

Please note that the proposed changes to this document have been drafted in ***bold italics and highlighted*** for ease of identification.

Guidance

Licence fee cost recovery principles proposed changes Jan 24

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This document is for gas transportation, electricity transmission and distribution licensees. It explains the licence fee cost recovery principles which are referenced in licence conditions.

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1. Introduction

1.1. The principles covered in this document set out the arrangements for making payments to the Gas and Electricity Markets Authority ('the Authority').

1.2. Under the Standard Licence Condition (SLC) entitled 'Payments by Licensee to the Authority' (SLC 3 in gas transportation licences and SLC A4 in electricity transmission licences, and SLC 5 'Licensee's payments to the Authority' in the electricity distribution licences), the amount to be paid annually by the licensee is an 'appropriate proportion' of the amounts specified in paragraphs 2(a)–2(e) of the gas transportation SLC, paragraphs 3(a)–3(e) of the electricity transmission SLC, paragraphs 5.1(a)–5.1(l) of the electricity distribution SLC; of any credit notes issued by the Authority, as noted in paragraph 3 of the gas transportation SLC, paragraph 4 of the electricity transmission; and any adjustment by reference to the actual costs of the previous year in SLC paragraph 5.1(m) of the electricity distribution SLC.

1.3. The 'appropriate proportion' is defined as 'the proportion of the costs attributable to the licensee in accordance with principles determined by the Authority for the purposes of this condition generally (after consultation with the licensee and others likely to be affected by the application of those principles) and notified to the licensee'. This document sets out the principles determined by the Authority for the purpose of calculating the 'appropriate proportion' in relation to the three types of licence referred to in paragraph 1.2 above.

1.4. The principles will be kept under review in the light of any material changes in circumstances, including any modifications made to the 'Payments by Licensee to the Authority' SLCs or where there has been a significant change in ownership of a licensed gas or electricity network. Ofgem would expect to consult licensees before making any changes to the principles.

2. The principles

Purpose

2.1. These principles set out the arrangements for making payments to the Authority.

Legal status

2.2. These principles constitute the principles for the purpose of the 'Payments by Licensee to the Authority' or 'Licensee's payments to the Authority' SLCs and explain how the Authority will calculate the total amount payable under these SLCs for each licence holder that has this SLC included in its licence. They will apply for the financial year 2024-25 and subsequent years until changed after consulting licensees.

The principles

2.3. All the costs that will be recovered by Ofgem will be recovered from the network businesses that hold the following types of licence:

- gas transportation;
- electricity transmission licences where the licensee has been issued with a Section C (system operator standard conditions) Direction which is still in effect; and
- electricity distribution.

2.4. The costs that will be recovered by Ofgem through the 'Payments by Licensee to the Authority' or 'Licensee's payments to the Authority' SLCs comprise in relation to a relevant year the estimate of:

- Ofgem's costs, being the net of:
 - All Ofgem's own costs, including **Ofgem's set up and ongoing costs related to the regulation of Heat Networks**, less Ofgem's exceptional costs (see paragraph 2.5.) and less Ofgem's own costs that will be recovered by means other than through the use of the 'Payments by Licensee to the Authority' or 'Licensee's payments to the Authority' SLCs (see Appendix 1); and
 - All Ofgem's own income. For the purposes of these principles Ofgem's own income excludes the income recovered through the 'Payments by Licensee to the Authority' or 'Licensee's payments to the Authority' SLCs;
- the appropriate proportion of the costs of Citizens Advice, Citizens Advice Scotland and Consumer Scotland which form part of the advocacy work plan related to the energy sector;
- the costs of the Secretary of State and Office for Product Safety and

Standards within **the Department for Business and Trade (DBT)** which relate to statutory metrology services; and

- any other adjustments, which will be explained in the letter accompanying the licence fee invoice.

