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for energy consumers

To: Company Secretary
National Grid Electricity System
Operator Limited
Faraday House, Gallows Hill
Warwick
CV34 6DA

Email: FSO@ofgem.gov.uk

Date: 23 September 2024

Dear colleagues,

Direction on the maximum value recoverable through the term FSOESOA_t pursuant to Special Condition 4.2 of NGENSO's electricity transmission licence

This letter sets out our¹ decision to issue a direction pursuant to paragraph 4.2.21 of Special Condition 4.2 (System Operator Internal Allowed Revenue) of National Grid Electricity System Operator Limited (NGESO)'s electricity transmission licence. This direction increases the total maximum amount recoverable by NGESO for all FSO Transition Activities carried out before 1 October 2024 from £75m to £91m (in 2018/19 prices).

Background

The new National Energy System Operator (NESO)² will be established on 1 October (a day also known as 'Day 1' of NESO). To deliver NESO, NGESO is being separated from National Grid plc (NG) and acquired by the Government. The process to establish NESO and separate NGESO from NG has resulted in costs for NGESO and NG.

In September 2023 we made a policy decision on the funding arrangements for work required by NGESO and NG to deliver NESO³ (which was previously referred to as the Future System Operator or 'FSO'). In October 2023 we modified the Special Conditions of NGESO's electricity transmission licence to implement these funding arrangements.⁴ This

¹ References to the "Authority", "Ofgem", "we", "us" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work.

² [Designation of the National Energy System Operator \(NESO\) - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/news/designation-of-the-national-energy-system-operator-neso)

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

⁴ [Decision on modifications to the Special Conditions of the Electricity Transmission Licence held by National Grid Electricity System Operator Limited - October 2023 | Ofgem](#)

included modifications to amend Special Condition 4.2 (System Operator Internal Allowed Revenue) and introduce Special Condition 2.15 (Obligations related to the implementation of the Future System Operator).

The funding arrangements include maximum values that NGENSO can recover for FSO Transition Activities⁵ prior to NESO Day 1.⁶ This includes a maximum value for the costs NGENSO directly incurs and recovers through the term FSOESOA_t (previously set at £75m in 2018/19 prices) and a maximum value for the amount NGENSO can recover on behalf on NG through FSONG_t (£114.5m in 2018/19 prices).

Part K of Special Condition 4.2 of NGENSO's licence enables the Authority to direct new maximum values for either FSOESOA_t or FSONG_t, subject to certain information being submitted by NGENSO, and following our assessment of this information.

Request by NGENSO

In August 2024 NGENSO submitted a request to increase the maximum value associated with FSOESOA_t. The request set out that the main driver was a later than originally expected Day 1 launch of NESO (from summer 2024 to 1 October 2024). NGENSO explained that this has resulted in additional costs for FSO Transition Activities being incurred prior to Day 1, pushing its forecasted expenditure beyond the original approved cap. This included additional months of incremental 'run-the-business' expenditure resulting from separation actions completed prior to Day 1, as well as expenditure on work needed to maintain progress towards 'Day 2' separation⁷. NGENSO proposed an increased maximum value to cover additional expenditure until the launch of NESO on 1 October 2024.

NGENSO proposed a maximum value of £91m (in 2018/19 prices). This is derived from a latest projected spend of £87m (in 2018/19 prices) inclusive of £4m (in 2018/19 prices) in contingency to accommodate for any unforeseen additional expenditures. Of the projected spend of circa £87m (in 2018/19 prices), £62m (in 2018/19 prices) is actual spend to June 2024, with the remaining £24m (in 2018/19 prices) being the forecasted spend from July 2024 to October 2024.

⁵ 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: (a) separate the licensee's business from National Grid Holdings One plc and other companies in National Grid plc's group; (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 (c) support the development of the governance and regulatory arrangements for the FSO.

⁶ See Part J of Special Condition 4.2 of NGENSO's transmission licence.

⁷ The point at which NESO has exited from the Transitional Services Agreement (TSA) with NG and developed fully autonomous functions to replace the business services provided in the TSA.

Decision

We have reviewed the evidence and justification provided by NGESO, alongside regular reports submitted to us by NGESO on its progress and spending on FSO Transition Activities over the course of this year. We recognise that changes from the original expected timing of Day 1 mean more costs have been incurred by NGESO than anticipated prior to Day 1.

We can confirm that the requirements in paragraphs 4.2.22 to 4.2.23 of Special Condition 4.2 have been met. We are satisfied that NGESO's request under Part K of Special Condition 4.2 is sufficiently well evidenced and justified and that NGESO would be unable to recover economic and efficient costs for FSO Transition Activities without a change in the maximum value recoverable under FSOESOA_t. We agree with the inclusion of a small amount of contingency on top of NGESO's latest expected forecast to accommodate any unforeseen changes prior to Day 1.

Under the power of direction granted by paragraph 4.2.21 of Special Condition 4.2 of NGESO's electricity transmission licence, we direct that the maximum value that can be recovered under FSOESOA_t is £91m (in 2018/19 prices). For the avoidance of doubt, the new maximum value is not a wholly new amount that NGESO can recover in addition to the previous maximum value. Instead, £91m supersedes the previous maximum value of £75m (resulting in an increase of £16m (in 2018/19 prices) in the maximum spend allowed). Our Direction is contained in the Annex to this letter.

For any question about the contents of this letter or Direction, please contact FSO@ofgem.gov.uk in the first instance.

Yours sincerely,

David Beaumont

Head of NESO Transition, Institutions for Net Zero

Energy Systems Management & Security

Signed for and on behalf of the Gas and Electricity Markets Authority

**Annex - Direction in relation to the maximum value of FSOESOA_t
For and on behalf of the Gas and Electricity Markets Authority**

**DIRECTION PURSUANT TO PARAGRAPH 4.2.21 OF SPECIAL CONDITION 4.2 OF
NATIONAL GRID ELECTRICITY SYSTEM OPERATOR LIMITED'S ELECTRICITY
TRANSMISSION LICENCE IN RELATION TO THE MAXIMUM VALUE OF FSOESOA_t**

**To: National Grid Electricity System Operator Limited (Company Number
11014226)**

Whereas:

1. 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. Special Condition ("SpC") 4.2 of the Licence sets the revenues NGESO can recover for certain costs, including costs for FSO Transition Activities.
2. Paragraph 4.2.21 of SpC 4.2 of the Licence, allows the Authority to direct changes to the maximum value of the cost term FSOESOA_t.
3. The Authority has assessed that the requirements in paragraphs 4.2.25 of SpC 4.2 of the Licence have been satisfied.
4. The reason for this Direction is to enable NGESO to recover additional costs for FSO Transition Activities carried out prior to Day 1 of NESO, as explained further in the main body of the letter.
5. This Direction may be revoked or amended upon reasonable notice in writing by the Authority from time to time.

Therefore:

In accordance with paragraph 4.2.21 of SpC 4.2, the Authority hereby directs that the maximum value of FSOESOA_t is £91m (in 2018/19 prices). For the avoidance of doubt, the new maximum value is not a wholly new amount that NGESO can recover in addition to the previous maximum value. Instead, £91m supersedes the previous maximum value of £75m (resulting in an increase of £16m (in 2018/19 prices) in the maximum spend allowed).

This Direction and the letter to which it is attached constitutes notice of the reasons for the decision pursuant to section 49A of the Act.

David Beaumont

Head of NESO Transition, Institutions for Net Zero
For and on behalf of the Gas and Electricity Markets Authority
23 September 2024