

To:

**National Grid Electricity System Operator Limited
Scottish Hydro Electric Transmission plc
SP Transmission Ltd
National Grid Electricity Transmission plc**

Direction under Part C of Special Condition 5.1 (Governance of the ESO Price Control Financial Instruments) of the Electricity System Operator Licence and Special Condition 8.1 (Governance of the ET2 Price Control Financial Instruments) of the Electricity Transmission Licence to make modifications to the ESO and ET2 Price Control Financial Instruments.

1. Each of the companies to which this Notice is addressed (each “the licensee”) is the holder of an Electricity Transmission Licence granted or treated as granted under section 6(1)(b) of the Electricity Act 1989.
2. Special Condition (“SC”) 5.1 (Governance of the ESO Price Control Financial Instruments) and Special Condition (“SC”) 8.1 (Governance of the ET2 Price Control Financial Instruments) of the licensee’s licences provide that the Gas and Electricity Markets Authority (“the Authority”) ¹ may direct a modification to the ESO or ET2 Price Control Financial Instruments (“the PCFI”) where:
 - a. it becomes aware of a modification that will improve the functionality or clarity of the PCFIs;
 - b. the modification will have either no impact on or an impact on the licensee’s revenue below the Materiality Threshold;
 - c. the modification is of a type listed in paragraphs 5.1.5 of SC 5.1 and 8.1.5 of SC 8.1; and
 - d. the Authority has followed the procedure in paragraphs 5.1.6 of SC 5.1 and 8.1.6 of SC 8.1.
3. The Authority has become aware of a number of manifest errors in the ESO and ET2 PCFI. The Authority considers that correcting these manifest errors improves the functionality and clarity of the PCFI. The Authority also considers that the correction of those errors will not have a material impact on the licensees’ revenue.
4. On 19 April 2022 the Authority published the text of the proposed direction and the reasons for the proposed direction on the Authority’s Website² and requested that any representations were made by 17 May 2022 by email to Michael.Smith@Ofgem.gov.uk.
5. We received 3 representations to our consultation and have placed all non-confidential representations on our website. We have considered those

¹ The “Authority”, “Ofgem”, “we” and “our” are used interchangeably in this document. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work.

² <https://www.ofgem.gov.uk/publications/proposed-direction-make-modifications-eso-and-et2-price-control-financial-instruments>

representations and decided to proceed with making the modifications as set out in the draft direction.

6. There have been no changes since the proposed amendments set out in the draft direction given the supportive representations from licencees.
7. The reasons for and descriptions of the modifications being made to both the ESO and ET Price Control Financial Model (PCFM) are set out below:
 - a. the introduction of the super-deduction legislation results in companies investing in qualifying new plant and machinery assets being able to claim accelerated capital allowances on qualifying plant and machinery investments and special rate assets in FY22 and FY23. The general and special rate tax pool opening balances in the PCFM require adjusting to reflect the impact of the super deduction regime. We have added rows in the input sheets to enable opening balance adjustments for these general and special rate tax pools;
 - b. to allow for the impact of the super deduction tax regime to be reflected we have updated the tax paid calculation within the 'System Operator' and 'Finance&Tax' sheet; and
 - c. we have updated names of variable values throughout the PCFM as per the latest published licence conditions for the licensees.
8. The reasons for and descriptions of the modifications being made only to the ESO PCFM are set out below:
 - a. within a tax year the ESO could potentially elect to transfer some or all of its intangible assets from the intangible pool to the general pool. We have added rows in the input sheet to enable this transfer between intangible and general pools;
 - b. the values for ESO Incentive and Bad Debt are not influenced by inflationary increases or decreases. As such, we have altered the input price bases for these PCFM Variable Values to nominal prices; and
 - c. the Final Determination annex confirmed that the capitalisation rate for ESO would be confirmed alongside the ESO's Business Plan 2.³ As such, the Authority proposes to change the colour of the capitalised share of totex cells from yellow to blue. A blue cell in the PCFM signifies that a value is a PCFM Variable Value and therefore can be updated through the Annual Iteration Process.
9. The modifications to the PCFM necessitate consequential changes to the ESO and ET2 Price Control Financial Handbook ("Handbook") for completeness and consistency with the PCFM.
10. This direction is our notice of reasons for the purposes of section 49A of the Electricity Act 1989.
11. The Authority hereby directs the modifications to the PCFI set out in Annexes 1 and 2 to this direction. Appendices 1 and 2 indicate the location of these changes within the Annexes. These modifications come into effect on 01 June 2022.