- 2.5. In any year where the Authority needs to recover exceptional costs the method for recovering these costs will either be disclosed in the forward work plan for that year or, if this is not possible, in the letter accompanying the licence fee invoice. Exceptional costs comprise significant costs that in the opinion of the Authority cannot be divided between gas and electricity licence holders without unreasonably penalising either gas or electricity customers.
- 2.6. The method for determining the number of gas and electricity customers is defined in Appendix 3. All the types of licence holder identified in paragraph 2.3 will be required to make formal returns, showing the number of customers on 30 September of the preceding year, to the Authority by 1 May in each year. It is this number which is used in the following calculations.
- 2.7. The costs that will be recovered by Ofgem as defined in paragraph 2.4 will be recovered from the gas licence holders holding the type of licence identified in paragraph 2.3 based on the following proportion:

$$\frac{\text{Total gas customers to}}{\text{Total gas customers plus total electricity customers}}$$

- 2.8. The costs that will be recovered by Ofgem as defined in paragraph 2.4 will be recovered from the electricity licence holders holding the types of licence identified in paragraph 2.2 based on the following proportion:

$$\frac{\text{Total electricity customers}}{\text{to}} \\ \text{Total gas customers plus total electricity customers}$$

- 2.9. For gas licence holders, half of the amount recoverable will be allocated to the National Transmission System (NTS) and half of the amount recoverable will be allocated to licensed gas transportation networks that are not the NTS. For the purposes of this document the NTS is that part of the system for the time being designated by National Grid Gas plc as such and described in National Grid Gas plc's Ten Year Statement.
- 2.10. The amount payable by National Grid Gas plc in its role as the owner of the NTS will be half of the total charge to gas transportation licence holders.

- 2.11. The amount payable by a gas transportation licence holder in its role as owner of a licensed gas transportation network that is not the NTS will be determined by the proportion of:

**Number of gas customers that are directly connected to any licensed gas
transportation network of the licence holder that is not the NTS**

to

Total number of gas customers

- 2.12. For electricity licence holders, one half of the amount recoverable will be allocated between the holders of an electricity transmission licence that has a Section C (system operator standard conditions) Direction in effect in their licence (at present this is only National Grid Electricity System Operator Limited who will therefore pay the whole of the transmission portion) and one half of the amount recoverable will be allocated between electricity distribution licence holders¹.
- 2.13. The amount payable by each holder of an electricity distribution licence will be determined by the proportion of:

**Number of electricity customers that are directly connected to any
licensed electricity distribution network of that electricity distribution
licence holder**

to

Total number of electricity customers

- 2.14. For price control purposes, the licence fee is treated as a pass-through cost.
- 2.15. Under BETTA, Ofgem amended the special conditions of each of the transmission licensees to allow recovery of the licence fee from the system operator rather than all transmission licensees. For transmission owners Ofgem retained the licence fee component in the price control but set it at zero from BETTA go-live. For the GB system operator, the licence fee component of its price control was increased to allow recovery of the total electricity transmission element of the licence fee. On 22 February 2005 Ofgem issued notices to the three transmission licensees in accordance with section 11 of the Electricity Act 1989 which included these proposals.

¹ Were more than one Transmission licensee to have Section C of the transmission SLCs in effect in their licenses, further changes would be required to the principles to consider the allocation of the transmission portion between these parties.

