

To:

National Grid Electricity System Operator Limited

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

Date: 18 October 2023

Dear Company Secretary,

**Decision on the proposal to modify the special conditions of the electricity transmission licence held by National Grid Electricity System Operator Limited (NGESO)**

This letter outlines our decision to modify NGESO's licence conditions to implement cost recovery arrangements for the transition to a Future System Operator (FSO), following our statutory consultation on 6 September.

We<sup>1</sup> received two responses to the consultation, which are published on our website. After considering the representations received via these responses, we have decided to modify the licence conditions in the manner set out in the consultation, however with amendments made to the text to improve clarity, as explained in this letter.

A licence modification notice under section 11A(1)(a) of the Electricity Act 1989 ('the Act') has been issued and is enclosed in this letter.

This letter summarises the background to our decision and the consultation responses received, as well as detailing our view on the responses, our decision and the reasons for that decision.

**Background**

In April 2022, Ofgem and the Department for Energy Security and Net Zero (DESNZ) jointly decided to proceed with the creation of a new, independent FSO. This will be an expert, impartial body with responsibilities across both the electricity and gas systems, to drive

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<sup>1</sup> The terms "the Authority", "we" and "us" are used interchangeably in this document.

progress towards net zero while maintaining energy security and minimising costs for consumers.

The implementation of the FSO creates transition costs for NGESO and National Grid plc (NG). We made policy decisions on the cost recovery arrangements for the transition to the FSO in our Final Determinations on the ESO's Business Plan 2 in March 2023<sup>2</sup>, and in our subsequent Decision on funding the transition to a FSO, in September 2023<sup>3</sup>.

To progress the implementation of this cost recovery framework, on 6 September 2023, we consulted on our proposal to modify the electricity transmission licence held by NGESO, granted or treated as granted under section 6(1)(b) of the Act, by modifying:

- Special Condition 1.1 ('SpC 1.1');
- Special Condition 4.2 ('SpC 4.2'); and
- Inserting a new Special Condition, Special Condition 2.15 ('SpC 2.15').

Alongside the proposal to modify the license, we also consulted on a draft version of the FSO Transition Funding Governance Document, which is a new Associated Document to SpC 2.15.

Separately to our proposals on the cost recovery framework for the transition to the FSO, we also proposed some small housekeeping modifications to:

- Special Condition 3.6 ('SpC 3.6');
- Special Condition 4.2 (SpC 4.2); and
- Special Condition 4.9 ('SpC 4.9').

## **Summary of consultation responses and our view**

We received two responses to the statutory consultation, one from NGESO and one from NG. The responses were broadly supportive of the proposed licence changes, but they also raised some general comments and issues in addition to more specific drafting suggestions. For example, NG raised wider issues around the cost recovery process, including its uncertainty on the detailed timelines and steps that would be followed by Ofgem and DESNZ.

An Issue Log showing our responses to the changes suggested to the licence is published alongside this letter. We intend to further discuss the wider issues raised by NGESO and NG

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<sup>2</sup> [Business Plan 2 Final Determinations - Electricity System Operator | Ofgem](#)

<sup>3</sup> [Decision on the funding of the transition to a Future System Operator | Ofgem](#)

separately to this licence change process, and where they are relevant, we will consider comments further as part of our finalisation of the FSO Transition Funding Governance Document.

## **Decisions**

Having considered the responses to the statutory consultation, we have decided to modify the licence in the manners set out in the consultation, with several changes to improve the clarity of the conditions and address housekeeping issues. This includes adopting several drafting suggestions received in the responses to the consultation.

These modifications will take effect from 13 December 2023.

Yours faithfully,

**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**

**18 October 2023**

**To:**  
**National Grid Electricity System Operator Limited**

**Electricity Act 1989**  
**Section 11A(1)(a)**

**Modification of the Special Conditions of the electricity transmission licence held  
by National Grid Electricity System Operator Limited**

1. National Grid Electricity System Operator Limited (NGESO) is the holder of an electricity transmission licence ('the Licence') granted or treated as granted under section 6(1)(b) of the Electricity Act 1989 ('the Act').
2. Under section 11A(2) of the Act the Gas and Electricity Markets Authority ('the Authority')<sup>4</sup> gave notice on 6 September 2023 ('the Notice') that we proposed to modify:
  - Special Condition 1.1 ('SpC 1.1');
  - Special Condition 4.2 ('SpC 4.2'); and
  - Insert a new Special Condition, Special Condition 2.15 ('SpC 2.15').

We further proposed housekeeping modifications to:

- Special Condition 3.6 ('SpC 3.6');
- Special Condition 4.2 (SpC 4.2); and,
- Special Condition 4.9 ('SpC 4.9').

We stated that any representations to the modification proposal must be made on or before 4 October 2023.

3. A copy of the Notice was sent to the Secretary of State in accordance with section 11A(4)(b) of the Act, and we have not received a direction that the change should not be made.
4. We received two responses to the Notice, which we carefully considered. We have placed the non-confidential responses on our website. The responses were broadly supportive of the proposed changes, although several wider issues were also raised that we intend to discuss with those stakeholders separately to this Licence modification process. Our replies to the responses relevant to the Licence are set out in the accompanying decision letter and Issue Log.
5. It is necessary to make a number of minor alterations to the modifications set out in the Notice. These alterations are shown in yellow highlight in the modified Special Licence Conditions. The reasons for any differences between the modifications set out in the Notice and the modifications reflected in the Special Conditions of the Licence published alongside this Notice are to improve general clarity and address minor issues and corrections raised in the consultation responses (please see the Issue Log published alongside this Notice for more detail).
6. The reason why we are making these Licence modifications is to implement policy decisions related to the FSO that we made in our RII0-2 Business Plan 2 (BP2) Final Determinations<sup>5</sup> and our subsequent decision on 'Funding the transition to a FSO'<sup>6</sup>.

