

To:
National Grid Electricity System Operator Limited

Electricity Act 1989
Section 11A(1)(a)

**Modification of the Special Conditions of the electricity transmission licence held
by National Grid Electricity System Operator Limited**

1. National Grid Electricity System Operator Limited (NGESO) is the holder of an electricity transmission licence ('the Licence') granted or treated as granted under section 6(1)(b) of the Electricity Act 1989 ('the Act').
2. Under section 11A(2) of the Act the Gas and Electricity Markets Authority ('the Authority')¹ gave notice on 30 June 2023 ('the Notice') that we proposed to modify:
 - Special Condition 1.1 ('SpC 1.1')
 - Special Condition 2.12 ('SpC 2.12')
 - Special Condition 4.2 ('SpC 4.2')
 - Special Condition 4.7 ('SpC 4.7')
 - Special Condition 5.1 ('SpC 5.1')
 - Special Condition 5.2 ('SpC 5.2')
 - housekeeping amendments to Chapter 1 of the special conditions of the Licence.

We stated that any representations to the modification proposal must be made on or before 28 July 2023.

3. A copy of the Notice was sent to the Secretary of State in accordance with section 11A(4)(b) of the Act, and we have not received a direction that the change should not be made.
4. We received one response to the Notice, which we carefully considered. We have placed the non-confidential response on our website. The response was supportive of the proposed changes. Our reply to this response is set out in full in the accompanying letter.
5. It is necessary to make a number of minor alterations to the modifications set out in the Notice. These alterations are shown in yellow highlight in the modified Special Licence Conditions. The reasons for any differences between the modifications set out in the Notice and the modifications reflected in the Special Conditions of the Licence published alongside this Notice are to address minor issues and corrections raised in the consultation response (please see the Issue Log published alongside this Notice for more detail).
6. The reason why we are making these Licence changes is to implement our RIIO-2 Business Plan 2 (BP2) Final Determinations² and improve the clarity of the Licence and its relationship with the Price Control Financial Instruments (PCFIs) established by the Licence, for both the ESO Price Control Financial Model (PCFM) and the ESO

¹ The terms "Ofgem", "the Authority", "we" and "us" are used interchangeably in this document.

² [Business Plan 2 Final Determinations - Electricity System Operator | Ofgem](#)

Price Control Financial Handbook (PCFH) following our PCFM Working Groups earlier this year.

7. The effect of the modifications will be to:
- Provide provisions of general interpretation necessary for efficient drafting, and remove unnecessary wording;
 - Align conditions with other sectors;
 - Provide clarity regarding the tax reconciliation assurance statement and SpC 4.2 Part I “Tax Allowance Adjustment”;
 - Enable NGESO to access the full NIA funding set for RIIO-2;
 - Align SpC 2.12 Tax Reconciliation assurance statement with other sectors and provide clarity regarding the tax reconciliation assurance statement;
 - Remove the wording regarding an Annual Iteration Process re-publication from SpC 5.2 (Annual Iteration Process for the ESO Price Control Financial Model), as well as to provide further clarity in the condition. This is in-line with our approach in Gas Distribution and Electricity Transmission where we have removed the wording related to a re-publication of the AIP in our recent decision.³
8. Where an application for permission to appeal our decision is made to the Competition and Markets Authority (CMA) under section 11C of the Act, Rule 5.7 of the Energy Licence Modification Appeals: Competition and Markets Authority Rules⁴ requires that the appellant must send to any relevant licence holders who are not parties to the appeal a non-sensitive notice setting out the matters required in Rule 5.2. The attached Schedule 2 provides a list of the relevant licence holders in relation to this modification. Section 11A(10) of the Act sets out the meaning of ‘relevant licence holder’.

Under the powers set out in section 11A(1)(a) of the Act, we hereby modify the Special Conditions of the Electricity Transmission Licence held by NGESO in the manner specified in the document published alongside this modification. This decision will take effect from 07 October 2023.

This document is notice of the reasons for the decision to modify the Licence held by NGESO as required by section 49A(2) of the Act.

