



Making a positive difference
for energy consumers

National Grid plc and Interested
Parties

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Date: 27 Mar 2024

Dear colleagues

Statutory Consultation on ET Special Licence Condition 6.1

Introduction

This letter describes the background to and reasons for the statutory consultation that we are undertaking. The acquisition of the Electricity System Operator ("ESO"), from National Grid plc by His Majesty's Government ("HMG"), and the creation of the National Energy System Operator ("NESO")¹, under public ownership as a result of the Energy Act (2023), requires changes to pension arrangements. These have been agreed in broad outline between National Grid and HMG, and this statutory consultation is to implement the required changes to the National Grid Electricity Transmission ("NGET") licence to effect this.

Our intention is that consumers will not face an increase in total costs as a result of these changes. These licence changes are intended to ensure that total pension costs are split between NGET and the NESO, by allowing a pass through of those pension costs which will apply to NESO employees as well as certain active and deferred members of the pension scheme who were employees of the ESO but are not transferring to the NESO.

¹ Previously referred to as the Future System Operator ("FSO").

Background

In February 2024 we published a Call for Input² regarding proposed changes to the pension arrangements for certain members of the NGE. We set out the background to the proposed changes and we summarise that background here.

National Grid is currently the sponsoring employer of a defined benefit pension scheme, the National Grid Electricity Group of the Electricity Supply Pension Scheme (“NGEG”). In establishing the NESO, the ownership of the ESO will transfer from National Grid to HMG. This will necessitate a formal separation of the pension liabilities.

The Department for Energy Security and Net Zero (“DESNZ”) is negotiating with National Grid and has responsibility for establishing the NESO.³ The Secretary of State will be the sole shareholder of the NESO.⁴ DESNZ has considered options regarding the treatment and future funding of pension liabilities with the transfer of the ESO from National Grid to HMG. DESNZ has indicated that there should be the creation and establishing of a new pension scheme for employees who are active members of NGE and who transfer to the NESO; and that deferred and pensioner members who previously worked in the ESO (but are not transferring over to the employ of the NESO) will remain members of the NGE.

This means that while the costs and risks associated with the deferred and pensioner members who previously worked in the ESO are currently funded as a pass-through cost through the ESO price control, those same costs and risks will not be funded through the NESO price control after separation date.

National Grid has therefore raised the need for changes to the Electricity Transmission Licence of National Grid Electricity Transmission plc (“NGET”) designed to avoid exposing NGET to the costs and risks associated with the deferred and pensioner members of the ESO who will remain within the NGE after separation date.

We are here proposing licence changes that, if adopted, this would result in the creation of a mechanism to allow cost recovery, via the NGET Licence, as an ET pass-through item in the RIIO-ET2 Price Control.

² [Call for Input – Pension scheme arrangements for National Grid employees transferring to the Future System Operator \(National Energy System Operator or NESO\) \(ofgem.gov.uk\)](#)

³ [Future System Operator - Second Policy Consultation and Update \(publishing.service.gov.uk\)](#)

⁴ [Draft: Strategy and policy statement for energy policy in Great Britain \(accessible webpage\) - GOV.UK \(www.gov.uk\)](#)

Our intention is that these licence changes adhere to two general principles:

- That consumers should be held neutral in funding pension costs under the new arrangements, relative to the current policy for the ESO; and
- That any solution be linked to Ofgem’s current pension policy⁵ and Pension Principles, and in particular, the principles regarding stewardship.⁶

Responses to the Call for Input

We received two responses to our Call for Input. One was from National Grid and another interested party.

National Grid’s response deals with the regulatory treatment of costs associated with non-transferring NGEG Deferred and Pensioner members. These costs are currently recovered as a pass-through cost under the NGESO price control. In their view the simplest and most equitable approach is to create a new pass-through cost recovery term in the NGET electricity transmission licence which would maintain the same pass-through approach for these costs as is currently provided in the NGESO Licence. This would maintain that NGET and its consumers are maintained in the same risk position as currently.

The interested party, stated that, over the past few years, a number of scheme sponsors (i.e. employers) have limited the value of annual pension increases to between 5% and RPI. In addition, because of Contracting Out, a large number of members do not qualify for a full state pension, and they feel they were disadvantaged by Contracting Out. They went on to note that:

“With the creation of the new NESO, that will be a public company, owned by the government, if the rules regarding limiting the increase to less the RPI still apply, you will have the bizarre scenario, that members in receipt of state pension will get full RPI, due to the triple lock, but won’t get full RPI on their NESO pension, which will also be paid by the government.”