<sup>4</sup> The terms "Ofgem", "the Authority", "we" and "us" are used interchangeably in this document.

<sup>5</sup> [Business Plan 2 Final Determinations - Electricity System Operator | Ofgem](#)

<sup>6</sup> [Decision on the funding of the transition to a Future System Operator | Ofgem](#)

We are also making some separate Licence modifications to address housekeeping issues to improve the clarity of the Licence.

7. The effect of the modifications will be to:
  - introduce a framework for the recovery of certain costs incurred by NGESO and National Grid plc associated with the implementation of the FSO;
  - put in place consumer protections associated with the recovery of these costs; and
  - resolve other general housekeeping issues raised by stakeholders to improve the clarity of the Licence.
  
8. Where an application for permission to appeal our decision is made to the Competition and Markets Authority (CMA) under section 11C of the Act, Rule 5.7 of the Energy Licence Modification Appeals: Competition and Markets Authority Rules<sup>7</sup> requires that the appellant must send to any relevant licence holders who are not parties to the appeal a non-sensitive notice setting out the matters required in Rule 5.2. The attached Schedule 2 provides a list of the relevant licence holders in relation to this modification. Section 11A(10) of the Act sets out the meaning of 'relevant licence holder'.

Under the powers set out in section 11A(1)(a) of the Act, we hereby modify the Special Conditions of the Electricity Transmission Licence held by NGESO in the manner specified in the Annex to this notice. This decision will take effect from 13 December 2023.

This document is notice of the reasons for the decision to modify the Licence held by NGESO as required by section 49A(2) 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**

**18 October 2023**

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<sup>7</sup> CMA70 [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/655601/energy-licence-modification-appeals-rules.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/655601/energy-licence-modification-appeals-rules.pdf)

## Annex: Modifications

(Deletions are shown in ~~strike-through~~; Additions are shown in double underline. **Yellow highlighted** text is an alteration to the proposed modifications set out in the Notice. **Green highlighted** text is a supporting note to the reader to clarify changes.)

### Special Condition 1.1 Interpretation and definitions

#### Part B: Definitions

*We are adding the following definitions in their respective locations alphabetically.*

<u>FSO Day 1</u>	<u>means the date on which the <b>first</b> designation of the Future System Operator as the Independent System Operator and Planner (ISOP) (as defined in the Energy Bill) has effect under the Energy Bill that was introduced into Parliament in July 2022, as and when this bill comes into effect.</u>
<u>FSO Day 1 Deliverables</u>	<u>means the key interim and final delivered outputs from FSO Transition Activities that the licensee and National Grid Holdings One plc need to achieve to enable the timely and successful establishment of the FSO by FSO Day 1, which are time-bound, measurable, and in line with the requirements in the FSO Transition Funding Governance Document.</u>
<u>FSO Day 1 Delivery Schedule</u>	<u>means a document containing the FSO Day 1 Deliverables, as established under Part B of Special Condition 2.15 (<b>Obligations related to the implementation of the Future System Operator</b>).</u>
<u>FSO Day 1 Report</u>	<u>means a report produced in accordance with Part F of Special Condition 2.15 (<b>Obligations related to the implementation of the Future System Operator</b>).</u>
<u>FSO Day 1 Transition Activities</u>	<u>means the FSO Transition Activities carried out prior to FSO Day 1.</u>
<u>FSO NG Cost Recovery Principles</u>	<u>means principles and conditions, set by the Authority, to prescribe which costs associated with FSO Transition Activities carried out by National Grid Holdings One plc are allowed to be recovered by the licensee following approval by the Authority, as established in the FSO Transition Funding Governance Document.</u>

<u>FSO Transition Activities</u>	means activities carried out by the licensee and/or National Grid Holdings One plc (together with other companies in National Grid plc's group) to: <ul style="list-style-type: none"> <li>(a) separate the licensee's business from National Grid Holdings One plc and other companies in National Grid plc's group;</li> <li>(b) transform the licensee so it has the capabilities, systems and processes needed to perform the roles and responsibilities of the FSO (including with respect to gas); and</li> <li>(c) <del>to</del> support the development of the governance and regulatory arrangements for the FSO.</li> </ul>
<u>FSO Transition Funding Governance Document</u>	means the document of that name maintained in accordance with Part A of Special Condition 2.15 (Obligations related to the implementation of the Future System Operator).
<u>FSO Transition Intragroup Contract</u>	means a contract entered into in accordance with Part C of Special Condition 2.15 (Obligations related to the implementation of the Future System Operator).
<u>Future System Operator (FSO)</u>	means the body that will be designated as the Independent System Operator and Planner (ISOP) (as defined in the Energy Bill) under the Energy Bill that was introduced into Parliament in July 2022, as and when this bill comes into effect.

