will be made separately and is not part of the scope of this consultation. This decision could impact on the calculation of LSOEMRINC<sub>t</sub>, and any revision will be reflected in the November 2022 AIP.



## 4. Offshore Coordination Project

This section explains our proposed methodology for closing out the Offshore Coordination Project.

### Questions

**Question 4: Do you agree with our proposed methodology for the Offshore Coordination Project for the ESO?**

## Background

4.1. In Ofgem’s Decarbonisation Action Plan, we set out an action to work with the ESO to ensure more effective coordination to deliver low-cost offshore networks.<sup>9</sup> The ESO set up the Offshore Coordination Project in March 2020 with support from Ofgem and BEIS as part of the BEIS Offshore Transmission Network Review (OTNR).

4.2. The work undertaken on this project in RIIO-1 was split into two phases. Phase 1 set out a vision and assessment of a conceptual integrated network, providing evidence to inform the other workstreams of the OTNR. The ESO delivered the Phase 1 Final Report in December 2020. Phase 2 commenced in January 2021 and established a collection of workstreams which span technical and commercial considerations, and tactical and strategic timeframes.

4.3. The Offshore Coordination Project work was not envisaged when funding was allocated at the start of RIIO-1. Prior to the work commencing in 2020, it was agreed that funding would be finalised through the RIIO-1 close out process.

4.4. We accepted funding requests for this project up to a total cap of £985k (2020-21 prices) for 2020-21. This was split between £644k for Phase 1 and £341k for Phase 2. This funding was contingent on compliance with the following principles:

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<sup>9</sup> Action 3, Ofgem’s Decarbonisation Action Plan: <https://www.ofgem.gov.uk/publications/ofgems-decarbonisation-action-plan>

1. Funding is provided on a 'pass through' basis, meaning that only actual costs incurred are to be recovered and are not subject to the Totex Incentive Mechanism (TIM).
2. The outcome of the project does not inform the level of reward or penalty liable to the ESO under the SO Incentives package.
3. The project must not impact the delivery of the ESO's core work.
4. Resources are to be ring-fenced such that the resources set out in the proposal will be utilised solely on this project, and their activities on this project will not be funded from other funding sources.
5. Any staff that are moved from teams working on other funded activities onto the project must have their previous roles backfilled, such that there is no double counting of the same resources.
6. It is the ESO's responsibility to ensure that where staff are moved from other areas of the organisation there is no negative impact on performance in those areas before their roles can be backfilled. To the extent that performance suffers in other areas we will address that robustly.
7. If costs are likely to go above the agreed cap, conversations need to take place with Ofgem before any overspend. Additional allowances will not be provided if overspend is committed to in advance of any discussions with Ofgem.

4.5. The ESO is requesting additional allowances of £751k (2020-21 prices) for the Offshore Coordination project. This is within the agreed spending cap of £985k.

## **Proposed methodology**

4.6. We intend to assess the efficiency of the ESO's expenditure and its compliance with the above conditional principles. We would use information included in the ESO's reports produced at the beginning and end of each phase of the project in RIIO-1. Our assessment would be guided by questions including but not limited to:

- Did the project impact the delivery of the ESO's core work?
- Were resources ring-fenced such that the resources set out in the funding proposals were utilised solely on this project, and their activities on this project were not funded from other funding sources?
- Was there any negative impact on performance in those areas where staff were moved from other areas of the organisation before these roles could be backfilled?
- Was the expenditure economic and efficient?

4.7. If the ESO can demonstrate compliance with the above conditional principles, we will be minded-to grant the requested additional allowances.

4.8. As per the RIIO-2 PCFM Guidance,<sup>10</sup> the ESO calculated provisional legacy values in accordance with the processes set out in Chapter 7 of the PCFH ahead of our RIIO-1 close out methodology decision. The ESO included an estimate of the closing position of its actual RIIO-1 spend on the Offshore Coordination Project in the Legacy PCFM submitted ahead of the November 2021 AIP. The actual spend was reflected in the RIIO-2 PCFM following the November 2021 AIP through the LSORAV and LSOMOD variable values.<sup>11</sup>

4.9. To complete the implementation of this proposed methodology, we intend to update the ESO's SOACO allowances in the Legacy PCFM. This would feed into the LSORAV and LSOMOD terms, which would be adjusted following the methodology described in Chapter 2 of this document. This adjustment would reflect the ESO's actual efficient costs in the RIIO-2 PCFM following the November 2022 AIP, following our assessment of the efficiency of the ESO's expenditure.

