

Ofgem  
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8<sup>th</sup> March 2022

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

Dear Luke

We welcome the opportunity to respond to your consultation on the close-out methodologies for RIIO1 for National Grid Electricity System Operator.

As 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.

We appreciate the work which has been carried out with Ofgem to develop the proposed approaches and we agree with much of what has been outlined in the consultation. There are some areas where we ask for further clarity to ensure that the close-out mechanisms work as expected.

Our key points are as follows

- We agree with the methodology to close-out Electricity Market Reform (EMR) IT funding. Ofgem asked for evidence to enable a decision to be made on the efficiency of the expenditure and this has been provided under separate cover to Mark Carolan ([Mark.Carolan@ofgem.gov.uk](mailto:Mark.Carolan@ofgem.gov.uk)).
- Whilst we agree with the overall principle for close-out of the Offshore Coordination Project and Early Competition Plan Project, we require further clarity on the variable value to be used to ensure close-out is delivered correctly.
- We agree with the proposed approach to the close-out of CMP345 Sunk IT Costs, Covid 19 adjustments and withdrawal from Project TERRE.

In our responses in the appendix below we have commented in more detail on the proposed methodologies to close-out RIIO-1.

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 our response then please contact Adelle Wainwright in the first instance at [adelle.wainwright@nationalgrideso.com](mailto:adelle.wainwright@nationalgrideso.com).

Yours sincerely,

Gareth Davies  
Regulation and RIIO Manager

## Appendix – NGESO Responses to Consultation Questions

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

We included provisional values for LSORAV, and SOLAR based on a forecast view of the impact of close-out in the November 2021 Annual Iteration Process (AIP). We agree that adjustments made through the November 2021 AIP are subject to the close-out methodologies as outlined in the ESO RIIO-2 Price Control Financial Handbook and that these should be implemented in the November 2022 AIP.

As outlined further in our response to question two, we think that there should be a change to Paragraph 7.20 of the ESO RIIO-2 Price Control Financial Handbook to clarify the approach of updating variables.

We do not agree with the phasing of the impact. The forecast view of the impact of close-out in the November 2021 AIP is not materially different from the change to the LSOMOD value based on Ofgem's minded-to position in this consultation. We propose instead that the legacy adjustment is trued-up in one year rather than smoothed across three years. 2023/24 would include the full impact of all changes. We believe that this approach reduces the regulatory reporting burden on both Ofgem and the ESO.

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

We agree the approach to adjusting the Legacy Price Control Financial Model (PCFM) to accommodate close-out methodologies as outlined in Chapter 7 of the ESO Price Control Financial Handbook. We also agree 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 allowances in the current Legacy PCFM, we propose using one of the existing variable values to make this adjustment. For the November 2021 AIP we included our estimate for all legacy adjustments in the SOEMRES 'Uncertain costs – Electricity Market Reform Enduring Solution'. Using this variable value gives the correct arithmetic effect in the Legacy PCFM and we propose that a similar approach is used to make the close-out adjustment.

We suggest therefore, that Paragraph 7.20 of the ESO RIIO-2 Price Control Financial Handbook is amended as follows

Current Wording	Proposed Wording
As in the RIIO-1 process, the PCFM Variable Values feeding into the Legacy ESO RIIO-1 PCFM are to be derived in accordance with Chapter 6 (Annual Iteration Process - Adjustments to the System Operator Revenue Restriction) of the Electricity Transmission Licence special conditions and the version of the RIIO-ET1 Price Control Financial Handbook as in force on 31 March 2021.	As in the RIIO-1 process, the PCFM Variable Values feeding into the Legacy ESO RIIO-1 PCFM are to be derived in accordance with Chapter 6 (Annual Iteration Process - Adjustments to the System Operator Revenue Restriction) of the Electricity Transmission Licence special conditions and the version of the RIIO-ET1 Price Control Financial Handbook as in force on 31 March 2021 <b>or as agreed with the Authority.</b>

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

As outlined in the consultation, we are providing additional information to enable Ofgem to determine the efficiency of the expenditure. This has been provided under separate cover to Mark Carolan (Mark.Carolan@ofgem.gov.uk) on 2nd March 2022.

We agree with the proposed methodology to true-up allowances for 2019-20 and 2020-21 and we agree that these should be implemented through the SOEMRES variable value in the Legacy PCFM.

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

We broadly agree with Ofgem's proposed approach for the Offshore Coordination Project. As noted in the consultation we delivered a Phase 1 Final Project Report. This was followed up in June 2021 by a Phase 2 Project Report for the period January to March 2021. Both reports were previously emailed to Ofgem and we

are happy to provide copies of these if needed. We believe that these demonstrate compliance with the principles which the additional allowance is contingent upon.

Whilst we agree with the approach to adjusting the Legacy PCFM to accommodate close-out methodologies, we wish to clarify that, in proposing to update the ESO's SOACO allowances in the Legacy PCFM, Ofgem do not mean to update the costs which have already been captured. SOACO is described as 'Actual controllable opex' and inclusion of the values in this line would result in double counting, as the expenditure incurred for the project has already been included through the 2021 Costs and Outputs Regulatory Reporting Pack.

The appropriate adjustment is to use a variable value that increases total allowances. As there is not a separate variable value for the Offshore Coordination Project allowances in the current Legacy PCFM we suggest that one of the existing variable values is used to make this adjustment.

For the November 2021 AIP we included our estimate for all legacy adjustments in the SOEMRES 'Uncertain costs – Electricity Market Reform Enduring Solution'. Using this variable value gives the correct arithmetic effect in the Legacy PCFM. We propose that a similar approach is used to make the close-out adjustment.

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

We note Ofgem's minded-to position to give effect to their decision to fund the Early Competition Plan Project and increase the ESO's RIIO1 allowance.

We agree with the approach to adjusting the Legacy PCFM to accommodate close-out methodologies. However, as outlined in our response to Question 4, we wish to clarify how SOACO would be used to facilitate close-out as we do not wish to update costs which have already been captured. As previously mentioned, we included our estimate for all legacy adjustments in SOEMRES 'Uncertain costs – Electricity Market Reform Enduring Solution'. Using this variable gives the correct effect and therefore we propose that a similar approach is used to make the close-out adjustment.

### 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?

We agree with the proposed approach and the 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 are excluded from the RIIO-1 close-out methodology. We also agree with the proposed true-up to remove the additional allowances included for the CMP345 IT costs within the November 2021 AIP.

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

We agree that any rebate resulting from withdrawal from Project TERRE should be passed back to consumers in full. Any such rebate will be received in the RIIO-2 period. We do not yet know the exact values of any rebate. We agree that Ofgem's proposed approach to report the rebate amounts in the Costs and Outputs Regulatory Reporting Pack submission which would then feed into the RIIO-2 PCFM will ensure that the full value of the rebate is passed back to consumers.

### Question 8: Are there any other areas we should consider for the close out of RIIO1 for the ESO?

We do not believe there are any other areas which should be considered for the close-out of RIIO-1.

We note the update on the upcoming decision on the revision of Peak National Demand Forecasting Accuracy Incentive (DFAt). The RIIO-2 PCFM does not currently enable any adjustments made to LSOEMRINCt post the November 2021 AIP to be captured in Revenues as there is currently no true-up for legacy values. If the final decision is different from the values used in the November 2021 AIP, we will have to agree with Ofgem how to process the change through revenues.