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## Special Condition 2.15 Obligations related to the implementation of the Future System Operator

### Introduction

- 2.15.1 This condition sets out the licensee's obligations on the licensee associated with the implementation of the FSO, including the arrangements it must follow to make any payments to National Grid Holdings One plc associated with the term FSONG<sub>t</sub> in Part J of Special Condition 4.2.
- 2.15.2 The condition also provides clarity on the licensee's obligations associated with the delivery of the FSO and puts in place consumer protections, reporting requirements and governance arrangements for the recovery of costs for FSO Transition Activities any associated payments to National Grid Holdings One plc.

2.15.3 This condition also establishes the FSO Transition Funding Governance Document and explains the process the Authority will follow in issuing and amending the FSO Transition Funding Governance Document.

#### **Part A: FSO Transition Funding Governance Document**

2.15.4 The licensee must comply with the FSO Transition Funding Governance Document.

2.15.5 The Authority will issue and may amend the FSO Transition Funding Governance Document by direction.

2.15.6 The Authority will publish the FSO Transition Funding Governance Document and any amendments to it on the Authority's Website.

2.15.7 The FSO Transition Funding Governance Document may make provision about the arrangements for the recovery of costs for FSO Transition Activities or impose requirements on the licensee related to the recovery of costs for FSO Transition Activities, which may include, but will not be limited to:

(a) The FSO Day 1 Delivery Schedule;

(b) The FSO Transition Activities;

(c) the FSO Transition Intragroup Contract, or any documents associated with the FSO Transition Intragroup Contract;

(d) the payments made or to be made to National Grid Holdings One plc in association with FSONG;

(e) the FSO NG Cost Recovery Principles;

(f) reporting requirements; and

(g) any other matters relating to the regulation of or arrangements for the recovery of costs for FSO Transition Activities.

2.15.8 Before issuing new or amending the FSO Transition Funding Governance Document, the Authority will publish on the Authority's Website:

(a) the text of the proposed FSO Transition Funding Governance Document;

(b) the date on which the Authority intends the FSO Transition Funding Governance Document, or the amendment to it, to come into effect; and

(c) a period during which representations may be made on the content of the FSO Transition Funding Governance Document, which will not be less than 28 days.



2.15.9 The steps required to issue or amend the FSO Transition Funding Governance Document may be satisfied by action taken before, as well as by action taken after, this condition comes into effect.

### **Part B: FSO Day 1 Delivery Schedule**

2.15.10 The licensee must use reasonable ~~best~~ endeavours within its control to establish a FSO Day 1 Delivery Schedule containing the FSO Day 1 Deliverables by a point in time that enables the licensee to meet its obligations under Part C to Part F of this condition and no later than the date on which this condition comes into effect, or another date agreed with the Authority.

2.15.11 The FSO Day 1 Delivery Schedule must be agreed with the Authority and the Secretary of State and meet the requirements in the FSO Transition Funding Governance Document.

### **Part C: FSO Transition Intragroup Contract**

2.15.12 The licensee must establish and maintain a FSO Transition Intragroup Contract with National Grid Holdings One plc.

2.15.13 The FSO Transition Intragroup Contract, ~~or any documents associated with the FSO Transition Intragroup Contract,~~ must meet the requirements set out in the FSO Transition Funding Governance Document and this Condition.

2.15.14 The FSO Transition Intragroup Contract, ~~or any documents associated with the FSO Transition Intragroup Contract,~~ must contain:

a) A schedule of dates when amounts meeting the conditions in Part D of this condition for when payments will become due payable from the licensee to National Grid Holdings One plc; ~~subject to the conditions in Part D of this Condition.~~

b) Details of the information National Grid Holdings One plc must provide to ~~or on behalf of~~ the licensee to support the licensee's requirements under part F of this condition;

c) Any other required contents set out in the FSO Transition Funding Governance Document.

2.15.15 The FSO Transition Intragroup Contract and any amendment to it ~~or to any document associated with the FSO Transition Intragroup Contract~~ must be approved by the Authority and the Secretary of State before it is ~~executed~~ signed.

2.15.16 The licensee must provide a copy of the ~~legally fully~~ executed, ~~legally binding and unconditional~~ FSO Transition Intragroup Contract to the Authority and the Secretary of State no later than the date on which this condition comes into effect, or another date agreed with the Authority.

2.15.17 The licensee must use reasonable endeavours to procure that the FSO Transition Intragroup Contract is amended to comply with any change required by any amendment to the FSO Transition Funding Governance Document.

#### **Part D: Payments to National Grid Holdings One plc**

2.15.18 The licensee **may must** only make payments to National Grid Holdings One plc in respect of costs incurred by National Grid Holdings One plc for FSO Transition Activities if:

- a) The payment is in compliance with the terms of the **legally fully** executed **and legally binding** FSO Transition Intragroup Contract which has been approved by the Secretary of State and the Authority;
- b) The Secretary of State has confirmed that they are satisfied that National Grid Holdings One plc has sufficiently demonstrated that it has taken the necessary actions within its control to achieve or make sufficient progress towards achieving the FSO Day 1 Deliverables, accounting for any changes to the FSO Day 1 Deliverables that are made through the processes set out in the FSO Transition Funding Governance Document;
- c) **The Authority has approved that the values National Grid Holdings One plc proposes to send as invoices to the licensee are** **The value invoiced to the licensee by National Grid Holdings One plc has been approved by the Authority as** eligible for recovery according to the FSO NG Cost Recovery Principles set out in the FSO Transition Funding Governance Document; and
- d) The Authority **has confirmed that it** is satisfied that National Grid Holdings One plc has provided the information the licensee requires under paragraph 2.15.14 (b), to comply with Part F of this condition.

