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To interested parties

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Dear Colleagues,

**Decision for the statutory consultation on proposed modifications to the RIIO-ET1 Price Control Financial Model to revise National Grid Electricity Transmission's allowances to account for the costs of implementing Electricity System Operator separation**

On 23<sup>rd</sup> August 2018, we published a Statutory Consultation<sup>1</sup> on proposed modifications to the RIIO-ET1 Price Control Financial Model (PCFM) to implement an additional £55.0 million funding for National Grid Electricity Transmission (NGET) related to the Electricity System Operator (ESO) separation, as set out in the notice<sup>2</sup> issued on 10<sup>th</sup> August 2018.

In the Statutory Consultation we stated that, if ESO separation did not go ahead, we would consider clawing back the additional allowances granted to NGET, as per our policy set out in the 10<sup>th</sup> August notice. However, on 4<sup>th</sup> September 2018 we published decisions<sup>3,4</sup> confirming that the ESO functions separation will go ahead, subject to NGET meeting certain conditions (which are set out in the accompanying consent notice<sup>5</sup>). Assuming that the transfer of the ESO functions goes ahead, we no longer plan to claw back the allowances, other than as a result of our review of the ESO separation costs in 2020/21, as per the 10<sup>th</sup> August notice.

**Effect of modifications**

The proposed PCFM modification would result in an increase to the NGET SO<sup>6</sup> Non-Variant Allowances by a total of £55.0 million over the years 2016/17 to 2020/21.

The additional allowances for ESO separation costs are predominantly recovered in the short term, via a corresponding increase in NGET SO allowed revenues. The remainder, in turn, is capitalised on to the company's Regulatory Asset Value (RAV), and is recovered at a slower pace over the years, via increased depreciation and return on the (higher) RAV.

We estimate that the revenue increase will amount to approximately £43 million during the RIIO-ET1 price control, and will start to be recovered from 2019/20.

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<sup>1</sup> <https://www.ofgem.gov.uk/publications-and-updates/statutory-consultation-modify-riio-et1-price-control-financial-model-account-electricity-system-operator-separation>

<sup>2</sup> <https://www.ofgem.gov.uk/publications-and-updates/notice-national-grid-s-allowances-costs-implementing-electricity-system-operator-separation>

<sup>3</sup> <https://www.ofgem.gov.uk/publications-and-updates/consent-partially-transfer-electricity-transmission-licence-held-national-grid-electricity-transmission-plc-national-grid-electricity-system-operator-limited-0>

<sup>4</sup> <https://www.ofgem.gov.uk/publications-and-updates/decision-modify-standard-conditions-all-electricity-transmission-licences>

<sup>5</sup> [https://www.ofgem.gov.uk/system/files/docs/2018/09/s11a\\_decision.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/09/s11a_decision.pdf)

<sup>6</sup> In the RIIO-ET1 price control we use the term "NGET SO" to account for the ESO function within NGET. From April 2019, as a result of the separation process, the ESO function will no longer be part of NGET and will be undertaken by National Grid Electricity System Operator Ltd.

The remainder of the revenues will be recovered in future price controls.

### **Summary of consultation response**

We received one response to the consultation from National Grid, which has been published on our website alongside the original consultation.

In its response, National Grid agreed that the proposed changes to the ET1 PCFM correctly implement the ESO cost allowances, as set out in the 10<sup>th</sup> August 2018 Notice.

### **Our decision**

Having carefully considered the response received to our statutory consultation, we have decided to proceed with the proposed modifications to the ET1 PCFM, as set out in the consultation.

### **Next steps**

We have published the revised ET1 PCFM on our website, alongside this decision. The ET1 PCFM modifications will come into effect on 22<sup>nd</sup> November 2018, 56 days after publication of this decision.

If you have any questions on this letter, please contact [Valerio.Uccello@ofgem.gov.uk](mailto:Valerio.Uccello@ofgem.gov.uk).

Yours sincerely,

**Geoffrey Randall**  
**Deputy Director, Network Price Controls**