4.10. We welcome views on our proposed methodology to implement the legacy adjustments for the Offshore Coordination Project.

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<sup>10</sup> Chapter 4, RIIO-2 ESO PCFM Guidance: <https://www.ofgem.gov.uk/publications/decision-riio-2-pcfm-guidance>

<sup>11</sup> The November 2021 AIP publication can be found [here](#). We have since re-published the November 2021 AIP and the re-publication can be found [here](#). The provisional legacy variable values LSORAV and LSOMOD are the same in both versions of the ESO PCFM.

## 5. Early Competition Plan Project

This section explains our proposed methodology for closing out the Early Competition Plan Project.

### Questions

**Question 5: Do you agree with our proposed methodology for the Early Competition Plan Project for the ESO?**

## Background

5.1. In our RIIO-2 Sector Specific Methodology Decision,<sup>12</sup> we requested that the ESO developed a plan for early competition. The plan looked at how early models of competition could be introduced to construct and own transmission assets. The ESO delivered the Early Competition Plan Project in April 2021.

5.2. The Early Competition Plan Project was not envisaged when funding was allocated to the ESO at the start of RIIO-1. On 6 March 2020, we confirmed that the associated deliverables for this work should be included within the ESO's Forward Plan 2020-21.<sup>13</sup> We agreed with the ESO that the RIIO-1 close-out was the appropriate route to recover the costs of this work.

5.3. In early 2020, the ESO initially requested an upfront allowance of £3.4m to be included in the close-out process for this work. Following a detailed consideration and assessment of the proposed costs, we confirmed that our close out process would allow an ex-ante allowance of £2.5m (2020-21 prices). This was conditional on the satisfactory delivery of the project deliverables and that any under/overspend would be subject to the TIM

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<sup>12</sup> Chapter 2, RIIO-2 Sector Specific Methodology Decision – Electricity System Operator: <https://www.ofgem.gov.uk/publications/riio-2-sector-specific-methodology-decision>

<sup>13</sup> Forward Plan 2020-21: <https://www.nationalgrideso.com/our-strategy/riio/previous-plans-and-documents>

sharing factor. The breakdown of anticipated expenditure against this allowance is set out in Table 4.

**Table 4: Breakdown of the allowance for the Early Competition Plan Project**

<b>Cost category</b>	<b>Cost (£m 2020-21 prices)</b>
Costs covering spend on project up to 7 February 2020	£0.3m
Consultants	£1.2m
External procurement experts	£0.2m
External legal support	£0.1m
Stakeholder workshop costs	£0.1m
Internal ESO team supporting project	£0.6m
<b>Total</b>	<b>£2.5m</b>

5.4. Against the allowance of £2.5m, the ESO has spent a total of £2.1m (2020-21 prices). This is split between costs of £0.5m for 2019-20 and £1.6m for 2020-21. This represents an underspend of £0.4m (2020-21 prices).

## Proposed methodology

5.5. Our minded-to position is to give effect to our decision to fund the Early Competition Plan Project and increase the ESO’s RIIO-1 allowance. The funding adjustment through close out is intended to cover costs already incurred in RIIO-1. We intend to adjust allowances to reflect the ex-ante allowance of £1.8m (2009-10 prices) through the RIIO-1 close out process.

5.6. We are content that the ESO has satisfactorily delivered the Early Competition Plan Project deliverables. As the ESO has underspent against the ex-ante allowance, the underspend of £0.3m (2009-10 prices) would be subject to the TIM sharing factor, as set out when the ex-ante allowance was agreed.

5.7. We propose to adjust allowances to reflect the ex-ante allowance such that the underspend is split equally between 2019-20 and 2020-21. Therefore, we would increase the 2019-20 allowance by £0.5m and the 2020-21 allowance by £1.3m (2009-10 prices). This is explained in Table 5, using a conversion factor of 0.733 from 2020-21 prices to 2009-10 prices.