2.15.19 The Authority may direct the licensee to make a payment of a different value to the amount National Grid Holdings One plc proposes to invoice the licensee for FSO Transition Activities, including where the Authority has deemed that not all proposed costs are consistent with the FSO Cost Recovery Principles.

#### **Part ED: General expectations for the delivery of the FSO Transition Activities**

2.15.20 The licensee must, **so far as is reasonably practicable, deliver its FSO Day 1 Deliverables and** take all reasonable steps, as are within its power or control, **to deliver its** and necessary or desirable to achieve the final milestone in the **FSO Day 1 Deliverables by the date of the final milestone in the FSO Day 1 Delivery Schedule** by the scheduled time for that milestone.

2.15.21 The licensee must **take all reasonable steps, as are within its power or control, to** carry out its FSO Transition Activities in an efficient, co-ordinated and economic manner. This includes, but is not limited to, the following:

- (a) sharing accurate, and timely information with the Authority and the Secretary of State when reasonably requested, at such times as the Authority or the Secretary of State may reasonably require;
- (b) coordinating and cooperating with the Authority and the Secretary of State, and, in so far as is necessary, National Grid Holdings One plc and all other relevant stakeholders, to ensure economic and efficient delivery of FSO Day 1; and
- (c) providing transparency and engagement, where appropriate, with relevant stakeholders that the licensee considers are impacted by the delivery and cost recovery for FSO Transition Activities, on the progress made on the delivery of FSO Transition Activities.

### **Part FE: Reporting Requirements**

- 2.15.22 The licensee must regularly report to the Authority and Secretary of State on its and National Grid Holdings One plc's progress against the FSO Day 1 Delivery Schedule and relevant costs associated with the FSO Transition Activities, in accordance with the requirements in the FSO Transition Funding Governance Document.
- 2.15.23 The licensee must regularly publish on its website, reports summarising the key information provided to the Authority and Secretary of State under paragraph 2.15.22 up until FSO Day 1.
- 2.15.24 Where the licensee considers that there are legitimate reasons for not publishing certain information or data on its website in accordance with paragraph 2.15.23, it must seek the Authority's approval to publish redacted versions of the reports required under paragraph 2.15.23.
- 2.15.25 The licensee must provide the Authority and Secretary of State with a FSO Day 1 Report that confirms the final values the licensee expects to recover through FSOESOA<sub>t</sub> and FSONG<sub>t</sub> and a final assessment of the licensee's and National Grid Holdings One plc's progress against the FSO Day 1 Delivery Schedule, in line with the requirements in the FSO Transition Funding Governance Document, by no later than two months following FSO Day 1 or another date agreed with the Authority.

## Special Condition 3.6 Adjustment term (ADJ<sub>t</sub>)

### Introduction

3.6.1 The purpose of this condition is to calculate the term ADJ<sub>t</sub> (the adjustment term), which in turn feeds into Maximum Revenue in Special Condition 3.1 (Transmission Network Revenue Restriction).

### Part A: Formula for calculating the adjustment term (ADJ<sub>t</sub>)

3.6.2 For the Regulatory Year commencing on 1 April 2021, the value of ADJ<sub>t</sub> is zero.

3.6.3 For subsequent Regulatory Years, the value of ADJ<sub>t</sub> is derived in accordance with the following formula:

*For clarity, we have removed an addition sign from the subscript of the second term in the second bracket of this formula.*

$$ADJ_t = (TO_{t-1} - TO^*_{t-1} - DISC_{t-1}) \times (1 + I_{t-1} + 1.15\%)$$

where:

- TO<sub>t</sub> means Maximum Revenue derived in accordance with Special Condition 3.1 (Transmission Network Revenue Restriction);
- TO\*<sub>t</sub> means Maximum Revenue as most recently forecast and published by the licensee by 1 April of Regulatory Year t;
- DISC<sub>t</sub> is derived in accordance with 3.6.4; and
- I<sub>t</sub> means the average value of SONIA.

3.6.4 DISC<sub>t</sub> is derived in accordance with the following formula:

$$DISC_t = (Term_t + TSP_t + TSH_t + TNGET_t + TOFTO_t + OFET_t + TICF_t + TICP_t) - (Term^*_t + TSP^*_t + TSH^*_t + TNGET^*_t + TOFTO^*_t + OFET^*_t + TICF^*_t + TICP^*_t)$$

where:

Term<sub>t</sub> + TSP<sub>t</sub> + TSH<sub>t</sub> + TNGET<sub>t</sub> + TOFTO<sub>t</sub> + OFET<sub>t</sub> + TICF<sub>t</sub> + TICP<sub>t</sub> are derived in accordance with Part A of Special Condition 3.2 (Pass-through items); and

Term\*<sub>t</sub> + TSP\*<sub>t</sub> + TSH\*<sub>t</sub> + TNGET\*<sub>t</sub> + TOFTO\*<sub>t</sub> + OFET\*<sub>t</sub> + TICF\*<sub>t</sub> + TICP\*<sub>t</sub> are the values for each of those terms which are included in the Maximum Revenue as most recently forecast and published by the licensee by 1 April of the Regulatory Year t.

