
Direction issued pursuant to Condition F10.5 of the conditions of the Electricity System Operator Licence (ISOP Implementation funding)

Direction issued pursuant to Condition F10.5 of the conditions of the Electricity System Operator Licence (ISOP Implementation funding)

To: The company currently known as National Grid Electricity System Operator Limited with company number 11014226, which is anticipated to be known as National Energy System Operator Limited (the "Licensee")

Whereas:

1. Following its designation as the Independent System Operator and Planner under Section 162 of the Energy Act 2023, the Licensee will become the holder of an Electricity System Operator Licence (the "Licence") granted or treated as granted under section 6(1)(da) of the Electricity Act 1989 (the "Act").
2. In accordance with Condition F10.5 of the Licence, the Gas and Electricity Markets Authority (the "Authority") has consulted with the Licensee and National Grid Holdings One plc ("NG") on the proposed contents of this Direction.
3. This Direction shall become active upon the date on which the designation of the Licensee as the Independent System Operator and Planner under Section 162 of the Energy Act 2023 takes effect.
4. This Direction may be revoked or amended upon reasonable notice in writing by the Authority from time to time.
5. The reason for this Direction is to set out the requirements for the contractual arrangement (the "Day 2 CTA Contract") between NG and the Licensee for the recovery of costs for NG's CTA2 Activities¹, subject to certain requirements being met.

Now the Authority directs pursuant to Condition F10.5 of the Licence, that the requirements which the Day 2 CTA Contract must meet are as follows:

¹ Unless stated otherwise, defined terms within this Direction shall have the same meaning as those in the Day 2 CTA Contract.

1. The Day 2 CTA Contract must not allow the recovery of costs that in total amount to more than a Directed Upper Value, which for the purposes of this Direction is £87,800,000 (EIGHTY-SEVEN MILLION AND EIGHT HUNDRED THOUSAND POUNDS STERLING).
2. The Day 2 CTA Contract must ensure that any invoiced costs are based on actual costs incurred (with a requirement that NG puts in place, and has available if requested, robust measures to ensure accuracy, for example auditable internal timesheets).
3. The Day 2 CTA Contract must establish a Delivery Schedule that provides a breakdown of key activities, outputs, milestones and cost forecasts associated with delivery of Day 1 to Day 2 FSO Transition Activities. This Delivery Schedule must be updated to contain a similar level of detail as the FSO Day 1 Delivery Schedule following finalisation of the NESO Exit Plan.
4. Recoverable costs under the Day 2 CTA Contract must meet these cost recovery principles:
 - All cost must relate directly to CTA 2 Activities.
 - Other costs not incurred for the purposes of CTA 2 Activities are ineligible for recovery.
 - Any costs which NG has recovered or intends to recover through any of the Separation Agreements or the Consequential Costs Mechanism are ineligible for recovery.
 - Any costs which NG is entitled to recover under any of the Separation Agreements are ineligible for recovery.
 - Costs are ineligible for recovery should they be demonstrably inefficient and wasteful expenditure.
5. The Day 2 CTA Contract must oblige NG to use all reasonable endeavours to only seek to recover costs that meet the listed cost recovery principles and the Progress Requirement (defined below), in addition to any process for the Licensee to approve costs.
6. The Day 2 CTA Contract must establish a reporting framework for progress against the Delivery Schedule and costs, requiring comparable content

requirements of version 1.0 of the FSO Transition Funding Governance Document (dated 11 December 2023) for the FSO Transition Intragroup Contract.²

7. Payments made under the Day 2 CTA Contract must be contingent on the Licensee being satisfied that NG has taken the necessary actions within its control to achieve or make sufficient progress towards achieving the CTA 2 Activities by the relevant dates set out in the Delivery Schedule (the "Progress Requirement"). For the avoidance of doubt, this does not mean that the achievement of milestones should come at any expense or be at the compromise of overall costs efficiency of the CTA 2 Activities.
8. The Day 2 CTA Contract must contain an ability for the Licensee and/or Ofgem to enquire for further information and NG to respond in a timely manner.
9. Payment timelines should enable sufficient time for the Licensee to review reporting materials and make enquiries about that payment. Payments should not be subject to accruing interest unless the Licensee has provided the Necessary Approvals relating to the relevant costs and then fails to make payment of the relevant amount in the time allowed by the Day 2 CTA Contract.
10. For changes to items contained within the Day 2 CTA Contract such as the Delivery Schedule, including activities and timelines, there must be a robust process for amending the agreement, including its associated components.

Further guidance relating to specific requirements set out above is contained in Annex 1 to this Direction.

Changes to the Day 2 CTA Contract that are not in line with the requirements set out in this Direction will require a new direction to be requested and issued by Ofgem.

² Document found here - [FSO Transition Funding Governance Document \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/fso-transition-funding-governance-document)

This Direction contains the reasons for the Authority's decision and constitutes notice pursuant to section 49A 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

29 August 2024

Annex 1 of the Direction issued pursuant to Condition F10.5 of the Licence

Further guidance related to specific requirements

Requirement 1: Directed Upper Value

The Directed Upper Value is a backstop to protect consumers from significant unforeseen cost increases. For the avoidance of doubt it does not represent an Ofgem view of an efficient cost. The Directed Upper Value is set at a high case scenario, which should therefore be unlikely to materialise. Nevertheless, we recognise that there could be circumstances where NG may need to incur efficient costs in excess of the Directed Upper Value in order to deliver the CTA 2 Activities. We will therefore consider any evidence from NG and the Licensee on the need to direct a different Directed Upper Value. This process, and the evidence required, should be broadly consistent with the cap review process for the FSO Transition Intragroup Contract³.

Requirement 2: Accurate Costs

Whilst NG does not by default have to provide detailed, auditable evidence of actual costs (such as invoices and timesheets) as part of its monthly reporting requirements, NG should have this information readily available upon request by Ofgem and/or the Licensee. We recognise that timesheets may not be required for all staff working on the CTA 2 Activities, but expect they would be required to maintain the accuracy of the costs submissions where an individual is only part working on the CTA 2 Activities.

Requirement 3: Delivery Schedule

The first version of the Delivery Schedule should be approved by the Authority. Any material changes to the scope of the CTA 2 Activities (for example the addition of new activities, or material changes to the type and approach to a separation activity) must be reflected in a revised Delivery Schedule which is approved by both the Licensee and the Authority. Changes to timelines and less material amendments to separation activities do not require Authority approval.

The first version of the Delivery Schedule may not be as comparable in detail to that of the FSO Day 1 Delivery Schedule. However, following finalisation of the NESO Exit Plan, the Delivery Schedule must be revised such that it contains a similar level of detail as the FSO Day 1 Delivery Schedule. This version should also be approved by the Authority.

³ For the FSO Transition Intragroup Contract process, see Part K of Special Condition 4.2 of the electricity transmission licence held by National Grid Electricity System Operator Limited immediately prior to the designation of the Independent System Operator and Planner.