⁵ <https://www.ofgem.gov.uk/publications/decision-ofgems-policy-funding-pension-scheme-established-deficits>

⁶ [Price Control Treatment of Network Operator Pension Costs Under Regulatory Principles](#)

Our Response

We are broadly in agreement with the points National Grid has made and our proposed Licence changes seem to us to be the simplest way of preserving cost neutrality for consumers in a way that meets DESNZ's intent regarding transfer of active employees to the NESO.

Although we are mindful of the other interested party's concerns regarding the treatment of pensioners by the ESPS, this is not something that is being addressed in this consultation or within our legal duties. However, where schemes have applied increases above 5%, this is at their discretion, who funds this can be reviewed as part of our triennial reasonableness review⁷, where we will consider whether this is consistent with the Pension Principles and is in the interest of existing and future consumers.

Current Licence Condition and Proposed Changes

We are consulting on amending the NGET Special Licence Condition 6.1 to permit the pass through of costs for deferred members and active pensioners of the NGESO who will not become members of the new NESO pension scheme that is to be created.

Consultation Details and Timelines

We are inviting views on the proposed modifications to the NGET Special Licence set out in Appendix 1 and 2. Please provide your views, preferably by email, to regfinance@ofgem.gov.uk, on or before **24 April 2024**.

We normally publish all responses on our website. However, if you do not wish your response to be made public then please clearly mark it as confidential. We prefer to receive responses in an electronic form so that they can be placed easily on our website. If you would prefer to reply by post, please address this to:

John Bolitho
Ofgem
10 South Colonnade
Canary Wharf
London
E14 4PU

⁷ [Revised pension allowance values and completion of 2023 reasonableness review | Ofgem](#)

If you have any questions regarding this letter, please contact regfinance@ofgem.gov.uk.

Yours faithfully

Mick Watson
Chief Financial Advisor, Deputy Director
Financial Resilience & Controls

Appendix 1. – Notice of statutory consultation

To: National Grid Electricity Transmission plc (02366977)

Electricity Act 1989 Section 11A(2)

Notice of statutory consultation on a proposal to modify the special conditions electricity transmission licence held by National Grid Electricity Transmission plc

1. The Gas and Electricity Markets Authority ('the Authority')⁸ proposes to modify the special conditions of the electricity transmission held by National Grid Electricity Transmission plc ("NGET") granted or treated as granted under of the Electricity Act 1989 by amending special condition 6.1.
2. We are proposing these modifications to facilitate the changes required to allow NGET to pass through costs relating to the pension arrangements for employees transferring to the National Energy System Operator (as well as deferred and active pensioners of the Electricity System Operator).
3. The effect of the proposed modifications is to hold consumers neutral to these changes.
4. A copy of the proposed modifications and other documents referred to in this Notice have been published on our website (www.ofgem.gov.uk). Alternatively they are available from information.rights@ofgem.gov.uk.
5. Any representations with respect to the proposed licence modifications must be made on or before **Wednesday 24th April** to: John Bolitho, Office of Gas and Electricity Markets, 10 South Colonnade, Canary Wharf, London, E14 4PU or by email to RegFinance@Ofgem.gov.uk.
6. We normally publish all responses on our website. However, if you do not wish your response to be made public then please clearly mark it as not for publication. We prefer to receive responses in an electronic form so they can be placed easily on our website.
7. If we decide to make the proposed modifications they will take effect not less than 56 days after the decision is published.

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Mick Watson
Deputy Director, Financial Resilience & Controls
Duly authorised on behalf of the Gas and Electricity Markets Authority
27th March, 2024

⁸ The terms "the Authority", "we" and "us" are used interchangeably in this document.

Appendix 2. -

We have included the sections of the special conditions we are proposing to amend below. Deletions are shown in strike through and new text is double underlined.