- 2.16. A reconciliation between the final version of the forward work plan for the relevant year, the budget voted by Parliament for the relevant year and the total sum being recovered for the relevant year through the 'Payments by Licensee to the Authority' or 'Licensee's payments to the Authority' SLCs will accompany invoices for licence fees.
- 2.17. The minimum licence fee payable will be £500 a year. Where the amount due under the formula set out above is less than this it will be rounded up to £500.
- 2.18. New licensees will not be included in the current financial year's licence fee. They will be included in their first full financial year of operation instead. For example, if the licence is granted in April 20X1 then the first licence fee will be paid in July 20X2.
- 2.19. Where licences have been revoked during the year, the licence fee is still payable for the current financial year. For example, if the licence is revoked in October 20X1 then a licence fee is still payable in July 20X1 and January 20X2. But no fee would be payable for July 20X2.
- 2.20. Ofgem may charge interest on fees which are not paid within 30 days of the invoice date.
- 2.21. Late fees or non-payment of fees may result in enforcement action.
- 2.22. Credit notes for any prior year surplus will be issued alongside the invoice for the following year. For example, 20X1 credit notes will be sent out with 20X2 invoices. This will allow licencees to offset the credit note against the new invoice if they choose. This is expected to be in July of each year (although if we have received all of the customer number information by mid-May and have final figures for the prior year, we may be able to issue invoices and credit notes in June). We will continue to ask for payment of licence fee invoices within 30 days from the invoice date.
- 2.23. If licencees do not wish to offset or are not able to do this, then we request that bank details be provided to Ofgem (on company letterhead sent to invoices@ofgem.gov.uk) to allow Ofgem to settle the credit note. If you would prefer this option, please provide the details in June to facilitate prompt payment.
- 2.24. Licence fees exceeding the £500 minimum will be payable in two tranches each year (tranche 1 and tranche 2).
- 2.25. Licencees paying the minimum £500 fee will continue to be billed for the full £500 in tranche 1 and nil in tranche 2. These parties will be excluded from the process to return funds unspent from the prior year so as not to burden them, and therefore consumers with additional transaction costs.
- 2.26. We are aware that licencees may need to raise a purchase order for the licence fee and that it is necessary to have advanced notice of the payment amount. Please contact invoices@ofgem.gov.uk in late May or early June to request the provisional amount. We cannot calculate the amounts until we receive all customer numbers from all licencees so we will provide an estimate of the invoice amount as soon as we can. Licencees should then send us the PO numbers in June to allow us to raise the invoice on a timely basis.

2.27. An overview of the process is set out in the summary below:

December to March

Ofgem consult on and publish a Forward Work Plan for the next year.

June

Ofgem agrees annual budget with HM Treasury, budget is laid before Parliament (Main Estimates).

The calculation for Tranche 1 invoices is prepared by Ofgem.

Purchase order numbers for Tranche 1 should be submitted to invoices@ofgem.gov.uk.

End June - July

Main Estimates figures are published.

Letters and invoices are issued for Tranche 1.

Credit notes are issued for any over-recovery from the prior year.

July – August

Tranche 1 payments are due 30 days after invoice date.

November

Ofgem agrees and changes to annual budget with HM Treasury (Supplementary Estimates).

The calculation for Tranche 2 invoices is prepared by Ofgem.

Purchase order numbers for Tranche 2 should be submitted to invoices@ofgem.gov.uk.

December

Letters and invoices are issued for Tranche 2.

January

Supplementary Estimates are laid before Parliament.

Tranche 2 payments are due 30 days after invoice date.

February

Supplementary Estimates figures are published.

Appendix 1 - Costs

Budget framework

1.1. To minimise our costs on consumers whilst maximising the impact we have, it is recognised that we have a responsibility to achieve value for money from all our activities. Ofgem set a Forward Work Plan each year and seek approval for the cost of this work from Parliament each year through the Supply Estimates process.

1.2. The Supply Estimates process is the way by which Ofgem and other government departments seek Parliamentary approval for their annual spend. An initial spending plan is put forward at the [Main Estimates](#), and any changes during the year are reflected in the [Supplementary Estimates](#). The approved budgets are published by HM Treasury.

What costs are included

1.3. All Ofgem's administration and depreciation costs will be included.

1.4. Expenditure which is not funded by licence fee is excluded. The main areas are within **Delivery & Schemes** and Offshore Tender.

