

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

Subject	Details
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The RIIO-1 price control for the Electricity System Operator (ESO) ran from 1 April 2013 until 31 March 2021. 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 information is available.

We consulted on our proposed RIIO-1 close out methodologies for the ESO, our minded-to position to exclude certain areas from the ESO’s RIIO-1 close out and whether there are any other areas that should be considered for the ESO’s RIIO-1 close out.

This document sets out our decision on the RIIO-1 close out methodologies for the ESO. These methodologies will be implemented through the November 2022 Annual Iteration Process of the ESO RIIO-2 Price Control Financial Model.

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## Contents

<b>1. Introduction .....</b>	<b>4</b>
Background.....	4
Summary of our decision .....	4
Approach to financial methodologies .....	4
RIIO-1 close out methodologies .....	5
Other adjustments.....	6
Related publications .....	7
Our decision-making process.....	7
Your feedback .....	8
General feedback .....	8
<b>2. Approach to financial methodologies .....</b>	<b>9</b>
Consultation position .....	9
Stakeholder views.....	10
Our decision.....	11
<b>3. Electricity Market Reform IT funding .....</b>	<b>12</b>
Background.....	12
Consultation position.....	13
Stakeholder views.....	13
Our decision.....	13
Update on upcoming decision on revision of DFA <sub>t</sub> .....	14
<b>4. Offshore Coordination Project.....</b>	<b>15</b>
Background.....	15
Consultation position .....	16
Stakeholder views.....	16
Our decision.....	17
<b>5. Early Competition Plan Project .....</b>	<b>19</b>
Background.....	19
Consultation position .....	20
Stakeholder views.....	21
Our decision.....	21

**6. Other adjustments ..... 22**

    Consultation position ..... 22

        CMP345 sunk IT costs and COVID-19 adjustments ..... 23

        Withdrawal from Project TERRE ..... 24

    Stakeholder views..... 24

    Our decision..... 25

## 1. Introduction

### Background

- 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. We consulted on our proposed approach to financial methodologies, our proposed close out methodologies and our minded-to position to exclude certain areas from the ESO’s RIIO-1 close out.<sup>2</sup> We also asked stakeholders whether there were any other areas we should be considering within the scope of the RIIO-1 close out. We received one response to our consultation from the ESO.

### Summary of our decision

#### Approach to financial methodologies

- 1.3. We will be broadly maintaining our consultation position regarding our approach to financial methodologies for the ESO’s RIIO-1 close out. However, we agree with the ESO’s suggestion to true-up the legacy adjustment in one year rather than smoothing the impact across the remainder of RIIO-2. We also agree with the ESO’s suggested change to the ESO Price Control Financial Handbook (PCFH) to allow all the legacy adjustments through the RIIO-1 close out to be implemented through the SOEMRES variable value in the Legacy Price Control Financial Model (PCFM). We will separately consult on changes to the ESO PCFH. Chapter 2 of this document sets out these decisions in more detail.

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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> Consultation on the RIIO-1 close out methodologies for the Electricity System Operator: <https://www.ofgem.gov.uk/publications/consultation-riio-1-close-out-methodologies-electricity-system-operator>

## RIIO-1 close out methodologies

1.4. We proposed 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

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. Table 1 provides a summary of our decisions on the RIIO-1 close out methodologies for the ESO. Adjustments are stated in 2009-10 prices for the purposes of our PCFM. Chapters 3-5 of this document set out these decisions in more detail.