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³ [RIIO-2 Final Determinations – Finance Annex \(REVISED\) \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/riio-2-final-determinations-finance-annex-revised)

Jonathan Gorrie
Chief Financial Advisor, Analysis and Assurance
Duly authorised on behalf of the Gas and Electricity Markets Authority
01 June 2022

Appendix 1 – Location of modifications within the Price Control Financial Model

Sector	Nature of Modification	Sheet reference	Cell reference
ET2	<p>The general and special rate tax pool opening balances require adjusting to reflect the impact of the super deduction regime.</p> <p>On the licensee-specific input sheets, we have added blue box rows in the input sheets to enable opening balance adjustments for these general and special rate tax pools. These rows are 'General Pool Opening Balance Adjustment' and 'Special Rate Pool Opening Balance Adjustment'.</p> <p>The cell colour signifies that these cells will become PCFM Variable Values that can therefore be updated as part of the Annual Iteration Process. The equivalent cells have been highlighted light green on the Input sheet, which signifies the same thing but uses a different colour scheme.</p> <p>These new rows have been linked to the 'Revisions' rows within the 'TaxPools' sheet under General and Special pools..</p>	<p>SHET</p> <p>SPTL</p> <p>NGET</p> <p>Input</p> <p>TaxPools</p>	<p>E166,G166,H166, AP166:AT166, E167,G167,H167, AP167:AT167</p> <p>E166,G166,H166, AP166:AT166, E167,G167,H167, AP167:AT167</p> <p>E166,G166,H166, AP166:AT166, E167,G167,H167, AP167:AT167</p> <p>E249,G249,H249, AP249:AT249, E250,G250,H250, AP250:AT250</p> <p>AP52:AT52, AP64:AT64</p>
ET2	<p>To allow for the impact of the super deduction tax regime to be reflected we have updated the tax paid calculation within the 'Finance&Tax' sheet.</p> <p>We have added 'Contributions to losses from clawback' and 'Adjustments to losses from tax trigger' in the tax paid calculation.</p> <p>We have updated the formula in the 'profits reduced by tax losses' row to account for these new rows</p>	Finance&Tax	E247,G247,AP247 :AT247,E248,G248,AP248:AT248,AP249:AT249
ET2	On the licensee-specific input we have updated names of variable values throughout per the latest published special licence conditions.	<p>SHET</p> <p>SPTL</p> <p>NGET</p>	<p>E24, E25, H61, E63, E69, E72, E73</p> <p>E24, E25, H61, E63, E69, E72, E73</p>

			E24, E25, H61, E63, E69, E72, E73
ESO	<p>The general and special rate tax pool opening balances require adjusting to reflect the impact of the super deduction regime.</p> <p>On the 'SystemOperator' sheet, we have added blue box rows to enable opening balance adjustments for general and special rate tax pools. These rows are 'General Pool Opening Balance Adjustment' and 'Special Rate Pool Opening Balance Adjustment'.</p> <p>The cell colour signifies that these cells will become PCFM Variable Values that can therefore be updated as part of the Annual Iteration Process.</p> <p>These new rows have been linked to the 'Revisions' rows within the 'SystemOperator' sheet under General and Special pools.</p>	System Operator	E55, G55, H55, AP55:AT55, E56, G56, H56, AP56:AT56, AP318:AT318, AP329:AT329
ESO	<p>To allow for the impact of the super deduction tax regime to be reflected we have updated the tax paid calculation within the 'SystemOperator' sheet.</p> <p>We have added 'Contributions to losses from clawback' and 'Adjustments to losses from tax trigger' in the tax paid calculation.</p> <p>We have updated the formula in the 'profits reduced by tax losses' row to account for these new rows</p>	System Operator	E651, G651, AP651:AT651, E652, G652, AP652:AT652, AP653:AT653
ESO	<p>Within a tax year the ESO could potentially elect to transfer some or all of its intangible assets from the intangible pool to the general pool.</p> <p>We have added the 'Transfer intangible assets to the general pool' row to the 'SystemOperator' sheet to enable this transfer between intangible and general pools.</p> <p>The cell colour signifies that these cells will become PCFM Variable Values that can therefore be updated as part of the Annual Iteration Process.</p>	System Operator	E57, G57, H57, AP57:AT57, AP319:AT319, AP360:AT360

	The values in 'Transfer intangible assets to the general pool' are linked to the 'Capex additions' rows under the Capital allowances section for the general and intangible pools.		
ESO	<p>The values for ESO Incentive and Bad Debt are not influenced by inflationary increases or decreases. As such, we have altered the input price bases for these PCFM Variable Values to nominal prices.</p> <p>To allow for this update we have also amended the formulas for the 'Bad debt allowance' and 'Reporting & Incentive Arrangments' in the 'SystemOperator' sheet to convert the nominal prices to £18/19 prices.</p>	System Operator	G20, AP20, AQ20, G31, AP31, AQ31, AP188:AT188, AP206:AT206
ESO	<p>The Final Determination annex confirmed that the capitalisation rate for ESO would be confirmed alongside the ESO's Business Plan 2.</p> <p>As such, we propose to change the colour of the capitalised share of totex cells from yellow to blue. A blue cell in the PCFM signifies that a value is a PCFM Variable Value and therefore can be updated through the Annual Iteration Process.</p>	System Operator	AR168:AT168

Appendix 2 – Location of modifications within the Price Control Financial Handbook

Sector	Nature of Modification	Page number
ET2	General updates and tidying up	1
ET2	Variable Value table 3.1 updated per PCFM Modifications described above.	31
ESO	General updates and tidying up	1
ESO	Variable Value table 3.1 updated per PCFM Modifications described above.	23, 24