## Special Condition 4.2 System Operator Internal Allowed Revenue

### Introduction

4.2.1 The purpose of this condition is:

- (a) to calculate the term  $SOIAR_t$  (the SO Internal Allowed Revenue term), which contributes to the calculation of SO Revenue from Balancing Services Activity term in Special Conditions 4.1 (System Operator Balancing Services Activity Revenue Restriction); and
- (b) to set out the obligations of the licensee in respect of  $SOIAR_t$ ;

### Part A: Formula for calculating the SO Internal Allowed Revenue term ( $SOIAR_t$ )

4.2.2 The value of  $SOIAR_t$  is derived in accordance with the following formula:

$$SOIAR_t = ADJR_t^* + SOLAR_t$$

where:

- $ADJR_t^*$  means adjusted revenue most recently published by the Authority pursuant to Part B of Special Condition 5.2 (Annual Iteration Process for the ESO Price Control Financial Model) prior to the start of Regulatory Year  $t$ ; and
- $SOLAR_t$  means legacy adjustments and is derived in accordance with Special Condition 4.9 (System Operator Legacy Adjustments ( $SOLAR_t$ )).

### Part B: Formula for calculating Adjusted Revenue ( $ADJR_t$ )

4.2.3 The value of  $ADJR_t$  is derived in accordance with the following formula

$$ADJR_t = R_t \times \frac{PI_t}{PI_{2018/19}} + ADJ_t$$

where:

- $R_t$  means Calculated Revenue derived in accordance with Part C;
- $PI_t$  means the price index term derived in accordance with Part D; and
- $ADJ_t$  means the AIP adjustment term derived in accordance with Part E.

### Part C: Formula for calculating the Calculated Revenue term ( $R_t$ )

4.2.4 The value of  $R_t$  is derived in accordance with the following formula:

$$R_t = FM_t + SOPT_t + DPN_t + RTN_t + EIC_t + ADF_t + DRS_t + ORA_t + ESORI_t + TAX_t + TAXA_t$$

- $FM_t$  means fast money and has the value set out in sheet *SystemOperator* of the ESO Price Control Financial Model;
- $SOPT_t$  is derived in accordance with Part F;

- $DPN_t$  means regulatory depreciation and has the value set out in sheet *SystemOperator* of the ESO Price Control Financial Model;
- $RTN_t$  means return and has the value set out in sheet *SystemOperator* of the ESO Price Control Financial Model;
- $EIC_t$  means equity issuance costs and has the value set out in sheet *SystemOperator* of the ESO Price Control Financial Model;
- $ADF_t$  means additional funding and has the value set out in sheet *SystemOperator* of the ESO Price Control Financial Model;
- $DRS_t$  means Directly Remunerated Services adjustment as defined in Special Condition 2.9 (Services treated as Directly Remunerated Services) and has the value set out in sheet *SystemOperator* of the ESO Price Control Financial Model;
- $ORA_t$  means other revenue allowance derived in accordance with Special Condition 4.6 (Total other revenue allowance);
- $ESORI_t$  means the incentive value for the Electricity System Operator Reporting and Incentive Arrangements, as derived in accordance with Special Condition 4.4 (Electricity System Operator Reporting and Incentive Arrangements);
- $TAX_t$  means the tax allowance and has the value given in sheet *SystemOperator* of the ESO Price Control Financial Model; and
- $TAXA_t$  means the tax allowance adjustment term and has the value zero, unless the Authority directs otherwise under Part I.

**Part D: Formula for calculating the Price Index term (PI<sub>t</sub>)** The value of PI<sub>t</sub> is the arithmetic average value of each of the twelve monthly values of PI<sub>m</sub> from 1 April to 31 March within Regulatory Year t, derived in accordance with the following formula:

*For clarity, we have amended the format of the second multiplication sign in the bracketed calculation of this formula by adding an “×” after 0.5.*

$$PI_m = \begin{cases} RPI_m, & \text{if } m < \text{April 2021} \\ PI_{m-1} \left( 0.5 \times \frac{CPIH_m}{CPIH_{m-1}} + 0.5 \times \frac{RPI_m}{RPI_{m-1}} \right), & \text{if } m = \text{April 2021} \\ PI_{m-1} \times \frac{CPIH_m}{CPIH_{m-1}}, & \text{if } m > \text{April 2021} \end{cases}$$

where:

- $M$  refers to a year and month;
- $RPI_m$  means the Retail Prices Index for the year and month  $m$ ; and
- $CPIH_m$  means the Consumer Prices Index Including Owner Occupiers' Housing Costs for the year and month  $m$ .

### Part E: Formula for calculating the AIP adjustment term (ADJ<sub>t</sub>)

4.2.6 For the Regulatory Year commencing on 1 April 2021, the value of ADJ is zero.

4.2.7 For subsequent Regulatory Years, the value of ADJ<sub>t</sub> is derived in accordance with the following formula:

$$ADJ_t = (ADJR_{t-1} - ADJR_{t-1}^*) \times (1 + TVM_{t-1})$$

where:

$ADJR_t$  is derived in accordance with Part B;

$ADJR_t^*$  means adjusted revenue most recently published by the Authority pursuant to Part B of Special Condition 5.2 (Annual Iteration Process for the ESO Price Control Financial Model) prior to the start of Regulatory Year t; and

$TVM_t$  means the time value of money term derived in accordance with paragraph 4.2.8.