**Table 1: Summary of our decision on the cost areas for the ESO's RIIO-1 close out**

Area	Summary of methodology	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. We are broadly satisfied with the efficiency of the ESO's expenditure on EMR IT in 2019-20 and 2020-21. We will true-up allowances through the SOEMRES variable value in the Legacy PCFM to reflect actual efficient costs incurred by the ESO.	£1.7m underspend in 2019-20 and £0.5m underspend in 2020-21 returned to consumers through allowance true-up.	3
Offshore Coordination Project	We are providing funding for expenditure on this project in 2020-21 through the RIIO-1 close out. We are satisfied that the ESO's original allowance request is efficient and compliant with the conditional funding principles following our assessment of the efficiency of the ESO's expenditure on this project. We	£0.6m additional allowance for 2020-21.	4

	will adjust allowances through the SOEMRES variable value in the Legacy PCFM to reflect actual efficient costs incurred by the ESO that comply with the conditional principles.		
Early Competition Plan Project	We are providing the agreed ex-ante allowance for this project in 2019-20 and 2020-21 through the RIIO-1 close out. We will adjust allowances through the SOEMRES variable value in the Legacy PCFM to reflect the ex-ante allowance. The underspend on this project will be subject to the Totex Incentive Mechanism (TIM) sharing factor.	£0.5m additional allowance for 2019-20 and £1.3m additional allowance for 2020-21 with underspend in each year subject to TIM sharing factor.	5

### Other adjustments

1.6. We also consulted on our minded-to position to exclude the following areas from the ESO's RIIO-1 close out:

- CMP345<sup>3</sup> sunk IT costs and COVID-19 adjustments; and
- Withdrawal from Project TERRE.<sup>4</sup>

1.7. The ESO agreed with our approaches to both these areas. Therefore, we will maintain our consultation positions. Chapter 6 of this document sets out these decisions in more detail.

1.8. Lastly, we also asked stakeholders whether there were any other areas that should be considered for the ESO's RIIO-1 close out. The ESO did not believe that there are any other areas that should be considered for the RIIO-1 close out process.

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<sup>3</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>4</sup> TERRE is the Trans-European Replacement Reserves Exchange.

## Related publications

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

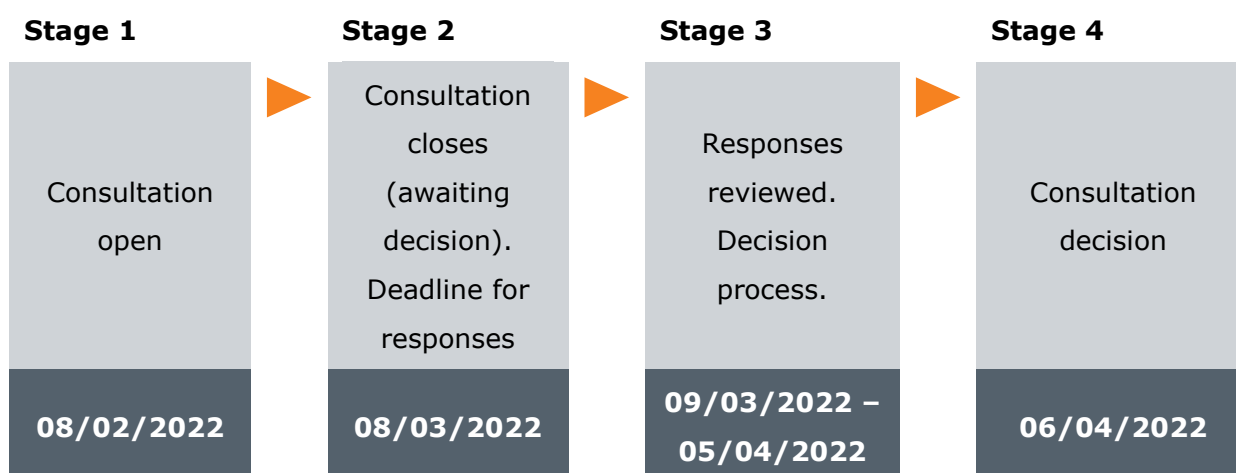
- Consultation on the RIIO-1 close out methodologies for the Electricity System Operator (8 February 2022 – 8 March 2022):  
<https://www.ofgem.gov.uk/publications/consultation-riio-1-close-out-methodologies-electricity-system-operator>
- National Grid Electricity System Operator Limited – Special Conditions:  
<https://www.ofgem.gov.uk/industry-licensing/licences-and-licence-conditions>
- ESO Price Control Financial Handbook V1.1:  
<https://www.ofgem.gov.uk/publications/decision-proposed-modifications-riio-2-transmission-gas-distribution-and-electricity-system-operator-licence-conditions-1-april-2022>
- RIIO-2 ESO PCFM Guidance: <https://www.ofgem.gov.uk/publications/decision-riio-2-pcfm-guidance>

