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for energy consumers

Email: electricitySOreform@ofgem.gov.uk

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Dear all interested parties,

National Grid's allowances for the costs of implementing Electricity System Operator Separation

In January 2017, we consulted on the future arrangements for the electricity system operator's (ESO) role and structure. In August 2017, we published a response to this consultation.¹ This response included our view of the appropriate level of costs related to ESO separation, which is £49.3m for one-off costs and £9.1m per annum for annual enduring costs up to the end of existing RIIO-T1 period in 2020/21 (all costs noted here are in 2016/17 prices).

This notice follows up on the detailed cost adjustments part of our August 2017 response document, confirms our previous view on the costs of ESO separation and sets out next steps.

Detailed Cost Adjustments

In 2017, we considered the cost implications of ESO separation (both one-off and annual enduring) and scrutinised National Grid's application to recover costs associated with the separation of its ESO business.

We carried out an assessment on the costs submitted by National Grid and used additional external consultancy support in specific areas to calculate the appropriate level of economic and efficient costs. We used internal resource to review the costs in areas such as IT and finance costs, as we had staff familiar with these areas. Where we required additional guidance in areas outside of our expertise, we obtained independent specialist consultants.

Our view of the appropriate level of funding is £49.3m (2016/17 prices) for one-off costs and £9.1m p.a. for annual enduring costs (2016/17 prices). For a detailed cost breakdown, please see Table 1 below.

¹ Future Arrangements for the Electricity System Operator: Response to Consultation on SO Separation
<https://www.ofgem.gov.uk/publications-and-updates/future-arrangements-electricity-system-operator-response-consultation-so-separation>

Table 1 – Cost Breakdown

Cost Area	NGET Bid (£million)		Ofgem estimate (£million)	
	Up front	Enduring	Up front	Enduring
<i>Business Change</i>	23.0	0.3	19.5	0.3
<i>Information services</i>	11.5	0.1	10.0	0.1
<i>Buildings</i>	9.6	1.5	8.2	1.5
<i>Financial</i>	1.2	0.4	0.7	0.1
<i>Enduring governance</i>	1.0	0.6	1.0	0.6
<i>Enduring staff</i>	6.5	5.2	5.3	4.7
<i>Additional ESO/GSO separation</i>	4.8	1.8	4.3	1.8
<i>Business Support</i>	1.9	0.6	0.4	0.1
TOTAL	59.7	10.3	49.3	9.1

Modifications to the Price Control Financial Model (PCFM)

After converting the costs in Table 1 to 2009/10 prices, NGET’s allowances would increase by £54.95m over the period 2016/17 to 2020/21. This type of expenditure is classified as non-operational capex and controllable opex. It is part of the non-variant allowance category. The profile of these adjustments is shown in Appendix 1 - Calculation of revised allowances. The allowance profile for the one-off costs is based on the expected spend profile.

Next Steps

As part of our ESO separation work, we recently consulted on the proposed partial transfer of the transmission licence held by National Grid Electricity Transmission and the associated licence modifications required to separate the ESO functions.² We expect to publish our decision on these consultations later this summer.

However, in order for National Grid’s cost recovery to begin from April 1st 2019, in line with the expected go-live of ESO separation, the PCFM would need to be modified in advance of this year’s Annual Iteration Process, which is due to conclude on 30 November 2018. Such modifications would be the subject of a separate notice.

If we decide, following the conclusion of the recent licence consultations and consideration of the responses, to proceed with steps to implement ESO separation then the expected go live date is April 1st 2019. If ESO separation does not proceed, we will revise and recoup National Grid’s allowances accordingly through further changes to the PCFM. In addition, if ESO separation does take place we expect to carry out a review in 2020/21, and this will include a review of the costs mentioned in this letter and National Grid’s actual expenditure on ESO separation activities.

Yours sincerely,

Grendon Thompson
Head of SO Regulation

² ESO Separation - notice of proposal to partially transfer an electricity transmission licence held by National Grid Electricity Transmission Plc to National Grid Electricity System Operator Limited
<https://www.ofgem.gov.uk/publications-and-updates/eso-separation-notice-proposal-partially-transfer-electricity-transmission-licence-held-national-grid-electricity-transmission-plc-national-grid-electricity-system-operator-limited>

ESO Separation - notice of proposed modifications to the standard conditions of all electricity transmission licences
<https://www.ofgem.gov.uk/publications-and-updates/eso-separation-notice-proposed-modifications-standard-conditions-all-electricity-transmission-licences>

Appendix 1 - Calculation of revised allowances

Revised Allowances for the RIIO-ET1 PCFM

NGET TO Non-variant Allowed Load Related Capex Expenditure

NGET SO Non-variant allowed non-operational capex

£m 2009/10 Prices

	31 Mar 2014	31 Mar 2015	31 Mar 2016	31 Mar 2017	31 Mar 2018	31 Mar 2019	31 Mar 2020	31 Mar 2021
Final Proposal Allowance (incl. MPR)	39.41	35.96	29.88	28.85	29.62	20.41	25.46	25.43
Legal Separation Costs	-	-	-	-	1.24	10.15	-	-
Enduring costs	-	-	-	-	-	-	-	-
Adjusted allowances	39.41	35.96	29.88	28.85	30.86	30.56	25.46	25.43

NGET SO Non-variant allowed controllable opex

£m 2009/10 Prices

	31 Mar 2014	31 Mar 2015	31 Mar 2016	31 Mar 2017	31 Mar 2018	31 Mar 2019	31 Mar 2020	31 Mar 2021
Final Proposal Allowance (incl. MPR)	74.12	75.75	79.10	82.16	82.47	82.91	84.05	85.77
Legal Separation Costs	-	-	-	2.52	5.90	20.31	-	-
Enduring costs	-	-	-	-	-	-	7.41	7.41
Adjusted allowances	74.12	75.75	79.10	84.68	88.38	103.22	91.46	93.18

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