4.2.8 The value of  $TVM_t$  is derived in accordance with the following formula:

$$TVM_t = (1 + WACC_t) \times \frac{PI_{t+1}}{PI_t} - 1$$

where:

$WACC_t$  means the vanilla weighted average cost of capital for the licensee as derived by the Authority in accordance with the ESO Price Control Financial Handbook; and

$PI_t$  means the price index derived in accordance with Part D.

### Part F: Formula for calculating the allowed pass-through items (SOPT<sub>t</sub>)

*For clarity, we are adding "FSO<sub>t</sub>" to end the end of the formula in SpC 4.29 as a new term.*

4.2.9 The value of SOPT<sub>t</sub> is derived in accordance with the following formula:

$$SOPT_t = RB_t + EDE_t + SOBD_t + WCF_t + FSO_t$$

where

$RB_t$  means the amount levied on the licensee in respect of the Prescribed Rates (or any equivalent tax or duty replacing them) or an amount directed under Part G;

$EDE_t$  means the payments in relation to the Pension Scheme Established Deficit repair expenditure for each Regulatory Year as further explained and elaborated upon in the ESO Price Control Financial Handbook;

$SOBD_t$  is derived in accordance with Part H; and

WCF<sub>t</sub> means the Working Capital Facility fees as defined in the PCFH; ~~and~~.

FSO<sub>t</sub> means the licensee's costs in effecting the **implementation** **delivery** of FSO Transition Activities and is derived in accordance with Part J.

### **Part G: Review of Prescribed Rates pass-through term (RB<sub>t</sub>)**

4.2.10 As part of any periodic revaluation, the licensee must:

- (a) engage with the Relevant Valuation Agency; and
- (b) use reasonable endeavours to minimise the amount of the Prescribed Rates to which it is liable.

4.2.11 The Authority will review the licensee's engagement with the Relevant Valuation Agency with respect to a revaluation.

4.2.12 If, after reviewing the licensee's engagement with the Relevant Valuation Agency and requesting any further information required from the licensee with respect to a particular revaluation, the Authority considers that the licensee has not complied with paragraph 4.2.10, the Authority will adjust the value of RB<sub>t</sub> by direction.

### **Part H: Formula for calculating the SO Bad Debt term (SOBD<sub>t</sub>)**

4.2.13 The value of SOBD<sub>t</sub> is derived in accordance with the following formula:

$$SOBD_t = SOBDA_t - SORBD_t$$

where:

*SOBDA<sub>t</sub>* means the aggregate value of SO Bad Debt the licensee has incurred or expects to incur, inclusive of RIIO-1 SO Bad Debt with respect to Balancing Services Activity charges owed to the licensee by one or more Defaulting Connection and Use of System Code Party; and

*SORBD<sub>t</sub>* means the aggregate value of SO Bad Debt previously recovered, inclusive of RIIO-1 SO Bad Debt, by the licensee via the *SOBDA<sub>t</sub>* term, where the licensee has received cash through either the Defaulting Connection and Use of System Code Party or been credited by the administrator or liquidator of a Defaulting Connection and Use of System Code Party.

### **Part I: Tax Allowance Adjustment (TAXA<sub>t</sub>)**

4.2.14 The Authority may undertake a tax review of any material, unexplained differences between the licensee's Calculated Tax Allowance and its Actual Corporation Tax Liability, in accordance with Chapter 5 of the ESO Price Control Financial Handbook.



- 4.2.15 Where the Authority notifies the licensee that it has decided to undertake a tax review and given the reasons for that decision, the licensee must:
- (a) procure an Appropriately Qualified Independent Examiner to examine the differences between the licensee's Calculated Tax Allowance and its Actual Corporation Tax Liability and send a report to the Authority;
  - (b) carry out any reasonable steps specified by the Authority for such a procurement and comply with any requirements reasonably specified by the Authority as to the terms of appointment of the Appropriately Qualified Independent Examiner;
  - (c) ensure that the Appropriately Qualified Independent Examiner carries out the work within the scope, and by the date, reasonably specified by the Authority, after discussing with the examiner; and
  - (c) send to the Authority a report from the Appropriately Qualified Independent Examiner in the form, and containing the content, specified by the Authority, following discussion with the examiner.
- 4.2.16 Following receipt of the Appropriately Qualified Independent Examiner's report, the Authority will:
- (a) direct any adjustment to the value of the  $TAXA_t$  term that it considers should be made, taking account of said report, in accordance with Chapter 5 of the ESO Price Control Financial Handbook; and
  - (b) specify the Regulatory Years to which those adjustments relate.
- 4.2.17 Before making a direction under paragraph 4.1.16, the Authority will publish on the Authority's Website:
- (a) the text of the proposed direction;
  - (b) the reasons for the proposed direction; and
  - (c) a period during which representations on the proposed direction may be made, which will not be less than 28 days.