## Our decision-making process

1.10. We launched a policy consultation on 8 February 2022. The consultation closed on 8 March 2022, with one response received from the ESO. This response was non-confidential and has been published on our website alongside the consultation and at [www.ofgem.gov.uk/consultations](http://www.ofgem.gov.uk/consultations).

1.11. The RIIO-1 close out methodologies for the ESO will be implemented through the November 2022 Annual Iteration Process (AIP) of the ESO RIIO-2 PCFM.

**Figure 1: Decision-making stages**





## Your feedback

### General feedback

1.12. We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this report. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall quality of this document?
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. Are its conclusions balanced?
5. Did it make reasoned recommendations?
6. Any further comments?

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

## 2. Approach to financial methodologies

### Section summary

In our consultation, we set out the process that we proposed to follow to determine any revisions to the ESO's Regulatory Asset Value (RAV) balances and revenue for the ESO RIIO-2 price control period. The ESO broadly agreed with our proposed approach. This section summarises the feedback we received to our questions and the changes we will make to our consultation approach to reflect the ESO's feedback.

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?**

## Consultation position

- 2.1. We proposed 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>5</sup> We also proposed to implement the ESO RIIO-1 close out methodologies in the November 2022 AIP, noting that corrections can be made in subsequent AIPs if necessary. We reiterated our position that any legacy

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<sup>5</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.

adjustments made through the November 2021 AIP remain subject to our close out methodologies and further true-up.<sup>6</sup>

- 2.2. In the current AIP process, the cumulative impact of all changes is included in the next SOMOD value. However, we proposed to smooth the impact of the November 2022 AIP legacy adjustments over the remaining three years of RIIO-2.
- 2.3. We noted that the ESO RIIO-2 PCFH already posits adjusting the Legacy PCFM to accommodate close out methodologies. However, we welcomed views on what should or should not be finally incorporated into the handbook.

## Stakeholder views

- 2.4. We received one response from the ESO to our consultation questions in this section.
- 2.5. The ESO agreed that adjustments made through the November 2021 AIP are subject to the close out methodologies and that these should be implemented in the November 2022 AIP. However, the ESO did not agree with the phasing of the impact. Instead, the ESO proposed that the legacy adjustment is trued-up in one year rather than smoothed across three years, such that 2023-24 would include the full impact of all changes. The ESO believe this approach would reduce regulatory burden for both Ofgem and the ESO, noting the forecast view of the impact of close out in the November 2021 AIP is not materially different from the change in LSOMOD based on our minded-to position in the consultation.
- 2.6. The ESO also agreed with the approach to adjusting the Legacy PCFM to accommodate close out methodologies as outlined in Chapter 7 of the ESO PCFH and that close out adjustments must feed into the Legacy PCFM variable value to impact total allowances. However, as there are not separate variable values for the Offshore Coordination Project and the Early Competition Plan Project allowances in the Legacy PCFM, the ESO proposed to use the SOEMRES variable value in the Legacy PCFM to make these adjustments. This was the provisional approach taken by the ESO for the November 2021 AIP. The ESO suggested an amendment to paragraph 7.20 of

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<sup>6</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.

the ESO PCFH to formally enable this approach. We will consult on the required PCFM modification, in due course.

## **Our decision**

- 2.7. We agree with the ESO's suggested changes to our approach. We will true-up the legacy adjustment in 2023-24 and we will amend the ESO PCFH such that the SOEMRES variable value can be used to make the legacy adjustments for the Offshore Coordination Project and the Early Competition Plan Project.
- 2.8. Additionally, we will implement the true-up in a single year rather than phasing the impact of the close-out adjustments.