Chapter 1: Interpretation and definitions

NGESO	Means National Grid Electricity System Operator Limited
<u>Incremental Deficit</u>	<u>has the meaning given in the Pensions RIGs</u>
<u>Future System Operator (FSO)</u>	<u>means the body that will be designated as the Independent System Operator and Planner (ISOP under the Energy Act (2023))</u>
<u>Pension Protection Fund</u>	<u>has the meaning given in the Pensions RIGs</u>
<u>Pensions Regulator</u>	<u>Has the meaning given in the Pensions Act 2004</u>
<u>Pension RIGS</u>	<u>means the guidance document issued by the Authority titled 'Network Operators' Price Control Pension Costs - Regulatory Instructions and Guidance: Triennial Pension Reporting Pack supplement including pension deficit allocation methodology</u>
<u>Pre Cut-Off Date Regulatory Fraction</u>	<u>has the meaning given in the Pensions RIGs</u>
<u>System Operator Pension Transfer Costs</u>	<u>means pension scheme costs properly incurred by the licensee that otherwise would not be incurred as a consequence of any transfer of assets and rights under Schedule 10 of the Energy Act 2023</u>

Chapter 6: Pass-through expenditure

Special Condition 6.1 Pass-through items (PT_t)

Introduction

- 6.1.1 The purpose of this condition is to calculate the term PT_t (the allowed pass-through term). This feeds into Calculated Revenue in Special Condition 2.1 (Revenue restriction).

6.1.2 The effect of this condition is to ensure that the licensee's Allowed Revenue reflects that certain costs can be passed through to Users.

Part A Formula for calculating the allowed pass-through term (PT_t)

6.1.3 The value of the PT_t term is derived in accordance with the following formula:

$$PT_t = RB_t + EDE_t + TPD_t + \underline{ESOP_t}$$

where:

RB_t means the amount levied on the licensee in respect of the Prescribed Rates or an amount directed under Part B;

EDE_t means the payments in relation to the Pension Scheme Established Deficit repair expenditure for each Regulatory Year, as further explained and elaborated upon in the ET2 Price Control Financial Handbook; ~~and~~

TPD_t means the temporary physical disconnection costs incurred by the licensee in relation to interruption payments made by the System Operator as part of its balancing services activity in the licensee's Transmission Area that are charged to the licensee in accordance with the provisions of the STC; and

ESOP_t means the System Operator Pension Transfer Costs and is derived in accordance with Part C.

Part B Review of Prescribed Rates pass-through term (RB_t)

6.1.4 As part of any periodic revaluation, the licensee must:

(a) engage with the Relevant Valuation Agency; and

(b) use its reasonable endeavours to minimise the amount of the Prescribed Rates to which it is liable.

6.1.5 If, after reviewing the licensee's engagement with the Relevant Valuation Agency and any further information required from the licensee with respect to a particular revaluation, the Authority considers that the licensee has not complied with paragraph 6.1.4, the Authority will adjust the value of RB_t by direction.

Part C Formula for calculating ESOP_t

6.1.6 ESOP_t is derived in accordance with the following formula:

$$\underline{ESOP_t = LSOIDE_t + LSOEDE_t + FSOE_t + FSOO_t}$$

where:

LSOIDE_t has the value directed by the Authority and means the payments made by the licensee in relation to the Incremental

Deficit for each Regulatory Year in respect of legacy pensioner and deferred pension members attributed to NGESO;

LSOEDE_t has the value directed by the Authority and represents the adjustment to offset any negative value incurred by the licensee for each Regulatory Year in relation to the Pension Scheme Established Deficit in respect of legacy pensioner and deferred pension members attributed to NGESO, including (for avoidance of doubt) any stranded surplus clawback, as further explained and elaborated upon in the ET2 Price Control Financial Handbook;

FSOE_t has the value directed by the Authority and represents the fair allocation of payments made by the licensee for external costs relating to the National Grid Electricity Group of the Electricity Supply Pension Scheme for each Regulatory Year as specified in paragraph 6.1.7 multiplied by the Pre Cut-Off Date Regulatory Fraction for NGESO, excluding any costs recovered by the licensee via NGESO as part of the FSO transition cost recovery process; and

FSOO_t has the value directed by the Authority and represents for each Regulatory Year other System Operator Pension Transfer Costs, excluding any costs recovered by the licensee via NGESO as part of the FSO transition cost recovery process.

6.1.7 Costs properly incurred by the Licensee for the purposes of calculating FSOE_t are:

- (a) scheme management and administration costs, including all explicitly charged investment fees and regulatory imposed costs such as Pension Protection Fund and related levies and other non-controllable costs of meeting regulatory requirements of the Pensions Regulator and all relevant statutory requirements;
- (b) reasonable pension liability management costs including the cost of early retirement, voluntary redundancy, flexible retirement options, transfer and pension increase exchange (PIE) exercises, and
- (c) such project costs incurred.

6.1.8 The licensee may submit evidence to the Authority of such other System Operator Pension Transfer Costs that in their view should be included in the calculation of FSOE_t.