Grendon Thompson
Interim Deputy Director
Institutions for Net Zero, Energy Systems Management and Security
Duly authorised on behalf of the
Gas and Electricity Markets Authority

11 August 2023

³ <https://www.ofgem.gov.uk/publications/decision-modifications-price-control-financial-instruments-and-licence-conditions-gas-transmission-gas-distribution-and-electricity-transmission>

⁴ CMA70 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/655601/energy-licence-modification-appeals-rules.pdf

Appendix 1 Changes to the ESO Price Control Financial Model (PCFM)

A1.1 The PCFM containing the modifications is attached as a schedule to this decision. The changes have been highlighted with red borders. A summary of the changes follows below.

Part A: Changes to the price base of pass-through terms in the PCFM for ESO

A1.2 The modifications made to the ESO PCFM are as follows:

- Amended the price base of Business Rates Payments (RB_t) pass-through costs in the "System Operator" sheet in the "Units" column to "£m nominal"; and
- Amended the formula in the "SystemOperator" sheet in cells AP193:AT193 to convert the RB_t pass-through cost line items to £m 18/19 prices, now that they are recorded as £m nominal in the input line item.

Part B: Changes to the capitalisation rates

A1.3 The modifications made to the ESO PCFM are as follows:

- Updated the capitalisation rates in row 176 to 38.3% and 37.6% for 2023/24 and 2024/25 respectively per Final Determinations⁵; and
- Changed the colour of the cells in row 176 from blue to beige for 2023/24 and 2024/25 to reflect the fact they are now fixed input values.

Part C: Added the pass-through term in the PCFM for ESO relating to FSO

A1.4 The modifications made to the ESO PCFM are as follows:

- Added a new pass-through input line item for FSO_t ;
- Added one row which links to the new pass-through input line item per our current PCFM structure and converts from £m nominal to £m 18/19 prices; and
- Amended the formula in row 199 to correctly sum the new FSO_t line.

A1.5 We are aware that the ESO may face tax liability in the 2023/24 Regulatory Year relating to the FSO transition costs on capital expenditure. In the PCFM, per the ESO BP2 WGs and the proposed licence modifications, the FSO costs will be a pass-through term

⁵ [Business Plan 2 Final Determinations - Electricity System Operator | Ofgem](#)

subject to 100% tax relief as it is treated as Operating expense (Opex) for tax purposes, and will therefore not generate a tax allowance. We do not think it is appropriate to make any amendment to the PCFM to this affect given the uncertainty around the transition from ESO to FSO, as the final tax position (including any tax liability from costs relating to the FSO to ESO transition) of the ESO should be discussed and resolved within the commercial arrangement itself.

Part D: Formula corrections and general housekeeping in the ESO PCFM

A1.6 The modifications made to the ESO PCFM are as follows:

- Amended the formula in cell AP337 in the "SystemOperator" sheet to align correctly with the formula the other cells in this row relating to capex additions.

Appendix 2 Changes to the ESO Price Control Financial Handbook (PCFH)

A2.1 The PCFH containing the modifications is attached as a schedule to this decision. The changes are tracked. A summary of the changes and where they appear follows below.

Part A: Removal of the wording regarding re-publication of the ESO PCFM

A2.2 The modifications to the PCFH can be seen in the attached schedule. We have removed the section titled “Re-publication of the ESO PCFM after 30 November”.

A2.3 The modifications made to the PCFH can be seen in:

- Chapter 2 “The ESO PCFM and the Annual Iteration Process”

Part B: Updating Chapter 5 to align with RIIO-ED2 and Regulatory Financial Performance Reporting (RFPR) Guidance and template

A2.4 In the tax chapter we have made updates to align the language with RIIO-ED2 and the language used in the RFPR Guidance and template.⁶

A2.5 The modifications made to the PCFH can be seen in:

- Chapter 5 “Tax Liability Allowances”

Part C: General Housekeeping

A2.6 Throughout the PCFH we have made amendments for general housekeeping purposes to improve clarity and additional detail where needed.

A2.7 The modifications made to the PCFH can be seen in:

- Chapter 1 “Introduction”
- Chapter 2 “The RIIO-XX2 PCFM and the Annual Iteration Process”
- Chapter 3 “The PCFM Variable Values”
- Chapter 4 “Cost of debt and cost of equity indexation”
- Chapter 5 “Tax Liability Allowances”

⁶ [Decision on the proposed modifications to the RIIO-2 Electricity Distribution licences | Ofgem](#)

- Chapter 6 “Pensions”
- Chapter 7 “Legacy Adjustments”
- “Appendices”