### 3. Electricity Market Reform IT funding

#### Section summary

In our consultation, we set out our proposed methodology for closing out Electricity Market Reform (EMR) IT funding. The ESO agreed with our proposed methodology. This section summarises the feedback we received to our question and confirms that we will follow the methodology that we proposed in our consultation. It also confirms the value of the allowance adjustment following our consideration of the efficiency of the ESO's expenditure in this area.

#### Questions

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

### Background

- 3.1. The EMR Delivery Body (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. Our September 2019 re-opener decision<sup>7</sup> provided additional allowances of £7.81m (2014-15 prices) for justifiable and efficient historical investment in the existing IT administration system ("the Portal"). The re-opener decision also provided additional allowances of £2m (2014-15 prices) to allow the EMR DB to develop a replacement Portal by April 2021. Following our re-opener decision, we decided that further allowance adjustments over the period October 2019 to March 2021 would be determined through the RIIO-1 close out.

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<sup>7</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>

- 3.3. The ESO proposed to return an underspend of £2.06m in 2019-20 and an underspend of £0.62m in 2020-21 (both 2014-15 prices) through the RIIO-1 close out. Using a conversion factor of 0.841, this is equivalent to an underspend of £1.7m in 2019-20 and an underspend of £0.5m in 2020-21 in 2009-10 prices.

## Consultation position

- 3.4. We stated our intention to request additional information from the ESO regarding its expenditure against allowances on EMR IT across 2019-20 and 2020-21 to enable us to determine whether this expenditure was efficient. We also set out a non-exhaustive list of questions that would guide our assessment.
- 3.5. We proposed to true-up allowances for 2019-20 and 2020-21 to reflect the actual efficient costs incurred by the ESO. This true-up would be implemented through the SOEMRES variable value in the Legacy PCFM.

## Stakeholder views

- 3.6. We received one response from the ESO to our consultation question in this section. The ESO also provided additional information to enable us to determine the efficiency of expenditure on EMR IT across 2019-20 and 2020-21.
- 3.7. The ESO agreed with our proposed methodology to true-up allowances for 2019-20 and 2020-21 and to implement this adjustment through the SOEMRES variable value in the Legacy PCFM.

## Our decision

- 3.8. We will maintain the RIIO-1 close out methodology proposed in our consultation for EMR IT funding, noting that the ESO agreed with our approach.
- 3.9. We have assessed the ESO's expenditure on EMR IT. We consider that the ESO's totex underspend against allowances should be returned to consumers. We are broadly satisfied with the efficiency of the ESO's expenditure on EMR IT in 2019-20 and 2020-21. However, we believe that the ESO could have delivered greater value for money in this area to maximise consumer benefit.
- 3.10. In our 2019 reopener decision, we provided the ESO with an additional £2m (2014-15 prices) capex allowance as an *'...initial allowance to the DB to deliver this [a*

Replacement IT System] *solution...*'. We note that this additional allowance has not been used to deliver a replacement solution, and instead has been allocated against changes to the existing IT portal. As set out in our 2019-20 EMR Delivery Body Performance Report,<sup>8</sup> we remain disappointed that the replacement EMR IT Portal was not delivered by April 2021.

- 3.11. We acknowledge that 2019-20 and 2020-21 saw greater regulatory and policy change than was expected at the time of the 2019 reopener decision. These changes have necessitated some investment in the existing IT portal. However, we have concerns that all the IT capex spend in 2019-20 and 2020-21 represents good value for money for consumers.
- 3.12. Following this assessment, we will adjust allowances to return the underspend of £1.7m in 2019-20 and the underspend of £0.5m in 2020-21 (both 2009-10 prices) to consumers in full.
- 3.13. Going forward, we expect the ESO to have greater regard for efficiency of spend in this area. Under the RIIO-2 price control, the EMR DB role is included in the ESO's performance incentives framework. The timely delivery of the replacement EMR IT Portal is necessary for the ESO to meet expectations for Role 2 through the incentives process.<sup>9</sup> We will also consider the ESO's costs, value for money and demonstration of consumer benefit as part of our assessment in this area.