1.5. **Delivery & Schemes** chiefly undertakes work on behalf of other government departments (such as scheme administration for Renewable Obligation, Feed-in Tariff, Domestic and Non-Domestic Renewable Heat Incentive) and these costs are recovered directly, either from the respective government departments (**such as The Department for Energy Security and Net Zero**), or from the scheme itself.

Setting our budget

1.6. Our budget setting process is led by our senior leadership team. We prioritise those activities that we expect to deliver the greatest value for consumers.

1.7. Our activities are split into projects and core business. Where project expenditure is lower than planned, savings are reassessed to ensure that the correct work is commissioned to achieve our strategic objectives.

Flexibility for future activities

1.8. The nature of some projects and legal cases undertaken by Ofgem can be quite significant in relation to the size of our overall budget. An unexpected major new project or a lengthy regulatory appeal could therefore have significant implications for the budget (and the costs potentially charged to licensees).

1.9. Any increase in Ofgem's budget must be approved by HM Treasury and then Parliament. If an increase is approved and the activity is funded through licence fees, then we will inform licensees that this amount will be recovered. Whilst Ofgem would aim to give licensees advance notification of such an event, this may not always be possible.

Year-end savings or overspend

1.10. Any licence fee saving identified at year-end will be returned to those who funded it, in line with the original apportionment calculation. Once the final position has been calculated and audited (usually in June or July), credit notes will be issued for any funds to be returned.

1.11. The treatment of any overspend would have to be agreed with HM Treasury and any additional costs would be communicated to licensees in a separate letter. Ofgem's senior leadership² monitor performance against budget on a monthly basis and action taken to mitigate the risk of overspending. An overspend would only occur in exceptional circumstances.

1.12. Ofgem will ensure that progress and details of any savings or overspend are fully transparent to licence fee payers. Information will be provided in the following ways:

- *Forward Work Programme*
Improving our efficiency and effectiveness for consumers is an essential element of our Forward Work Programme.
- *Annual Report and Accounts*
Ofgem's Annual Report and Accounts, which is audited by the National Audit Office, will detail the savings or overspend outstanding at the financial year end.
- *Licence fee request*
Reconciliations between the Forward Work Plan, costs approved by Parliament, and the licence fee will be provided in the letter accompanying the invoices.

² Managing public money: <https://www.gov.uk/government/publications/managing-public-money>

Appendix 2 - Licence fee calculation template

The total cost to licence fee payers for Ofgem will be £xx,xxx million. The calculation is as follows:

	£000	£000
Ofgem gross expenditure 20xx-xx ¹		xx,xxx
Less <i>Delivery & Schemes</i> related income:		
• Administration of environmental schemes excluding Renewable Energy Guarantees Origin	(xx,xxx)	
• Renewable Energy Guarantees Origin ²	<u>-(xxx)</u>	(xx,xxx)
Less other income:		
• Offshore tenders and competition income	(x,xxx)	
• Income which is not funded by the licence fee	<u>(x,xxx)</u>	(xx,xxx)
Ofgem net cost to licence fee payers		xx,xxx
Add other relevant organisation costs:		
• Advocacy costs ³		xx,xxx
• Metrology costs ⁴		xx,xxx

¹ Ofgem gross costs will be shown in the Forward Work Programme and the Main/ Supplementary Estimate.

² Administration of the Renewable Energy Guarantees Origin (REGO) is not funded through the licence fee.

³ Payments to **DBT** which represent the energy-sector related costs of Citizens Advice. This is an estimate based on the prior-year budget, which will be amended in the second-tranche licence fee request.

⁴ Payments to **DBT** in respect of their statutory responsibility to undertake metrology services.

Relevant details concerning actual licence fee calculations for future years will be set out in that year's Forward Work Programme and licence fee request.

Appendix 3 - Definition of gas and electricity customers

The same basis for defining gas customers applies to all gas transportation licence holders for the purposes of this document.