**Part J: Formula for calculating the Future System Operator Transition Funding term (FSO<sub>t</sub>)**

4.2.18 The value of FSO<sub>t</sub> is derived in accordance with the following formula:

$$FSO_t = FSOESO A_t + FSOESOB_t + FSONG_t$$

where:

FSOESO A<sub>t</sub> means the costs the licensee incurs to carry out the FSO Transition Activities prior to FSO Day 1, excluding any demonstrably inefficient or wasteful expenditure disallowed by the Authority in line with the procedures in the Regulatory Instructions and Guidance, and ~~excluding any costs in association with FSONG<sub>t</sub> or costs for FSO Transition Activities~~

carried out by National Grid Holdings One plc or payments falling within FSONG<sub>t</sub> and is in accordance with paragraph 4.2.19;

**FSOESOB<sub>t</sub>** means the costs the licensee incurs to carry out the FSO Transition Activities after FSO Day 1, excluding any demonstrably inefficient or wasteful expenditure disallowed by the Authority in line with the procedures in the Regulatory Instructions and Guidance, and excluding any costs for FSO Transition Activities carried out by National Grid Holdings One plc or payments falling within FSONG<sub>t</sub>; and

**FSONG<sub>t</sub>** means the payments from the licensee to National Grid Holdings One plc for the FSO Day 1 Transition Activities, made under the FSO Transition Intragroup Contract, and is in accordance with paragraph 4.2.20~~1~~.

4.2.19 The licensee's costs for FSO Day 1 Transition Activities recovered under FSOESOB<sub>t</sub> must not exceed a maximum value of £75,000,000 or such other value directed by the Authority under Part K.

~~4.2.20~~ The Authority may disallow expenditure under FSOESO that is demonstrably wasteful or inefficient, in line with the procedures in the Regulatory Instructions and Guidance.

4.2.20 Payments made to National Grid Holdings One plc as part of FSONG<sub>t</sub> must first be approved by the Authority pursuant to the arrangements set out in Special Condition 2.15 and must not exceed £114,500,000 or such other value directed by the Authority under Part K.

### **Part K: Revising the maximum value of FSOESOB<sub>t</sub> and/or FSONG<sub>t</sub>**

4.2.21 On receipt of a request by the licensee, Ofgem may direct changes to the maximum value of FSOESOB<sub>t</sub> and/or FSONG<sub>t</sub> in Special Condition 4.2 Part J where sufficient information is provided by the licensee to justify such a change.

4.2.22 The licensee must submit the following information to allow the Authority to review a maximum value for FSOESOB<sub>t</sub> and/or FSONG<sub>t</sub>:

- (a) the suggested proposed new maximum value;
- (b) a breakdown of estimated costs which make up the new maximum value; and
- (c) justification for differences in estimated costs between the estimated costs which made up the existing maximum value and those in the proposed suggested new maximum value.

4.2.23 A request under this Part K must be confined to costs incurred or expected to be incurred for delivering the FSO Day 1 Transition Activities.

4.2.24 The licensee must notify the Authority that it intends to make a request under this Part K as soon as practically possible once it becomes aware that a change in the maximum value is likely to be required.

4.2.25 The Authority may only make modifications to the licence under this Part K by direction where:

(a) the requirements in paragraphs 4.2.223 to 4.2.234 have been met; and

(b) the Authority is satisfied that the request under Part K is sufficiently well evidenced and justified and that the licensee and National Grid Holdings One plc would be unable to recover economic and efficient costs for FSO Transition Activities without a change in the maximum value for FSOESOA<sub>t</sub> and/or FSONG<sub>t</sub>.

## **Special Condition 4.9 System Operator Legacy Adjustments (SOLAR<sub>t</sub>)**

### **Introduction**

4.9.1 The purpose of this condition is to calculate the term SOLAR<sub>t</sub> (the System Operator legacy adjustments term), which in turn feeds into SO Internal Allowed Revenue in Special Condition 4.2 (System Operator Internal Allowed Revenue).

### **Part A: The formula for calculating the System Operator legacy adjustment term (SOLAR<sub>t</sub>)**

4.9.2 The value of the SOLAR<sub>t</sub> term is derived in accordance with the following formula:

$$SOLAR_t = LSOMOD_t + LSOTRU_t + LSOEMRINC_t$$

where:

*LSOMOD<sub>t</sub>* has the value in sheet *SystemOperator* of the ESO Price Control Financial Model unless the Authority directs otherwise in accordance with Parts B and C;

*LSOTRU<sub>t</sub>* is derived in accordance with Part D; and

*LSOEMRINC<sub>t</sub>* is derived in accordance with Part E.

### **Part B: The formula for calculating the System Operator legacy MOD term (LSOMOD<sub>t</sub>)**

4.9.3 For the Regulatory Years commencing on 1 April 2021 and 1 April 2022, the value of LSOMOD<sub>t</sub> is derived in accordance with the following formula:

$$LSOMOD_t = SOMOD_t \times RPIF_t$$

where:

SOMOD<sub>t</sub> has the value directed by the Authority coinciding with the Annual Iteration Process, related to revisions to the ESO Price Control

Financial Model, performed in accordance with Chapter 6 (Legacy Adjustments) of the ESO2 Price Control Financial Handbook; and  
 RPIF<sub>t</sub> has the value of RPIF<sub>t</sub> as determined in accordance with paragraph 3A.7 of Part C of Special Condition 3A (Restriction of Transmission Network Revenue) of this licence as in force on 31 March 2021 as amended by sections 6.14 and 6.15 of the Price Control Financial Handbook.