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

- 3.14. In our consultation, we also provided an update on our upcoming decision on the revision on the Peak National Demand Forecasting Accuracy Incentive (DFA<sub>t</sub>). The ESO highlighted that, should our decision result in a change to the incentive value captured in the LSOEMRINC term in the RIIO-2 PCFM, Ofgem and the ESO will need to agree a process to enable adjustments. We will consider this information when we make our decision on DFA<sub>t</sub> later this year.

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<sup>8</sup> Annual report on the EMR Delivery Body's Performance of its functions in relation to the Capacity Market: <https://www.ofgem.gov.uk/publications/annual-report-emr-delivery-bodys-performance-its-functions-relation-capacity-market-0>

<sup>9</sup> Our expectations are set out in the ESO Roles Guidance 2021-23. Our ESO performance incentives framework is set out in the ESORI Guidance Document 2021-23. These documents are available at: <https://www.ofgem.gov.uk/publications/decisions-eso-guidance-documents-2021-23>

## 4. Offshore Coordination Project

### Section summary

In our consultation, we set out our proposed methodology for closing out the Offshore Coordination Project. Stakeholders broadly agreed with our proposed methodology. This section summarises the feedback we received to our question and the changes we will make to the methodology that we proposed in our consultation to reflect the ESO's feedback. It also confirms the value of the allowance adjustment following our assessment of the efficiency of the ESO's expenditure in this area.

### Questions

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

## Background

- 4.1. 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.
- 4.2. The work undertaken on this project was split into two phases. 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 principles listed in Table 2.
- 4.3. The ESO requested additional allowances of £751k (2020-21 prices) for the Offshore Coordination project, which is within the agreed spending cap of £985k. This is equivalent to an additional allowance request of £0.6m in 2009-10 prices, using a conversion factor of 0.733 from 2020-21 prices.



## Consultation position

- 4.4. We stated our intention to assess the efficiency of the ESO's expenditure on the Offshore Coordination Project and its compliance with the conditional principles shown in Table 2. We stated that 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 for our assessment. We also set out a non-exhaustive list of questions that would guide our assessment.
- 4.5. Our minded-to position was that, if the ESO could demonstrate compliance with the conditional principles, we would grant the requested additional allowances.
- 4.6. The ESO's actual spend was reflected in the RIIO-2 PCFM following the November 2021 AIP through provisional LSORAV and LSOMOD variable values.<sup>10</sup> To complete the implementation of our proposed methodology, we set out our intention to update the ESO's SOACO allowances in the Legacy PCFM. This would feed into the LSORAV and LSOMOD terms. 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.

## Stakeholder views

- 4.7. We received one response from the ESO to our consultation question in this section.
- 4.8. The ESO broadly agreed with our proposed approach for the Offshore Coordination Project. However, the ESO sought to clarify that, in proposing to update the ESO's SOACO allowances in the Legacy PCFM, that we do not mean to update the costs that have already been captured. The ESO highlighted the importance of avoiding double counting expenditure incurred for the project that has already been included through the 2020-21 Costs and Outputs Regulatory Reporting Pack (C+O RRP).
- 4.9. The ESO believe the appropriate adjustment is to use a variable value that increases total allowances. As there is not a separate variable value for the Offshore

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<sup>10</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.

Coordination Project allowances in the Legacy PCFM, the ESO suggested using the SOEMRES variable value instead.

## Our decision

- 4.10. We agree with the ESO's suggested change to our close out methodology. We will use the SOEMRES variable value to implement this RIIO-1 close out methodology.
- 4.11. We have assessed the efficiency of the ESO's expenditure on the Offshore Coordination Project, noting that the ESO is only requesting additional allowances for expenditure that complied with our conditional funding principles. Following our assessment, we are satisfied that this expenditure is compliant with our funding principles, as per the summary provided in Table 2. We are also content that the RIIO-1 project deliverables were successfully achieved. We note that the additional allowances that the ESO are requesting are below the agreed spending cap across both phases of work. We were previously satisfied that the spending cap was set at a value that represented efficient costs.