**Table 5: Breakdown of the allowance for the Early Competition Plan Project**

Category	£m 2020-21 prices	£m 2009-10 prices
Ex-ante allowance across 2019-20 and 2020-21	2.5	1.8
ESO expenditure in 2019-20	0.5	0.4
ESO expenditure in 2020-21	1.6	1.2
Underspend against ex-ante allowance across 2019-20 and 2020-21	0.4	0.3
Proposed allowance in 2019-20 including equal split of underspend	0.7	0.5
Proposed allowance in 2020-21 including equal split of underspend	1.8	1.3

5.8. As per the RIIO-2 PCFM Guidance,<sup>14</sup> the ESO calculated provisional legacy values in accordance with the processes set out in Chapter 7 of the PCFH ahead of our RIIO-1 close out methodology decision. The ESO included an estimate of the closing position of its actual RIIO-1 spend on the Early Competition Plan Project in the Legacy PCFM, submitted ahead of the November 2021 AIP. The actual spend was reflected in the RIIO-2 PCFM following the November 2021 AIP through the LSORAV and LSOMOD variable values.

5.9. To complete the implementation of this proposed methodology, we intend to update the ESO’s SOACO allowances in the Legacy PCFM. This would feed into the LSORAV and LSOMOD terms, which would be adjusted following the methodology described in Chapter 2 of this document. This adjustment would reflect the ESO’s ex-ante allowance for the Early Competition Plan Project in the RIIO-2 PCFM November 2022 AIP and would ensure that the underspend is reflected through the TIM sharing factor.

5.10. We welcome views on our proposed methodology to implement the legacy adjustments for the Early Competition Plan Project.

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<sup>14</sup> Chapter 4, RIIO-2 ESO PCFM Guidance: <https://www.ofgem.gov.uk/publications/decision-riio-2-pcfm-guidance>

## 6. Other adjustments

This section explains our proposed approach to the following areas that we propose not to include in the ESO's RIIO-1 close out process and for which we set out alternative approaches:

- CMP345 sunk IT costs and COVID-19 adjustments
- Withdrawal from Project TERRE

### Questions

**Question 6: Do you agree with our proposed approach to the ESO's additional funding request for sunk IT costs on CMP345 and COVID-19 adjustments?**

**Question 7: Do you agree with our proposed approach to recover money from the ESO's withdrawal from Project TERRE?**

**Question 8: Are there any other areas we should consider for the close out of RIIO-1 for the ESO?**

## Overview

6.1. There are further areas that are related to the close out of RIIO-1 for the ESO, as the expenditure for these areas was incurred in the legacy period. These are:

- CMP345 sunk IT costs and COVID-19 adjustments
- Withdrawal from Project TERRE

6.2. Our minded-to position is not to include these areas in the RIIO-1 close out. We have set out our proposed alternative approaches, which do not require any legacy adjustments, to these areas below. We welcome views on our proposed alternative approaches.

6.3. We are also interested in stakeholders' views as to whether there are any additional areas that should be considered as part of the ESO's RIIO-1 close out process.

## **CMP345 sunk IT costs and COVID-19 adjustments**

### **CMP345 sunk IT costs background**

6.4. CMP345 is a modification to the Connection and Use of System Code (CUSC). CMP345 deferred the additional Balancing Services Use of System (BSUoS) costs arising from COVID-19 that were incurred in 2020-21 to 2021-22.

6.5. Ofgem’s decision on CMP345<sup>15</sup> allowed the ESO to reclaim all costs associated with the financing and administration of the modification, subject to the Authority’s approval.

6.6. The ESO previously requested an additional allowance adjustment of £159k (2020-21 prices) for 2020-21 through the RIIO-1 close out. These costs were incurred on an IT investment for extended payment option alternatives. These option alternatives were developed in parallel to the CMP345 decision process due to the short timescale of needing to implement the decision.

6.7. The ESO included this anticipated allowance adjustment in its Legacy PCFM ahead of the November 2021 AIP. Therefore, we included this additional funding in the November 2021 AIP of the RIIO-2 PCFM, based on the ESO’s forecast that this additional funding request would be granted.

### **COVID-19 adjustments background**

6.8. In May 2020, we published an open letter<sup>16</sup> setting out a process for the ESO to demonstrate necessary delays in “lower priority” activities to enable its response to COVID-19. In this letter, we also stated that “to the extent that any re-prioritisation of work leads to the deferral of expenditure, we will seek to make appropriate adjustments to the ESO’s revenues if necessary for this in the close-out of the price controls, to ensure consumers are suitably protected.”

