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Email: [esoperformance@ofgem.gov.uk](mailto:esoperformance@ofgem.gov.uk)

Date: 20 August 2018

Dear Colleague,

### **Authority determination to adjust black start costs incurred in 2017/18**

This letter sets out the Authority's<sup>1</sup> decision to direct an adjustment of £0 to the term BSTA<sub>t</sub> of National Grid Electricity Transmission plc's (NGET) licence for relevant year 2017/18 in accordance with Special Condition 4G.21. This decision means that the Electricity System Operator (ESO) can recover £57,743,277.99 of costs incurred to procure black start services in 2017/18.

We have considered all of the costs submitted to us against the criteria in Special Condition 4G. For most costs, we have no concerns on their accuracy or compliance with the approved methodologies. However, for £254,628.17 of costs related to a feasibility study contract we have concerns on whether these costs were incurred in the relevant year 2017/18. Following our analysis of further evidence submitted by the ESO, we believe these costs were incurred in 2016/17 as the invoices were received and validated for payment by the ESO in that year. Nevertheless, given that the ESO incurred these costs in the spirit of the approved methodologies and conducting the feasibility study was in the interest of consumers, we have decided to direct the value for the term BSTA<sub>t</sub> to be £0.

This letter sets out how we define when costs are incurred for feasibility studies and provides reasons for the Authority's decision to direct an adjustment to the costs specified in the ESO's annual report.

### **Background**

Black start is the process used to recover from an event which results in the full or partial shutdown of the transmission system. Isolated power stations are started individually without an external power supply, and gradually reconnected in order to re-energise the system. NGET, in its role as the ESO in Great Britain (GB), has an obligation under the Grid Code<sup>2</sup> to ensure black start capability is available. NGET also sets local joint restoration plans with relevant parties including transmission owners and distribution network operators.

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<sup>1</sup> The terms "we", "us", "our", "Ofgem" and "the "Authority" are used interchangeably in this document and refer to the Gas and Electricity Markets Authority. Ofgem is the office of the Authority.

<sup>2</sup> As set out in Grid Code CC6.3.5 and OC9.4.7.12.

On 1 April 2017, we introduced a new regulatory framework for determining the allowed revenue derived from black start that NGET may recover each year.<sup>3</sup> In addition to the submission of the methodologies, NGET is required by Part E of Special Condition 4G to submit the total costs associated with the provision of black start provision to the Authority for an ex post assessment at the end of each Relevant Year. We then determine whether the total costs were incurred in accordance with the approved methodologies.

The new regulatory framework relies on efficiency checks at the end of each year against the approved methodologies to ensure that costs incurred are economical and efficient and in the interest of consumers. Therefore, it is vital that all costs incurred in any relevant year are reported.

The different costs incurred by NGET are to pay for black start service providers to be available to provide the service, to warm service providers that would have otherwise been unavailable, to test and provide capital to ensure capability to service providers, as well as to assess the feasibility of new service providers to provide this service.

### **NGET's Submissions**

On 30 April 2018, the ESO submitted an annual report ('the Report') to the Authority of the total black start costs totalling £57,743,277.99 in 2017/18, pursuant to Special Condition 4G.13. The Report was accompanied by a statement from an independent auditor. On 15 June 2018, we directed the ESO to provide us with additional information in order for us to assess the costs incurred. We received the ESO's further submission on 29 June 2018.

### **The Authority's decision**

Having considered the Report and additional information submitted to us by the ESO, the licence obligations under Special Condition 4G, as well as our principal objective and statutory duties, we have decided to:

- Direct the value for the term  $BSTA_t$  to be £0 for relevant year 2017/18 pursuant to Special Condition 4G.21.

Our assessment described in the subsections below explains the process that was followed in accordance to Special Condition 4G.20 to determine whether the costs incurred were compliant with the approved methodologies.

#### *Assessment of costs accuracy*

We have performed the following checks to assess the accuracy of the total costs submitted:

- Recalculation of availability payments based on contract values; and
- Assessment of invoices submitted to the Authority.

These checks were in addition to the independent auditor's report, which indicated that to the best of their knowledge, the costs reported were accurate.

Our assessment concluded that these costs were accurate. It is important to note that all figures exclude value added tax.

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<sup>3</sup> <https://www.ofgem.gov.uk/publications-and-updates/decision-electricity-system-operator-incentives-april-2017-modification-standard-and-special-licence-conditions-transmission-licence>

### *Assessment of Compliance with the Approved Methodology*

We have performed the following checks to assess compliance with the approved methodologies:

- Review of the methodology applied on warming;
- Review of the process followed for making availability payments;
- Review of the additional evidence of how portfolio contracts contributed to a reduction of costs; and
- Review of the additional evidence of how the approved methodologies such as alternative cost assessment, competitive pressures and secondary benefits were used.

These checks were in addition to the independent auditor's report, which indicated that to the best of their knowledge, the costs were aligned with the approved methodologies. Our assessment concluded that these costs were incurred in accordance with the approved methodologies.

### *Costs incurred for Feasibility Studies*

Special Condition 4G.13 allows NGET to submit total costs incurred in the relevant year. In the case of the Report, the relevant year is 2017/18. Feasibility studies are different to other black start costs, as contracts for this service can last multiple years. They are also not directly associated with a 30-minute settlement period as is the case with availability or warming costs.

In our assessment of feasibility study costs for 2017/18, we found that invoices for three contracts were dated before 1 April 2017. Upon further investigation with the ESO, we identified that invoices for two contracts were received by the ESO during the relevant year 2017/18. However, invoices for one contract, totalling £254,628.17 of costs, were received in the year 2016/17. The ESO provided conflicting information on its view of whether costs incurred should be interpreted as the time when payments are made by the ESO or when invoices are received by the ESO.

In accordance with standard accounting practices, we do not believe that the date on which payments are made determines when the costs are incurred for black start feasibility studies. Instead, we have determined that for feasibility study contracts, the date that invoices are submitted to the ESO is deemed to be when the costs are incurred.

### *BSTA<sub>t</sub> adjustment*

Following our assessment, we have determined that the appropriate value for the term  $BSTA_t$  to be applied in 2017/18 to be £0 for the following reasons:

- While £254,628.17 of the Feasibility Study costs were incurred outside the relevant year, they were incurred in accordance with the spirit of the approved methodologies.
- Finding new black start providers is in the interest of consumers, by promoting competition and ensuring adequate service provision. As a result, conducting this feasibility study in an economic and efficient manner was in the interest of consumers.
- We believe that it is proportionate in the first year of the new scheme to not deduct these economic and efficient costs and instead provide further guidance on the expectations under the licence.

## **Next Steps**

Following the completion of the first year of the existing arrangements, we will engage with the ESO in order to understand what processes the ESO has in place to ensure that all costs in a given relevant year are accounted for in its annual report. Moreover, we will also seek to establish a process by which the ESO submits details of all live and completed feasibility study contracts so that we can better monitor how feasibility studies are contracted, conducted and remunerated. Finally, we will clarify our expectations on the level of detail we expect to be included in any future independent auditor's statement that the ESO is required to provide.

There remains continued work on reviewing and ensuring the suitability of black start arrangements. We are engaged in those efforts and, if required, we will make adjustments to the ESO's licence conditions to accommodate new developments in this area.

Published alongside this letter is a copy of the Direction. This letter constitutes notice for the purposes of section 49A of the Electricity Act 1989 in relation to the Direction.

Yours faithfully

**Grendon Thompson**  
**Head of SO Regulation - Duly authorised on behalf of the Authority**

**Dated: 20/08/2018**