**Table 2: Assessment of compliance with the conditional funding principles**

Conditional funding principle	Evidence of compliance
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).	The ESO has only requested funding for actual expenditure on the project that complies with the principles, providing evidence in the form of external invoices and information on internal staff costs.
The outcome of the project does not inform the level of reward or penalty liable to the ESO under the SO Incentives package.	The outcome of the project did not inform the level of reward or penalty liable to the ESO in our decision on the ESO's financial incentive for 2020-21. <sup>11</sup>
The project must not impact the delivery of the ESO's core work.	The project was delivered through a dedicated project team with the support of external consultants. We have not seen any

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<sup>11</sup> Decision and Direction on the Electricity System Operator's financial incentive for 2020-21: <https://www.ofgem.gov.uk/publications/decision-and-direction-electricity-system-operators-financial-incentive-2020-21>

	evidence to suggest that this project had an impact on the delivery of the ESO's core work.
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.	The cost of each project team member was allocated to a specific, ring-fenced project cost code. Where they were required to carry out work for another area, the costs for that time were allocated to the alternative cost centre. Where resources supported the project that were already funded in other areas, their costs remained allocated to their substantive teams.
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.	Costs of individuals' working on the project were only allocated to the project cost code when their previous roles were backfilled. Where individuals' roles were not backfilled, they were not allocated to the costs included in the additional funding request.
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.	Team members were not transferred to the project until their previous responsibilities could be progressed in a way that did not negatively impact on the ESO's performance. We have not seen any evidence to suggest that this project had a negative impact on ESO performance.
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.	Costs did not go above the agreed cap.

4.12. Therefore, we are content that the ESO's expenditure on the Offshore Coordination Project was efficient. We will grant additional allowances of £0.6m (2009-10 prices), in line with the ESO's original request.

## 5. Early Competition Plan Project

### Section summary

In our consultation, we set out our proposed methodology for closing out the Early Competition Plan Project. The ESO broadly agreed with our proposed methodology. This section summarises the feedback we received to our question and the changes we will make to the methodology that we proposed in our consultation. It also confirms the value of the allowance adjustment following our assessment of the efficiency of the ESO's expenditure in this area.

### Questions

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

## Background

- 5.1. The Early Competition Plan Project was not envisaged when funding was allocated to the ESO at the start of RIIO-1. We agreed with the ESO that the RIIO-1 close-out was the appropriate route to recover the costs of this work.
- 5.2. 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 sharing factor.
- 5.3. 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). As the PCFM uses a 2009-10 price base, Table 3 sets out how this allowance and expenditure breaks down in 2009-10 prices using a conversion factor of 0.733 from 2020-21 prices.

**Table 3: 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

## Consultation position

- 5.4. Our minded-to position was to give effect to our decision to fund the Early Competition Plan Project and increase the ESO's RIIIO-1 allowance. We set out our intention to adjust allowances to reflect the ex-ante allowance of £1.8m (2009-10 prices) through the RIIIO-1 close out process.
- 5.5. We proposed 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).
- 5.6. The ESO's actual spend was reflected in the RIIIO-2 PCFM following the November 2021 AIP through provisional LSORAV and LSOMOD variable values. To complete the implementation of our proposed methodology, we set out our intention to update the ESO's SOACO allowances in the Legacy PCFM. This would feed into the LSORAV and LSOMOD terms. This adjustment would reflect the ESO's ex-ante allowance for the Early Competition Plan Project in the RIIIO-2 PCFM November 2022 AIP and would ensure that the underspend is reflected through the TIM sharing factor.

## Stakeholder views

- 5.7. We received one response from the ESO to our consultation question in this section.
- 5.8. The ESO agreed with our approach to adjusting the Legacy PCFM to accommodate close out methodologies. However, in line with the response to the Offshore Coordination Project methodology, the ESO suggested that the appropriate way to implement this methodology would be to update the SOEMRES variable value. The ESO sought clarification as to how SOACO would be used to facilitate the close out as they do not wish to update costs which have already been captured.