A gas customer is:

A customer means any person to whose premises or pipe-line system gas has been conveyed by a Gas Distribution Network. Customers should be identified from their unique Supply Meter Point Reference Number (MPRN) or connected system exit point (CSEP) location. The method adopted by GDNs to identify customers from their MPRNs or CSEPs shall be agreed in advance with the Gas and Electricity Markets Authority (the "Authority").

Source:

- The above definition of gas customers has been extracted from version 5 of the QoS RIGs.
- The same basis for defining electricity customers applies to all electricity transmission and electricity distribution licence holders for the purposes of this document.

An electricity customer is:

Any energised or de-energised entry or exit point to the licensed electricity distribution system, where metering equipment is used for the purpose of calculating charges for electricity consumption. Customers should be identified from Metering Point Administration Numbers (MPANs), such that individual customers are identified at each connection point.

The total number of electricity customers is defined as the total number of customers directly connected to the licence holder's licensed electricity distribution network as at 30 September each year.

Only one (individual) customer should be identified at each connection point. This means aggregating multiple MPANs which arise due to the type of "tariff" (or equivalent) and/or metering arrangements (e.g. import/export meters) but are associated with a single connection point (i.e. MPANs in respect of additional concurrent meters should not be counted).

In some cases (e.g. flats) the connection point may be from the licensed electricity distribution system to wiring owned by a landlord or a facilities manager. In such cases, individual customers supplied by such wiring are classed as customers of the licensed distribution system where they are identifiable from MPANs.

Source:

- The above definition of electricity customers has been developed from Annex A – Glossary of the Regulatory Instructions and Guidance.

Appendix 4 - Illustrative allocation of licence fees to licence holders

Illustrative allocation of licence fees to licence holders

Licence holders	Illustrative Customer numbers	Allocation of licence fees (%)
Electricity distribution		
Electricity Distributor 1	1,000,000	1.5625
Electricity Distributor 2	1,000,000	1.5625
Electricity Distributor 3	1,000,000	1.5625
Electricity Distributor 4	1,000,000	1.5625
Electricity Distributor 5	1,000,000	1.5625
Electricity Distributor 6	1,000,000	1.5625
Electricity Distributor 7	1,000,000	1.5625
Electricity Distributor 8	1,000,000	1.5625
Electricity Distributor 9	1,000,000	1.5625
Electricity Distributor 10	1,000,000	1.5625
Electricity Distributor 11	1,000,000	1.5625
Electricity Distributor 12	1,000,000	1.5625
Electricity Distributor 13	1,000,000	1.5625
Electricity Distributor 14	1,000,000	1.5625
Electricity Distributor 15	1,000,000	1.5625
Electricity Distributor 16	1,000,000	1.5625
Electricity Distributor 17	1,000,000	1.5625
Total	17,000,000	26.5625
Electricity Transmission		
National Grid Electricity System Operator Limited (50%)	17,000,000	26.5625
Total Electricity	34,000,000	
Gas transportation networks (excluding the NTS)		
Gas Transporter 1	1,000,000	1.5625
Gas Transporter 2	1,000,000	1.5625
Gas Transporter 3	1,000,000	1.5625
Gas Transporter 4	1,000,000	1.5625
Gas Transporter 5	1,000,000	1.5625
Gas Transporter 6	1,000,000	1.5625
Gas Transporter 7	1,000,000	1.5625
Gas Transporter 8	1,000,000	1.5625
Gas Transporter 9	1,000,000	1.5625
Gas Transporter 10	1,000,000	1.5625
Gas Transporter 11	1,000,000	1.5625
Gas Transporter 12	1,000,000	1.5625
Gas Transporter 13	1,000,000	1.5625
Gas Transporter 14	1,000,000	1.5625
Gas Transporter 15	1,000,000	1.5625
Total	15,000,000	23.4375
Gas Transmission		
National Gas Transmission (50%)	15,000,000	23.4375
Total Gas	30,000,000	
Total Gas and Electricity	64,000,000	100.000