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<sup>15</sup> CMP345: Defer the additional COVID-19 BSUoS costs:

<https://www.ofgem.gov.uk/publications/cmp345-defer-additional-covid-19-bsuos-costs>

<sup>16</sup> Ofgem’s response to the Electricity System Operator’s COVID-19 Impact Update Letter:

<https://www.ofgem.gov.uk/publications/letter-electricity-system-operator-priorities-during-covid-19>



### **Proposed approach to CMP345 sunk IT costs and COVID-19 adjustments**

6.9. Following further discussion with the ESO, we consider that the additional allowance request of £159k (2020-21 prices) for the CMP345 IT investment broadly balances out any costs we would be expecting to recover from the ESO for deferred expenditure associated with deliverables delayed due to COVID-19. Therefore, our minded-to position is to exclude these items from the RIIO-1 close out as we consider the overall monetary impact on the RIIO-1 close out will be negligible.

6.10. We intend to true-up the provisional values that were included in the RIIO-2 PCFM at the November 2021 AIP to remove the additional allowances included for the CMP345 IT investment to implement this approach. This would be done through the November 2022 AIP.

6.11. We welcome views on our proposed approach to CMP345 sunk IT costs and COVID-19 adjustments.

## **Withdrawal from Project TERRE**

### **Background**

6.12. In RIIO-1, the ESO undertook considerable work in preparation for joining the Trans-European Replacement Reserves Exchange (TERRE). Following GB's exit from the EU internal energy market, the ESO can no longer participate fully in TERRE. The ESO fully withdrew from TERRE in Oct 2021.

6.13. The majority of the ESO's expenditure on TERRE was required to prepare for membership and cannot be recovered now that GB cannot fully participate. However, the ESO should be able to recover a proportion of its costs as a result of withdrawal. It is not currently clear what type of costs the ESO can recover from TERRE, how much can be recovered or when the ESO will be able to recover costs.

### **Proposed approach**

6.14. We consider that any rebate as a result of withdrawal from Project TERRE should be passed back to consumers in full as consumers will not see the benefits of the ESO's previous expenditure on Project TERRE. Our minded-to position is that it would be simpler to implement a totex adjustment in RIIO-2 to return any rebate received by the ESO to consumers in full rather than to include this area in the RIIO-1 close out.

6.15. Should we decide to take this approach, the ESO would be required to report the rebate amounts to us as part of its Costs and Outputs Regulatory Reporting Pack (C+O RRP) submission. These amounts would then net off against reported totex that would feed into the RIIO-2 PCFM and should be clearly signposted in the supporting commentary to the C+O RRP submission.

6.16. We welcome views on our proposed approach to recover money from the ESO's withdrawal from Project TERRE.

## Appendices

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## **Appendix 1 – Consultation questions**

**Question 1: Do you agree with our proposed approach to financial methodologies, including the phasing of the impact?**

**Question 2: What are your views on what should, or should not, be finally incorporated into the financial handbook?**

**Question 3: Do you agree with our proposed methodology for EMR IT funding for the ESO?**

**Question 4: Do you agree with our proposed methodology for the Offshore Coordination Project for the ESO?**

**Question 5: Do you agree with our proposed methodology for the Early Competition Plan Project for the ESO?**

**Question 6: Do you agree with our proposed approach to the ESO's additional funding request for sunk IT costs on CMP345 and COVID-19 adjustments?**

**Question 7: Do you agree with our proposed approach to recover money from the ESO's withdrawal from Project TERRE?**

**Question 8: Are there any other areas we should consider for the close out of RIIO-1 for the ESO?**

## Appendix 2 – Privacy notice on consultations

### Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

#### 1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, “Ofgem”). The Data Protection Officer can be contacted at [dpo@ofgem.gov.uk](mailto:dpo@ofgem.gov.uk)

#### 2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

#### 3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. i.e. a consultation.

#### 3. With whom we will be sharing your personal data

We do not plan to share any personal data with any other organisations. We may upload non-confidential consultation responses to our website.

#### 4. For how long we will keep your personal data, or criteria used to determine the retention period.

We do not plan to keep any personal data.

#### 5. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete
- ask us to delete personal data when we no longer need it

- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3<sup>rd</sup> parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at <https://ico.org.uk/>, or telephone 0303 123 1113.

**6. Your personal data will not be sent overseas.**

**7. Your personal data will not be used for any automated decision making.**

**8. Your personal data will be stored in a secure government IT system.**

**9. More information** For more information on how Ofgem processes your data, click on the link to our "[Ofgem privacy promise](#)".