## Our decision

- 5.9. We agree with the ESO's suggested change to our close out methodology. We will use the SOEMRES variable value to implement this RIIO-1 close out methodology.
- 5.10. We will maintain our position to provide additional allowances of £0.5m for 2019-20 and £1.3m for 2020-21 (both 2009-10 prices) for the Early Competition Plan Project.

## 6. Other adjustments

### Section summary

In our consultation, we set out our proposed approach to the following areas (which was to not include them in the ESO's RIIIO-1 close out process):

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

We also sought views on whether there are any other areas that we should consider in the ESO's RIIIO-1 close out.

The ESO agreed with our proposed approaches and did not propose any further areas to include in the close out process. This section summarises the feedback we received to our questions and confirms that we will follow the approaches that we proposed in our consultation.

### 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 RIIIO-1 for the ESO?**

## Consultation position

6.1. There are further areas that are related to the close out of RIIIO-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 was to not include these areas in the RIIIO-1 close out. We proposed alternative approaches, which do not require any legacy adjustments, to these areas.

- 6.3. We also sought 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**

- 6.4. CMP345 deferred the additional Balancing Services Use of System (BSUoS) costs arising from COVID-19 that were incurred in 2020-21 to 2021-22. Ofgem's decision on CMP345<sup>12</sup> allowed the ESO to reclaim all costs associated with the financing and administration of the modification, subject to the Authority's approval.
- 6.5. The ESO previously requested an additional allowance adjustment of £159k (2020-21 prices) for 2020-21 through the RIIO-1 close out. 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.
- 6.6. In May 2020, we published an open letter<sup>13</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."
- 6.7. 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 was 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.
- 6.8. We set out our intention to true-up the provisional values that were included in the RIIO-2 PCFM at the November 2021 AIP to remove the additional allowances

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<sup>12</sup> CMP345: Defer the additional COVID-19 BSUoS costs:

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

<sup>13</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>



included for the CMP345 IT investment to implement this approach. This would be done through the November 2022 AIP.

### **Withdrawal from Project TERRE**

- 6.9. 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 October 2021.
- 6.10. The ESO should be able to recover a proportion of its costs following withdrawal. We consider that any rebate following 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.
- 6.11. We set out our minded-to position 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. We also set out that the ESO would be required to report the rebate amounts to us as part of its 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.

### **Stakeholder views**

- 6.12. We received one response from the ESO to our consultation questions in this section.
- 6.13. The ESO agreed with our proposed approach and minded-to position that as the overall monetary impact of CMP345 sunk IT costs and COVID-19 deferred expenditure adjustments will be negligible, these items should be excluded from the close out process. The ESO also agreed with the proposed true-up to remove the additional allowances included for the CMP345 IT costs within the November 2021 AIP.
- 6.14. The ESO agreed that any rebate resulting from Project TERRE withdrawal should be passed back to consumers in full. The ESO confirmed that any such rebate will be received within the RIIO-2 period although it is not yet clear what the exact value of any rebate will be. The ESO also agreed with our proposed approach to report the

rebate amounts in the C+O RRP submission which would then feed into the RIIO-2 PCFM and ensure that the full value of the rebate is passed back to consumers.

- 6.15. The ESO did not believe that there are any other areas which should be considered as part of the RIIO-1 close out process.

## **Our decision**

- 6.16. We will maintain our proposed approaches in our consultation. The ESO's IT costs for CMP345 and COVID-19 adjustments will be excluded from the ESO's RIIO-1 close out. We will implement a totex adjustment in RIIO-2 to return any rebate received by the ESO for the withdrawal from Project TERRE, noting that the full amount will be passed back to consumers in full. The ESO will report the rebate amounts in the C+O RRP submission, which would then feed into the RIIO-2 PCFM.