4.9.4 For the Regulatory Year commencing on 1 April 2023, the value of LSOMOD<sub>t</sub> is derived in accordance with the following formula:

*For clarity, we are swapping the subscripts for the terms in the fraction of this formula.*

$$LSOMOD_t = COA \times CWACC_t \times \frac{PI_{t2018/19}}{PI_{\#2018/19}}$$

where:

COA means the closeout adjustment in 2018/19 prices, and has the value directed by the Authority in accordance with Chapter 6 (Legacy Adjustments) of the ESO Price Control Financial Handbook;

CWACC<sub>t</sub> means compound WACC and has the value derived in accordance with Part C;

PI<sub>t</sub> has the value given to it by Part ~~D~~E of Special Condition 4.2; and

PI<sub>2018/19</sub> has the value of PI<sub>t</sub> for the Regulatory Year commencing on 1 April 2018.

For the Regulatory Years commencing on or after 1 April 2024 the value of LSOMOD<sub>t</sub> is zero.

4.9.5 The Authority will direct revisions to LSOMOD<sub>t</sub>, coinciding with the Annual Iteration Process.

4.9.6 Before making a direction under paragraph 4.9.5 the Authority will publish on the Authority's Website:

- (a) the text of the proposed direction;
- (b) the reasons for the proposed direction; and
- (c) a period during which representations may be made on the proposed direction, which will not be less than 28 days.

### Part C: Compound WACC

4.9.7 For Regulatory Years commencing on or after 1 April 2022,  $CWACC_t$  is derived in accordance with the following formula:

$$CWACC_t = \prod_{t=2021/22}^{t-1} (1 + WACC_t)$$

where:

$WACC_t$  means vanilla weighted average cost of capital, set out in accordance with the ESO Price Control Financial Handbook.

### Part D: The formula for calculating the System Operator legacy TRU term ( $LSOTRU_t$ )

4.9.8 For the Regulatory Years commencing on 1 April 2021 and 1 April 2022, the value of  $LSOTRU_t$  is derived in accordance with the following formula:

$$LSOTRU_t = SOTRU_t \times RPIF_t$$

where:

$SOTRU_t$  has the value of  $SOTRU_t$  as determined in accordance with paragraph 4A.5 of Part C of Special Condition 4A (Restriction of System Operator Internal Revenue) of this licence as in force on 31 March 2021; and

$RPIF_t$  has the value of  $RPIF_t$  determined in accordance with paragraph 3A.7 of Part C of Special Condition 3A (Restriction of Transmission Network Revenue) of this licence as in force on 31 March 2021 as amended by sections 6.14 and 6.15 of the Price Control Financial Handbook.

4.9.9 For the Regulatory Years commencing on 1 April 2023 and 1 April 2024, the value of  $LSOTRU_t$  is derived in accordance with the following formula:

$$LSOTRU_t = \left[ \frac{RPIA_{t-2} - RPIF_{t-2}}{RPIA_{t-2}} \right] \times LPVF_{t-2} \times LPVF_{t-1} \times SOREV_{t-2} \times \frac{PI_t}{PI_{2009/10}}$$

where:

$RPIA_t$  has the value given to it by Part C of Special Condition 3A (Restriction of Transmission Network Revenue) of this licence as in force on 31 March 2021;

$RPIF_t$  has the value of  $RPIF_t$  determined in accordance with paragraph 3A.7 of Part C of Special Condition 3A (Restriction of Transmission Network Revenue) of this licence as in force on 31 March 2021 as

- amended by sections 6.14 and 6.15 of the ESO Price Control Financial Handbook;
- SOREV<sub>t-2</sub> has the value of SOREV<sub>t-2</sub> as determined in accordance with Part C of Special Condition 4A (Restriction of System Operator Internal Revenue) of this licence as in force on 31 March 2021. For this calculation the component SOPU (SO Opening Base Revenue Allowance) is zero;
- LPVF<sub>t</sub> has the value derived in accordance with paragraph 4.9.10;
- PI<sub>t</sub> has the value given to it by Part D of Special Condition 4.2; and
- PI<sub>2009/10</sub> has the value of PI<sub>t</sub> for the Regulatory Year commencing on 1 April 2009.

4.9.10 The value of LPVF<sub>t</sub> is derived in accordance with the following formula:

$$LPVF_t = 1 + WACC_t$$

where:

- WACC<sub>t</sub> means vanilla weighted average cost of capital, derived in accordance with the ESO Price Control Financial Handbook.

### **Part E: The formula for calculating the System Operator legacy EMR incentives term (LSOEMRINC<sub>t</sub>)**

4.9.11 For the two Regulatory Years commencing on 1 April 2021 and 1 April 2022, the value of LSOEMRINC<sub>t</sub> is derived in accordance with the following formula:

$$LSOEMRINC_t = SOEMRINC_t \times RPIF_t$$

where:

- SOEMRINC<sub>t</sub> has the value of SOEMRINC<sub>t</sub> as determined in accordance with Part C of Special Condition 4L (Financial Incentives on EMR) of this licence as in force on 31 March 2021; and
- RPIF<sub>t</sub> has the value of RPIF<sub>t</sub> as determined in accordance with paragraph 3A.7 of Part C of Special Condition 3A (Restriction of Transmission Network Revenue) of this licence as in force on 31 March 2021 as amended by sections 6.14 and 6.15 of the Price Control Financial Handbook;

for Regulatory Years commencing on or after 1 April 2023 the value of LSOEMRINC<sub>t</sub> is zero.