



# Consequential costs

National Grid's response to Ofgem's consultation

October 2024

nationalgrid

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**Funding National Grid's consequential costs from the separation of the Electricity System Operator**

Dear David,

Thank you for the opportunity to respond to Ofgem's consultation on the proposed adjustment to National Grid Electricity Transmission's (NGET's) totex allowance and licence term. We believe this will provide funding arrangements for National Grid's consequential cost recovery in RIIO-2.

I am pleased to include National Grid's response to the consultation.

Should you require more information on any of the points raised in our response please contact Matthew Howson in the first instance at [matthew.howson@nationalgrid.com](mailto:matthew.howson@nationalgrid.com).

We do not consider this response to be confidential.

Yours sincerely



Nikki Jamieson  
Separation Director FSO

# Consequential costs

## 1. Introduction and context

National Grid<sup>1</sup> is an energy company operating in the UK and US. We play a vital role in connecting millions of people to the energy they use. We enable the innovation that is transforming the energy system.

In this document, we share our response to Ofgem's consultation on 'Funding National Grid's consequential costs from the separation of the Electricity System Operator'<sup>2</sup>, published on 2 September 2024. It includes feedback from National Grid Electricity Transmission (NGET), National Grid Electricity Distribution (NGED), and National Grid Ventures (NGV).

As noted in our previous responses to consultations in relation to National Grid's separation cost recovery, the transfer of ESO is the decision of the UK government, not National Grid, and National Grid is entitled to recover its costs incurred as a result of separation on the basis of full reparation so as to leave it in the financial position which would have existed but for the separation.

We have structured our response in line with the questions posed in section three of Ofgem's consultation.

## 2. Do you agree with the scope of consequential costs that we are proposing to fund?

### Scope

We support Ofgem's policy proposal for the treatment of National Grid's consequential costs in RIIO-2 and a new licence term to adjust NGET's totex. We believe the scope reflects our understanding of the transaction and separation process.

### Cyber investments

There is one notable risk which we raise here for full transparency.

We shared our NGET/Electricity System Operator (ESO) RIIO cyber plan in October 2023 (for continuation activities) and December 2023 (for enhanced/new activities). If Ofgem's determination or the National Energy System Operator's (NESO's) cyber approach differs to our assumptions, this could create additional consequential costs particularly in capex investments. We believe the stranded capex formula (consultation document, 3.20, p.16) could accommodate these changes.

### RIIO-3

We recognise that Ofgem cannot presume the outcome of a consultation, and it is unable to provide any conclusions on the potential outcomes from the RIIO-3 business plan assessment process. However, knowing that we will incur consequential costs in RIIO-3, we do need a mechanism to provide these costs for assessment, independent of NGET's business plan.

Our proposal is for an approach that considers the baseline cost to provide the transitional services agreement (TSA), TSA cost recovery, and early or deferred TSA exit.

The approach would also need to consider the time required to mitigate these costs and to remove any dis-synergy resulting from the transaction. This mitigation glide path would need to recognise the scale and complexity of the people, technology, and processes that underpin the TSA. We anticipate this being a multi-year process to re-design and implement organisational changes of this scale.

This glide path might be based on specific mitigations with an associated cost to achieve, which would require a reopener early in the RIIO-3 period for us to provide detailed investment

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<sup>1</sup> The terms 'National Grid PLC', 'National Grid', 'we', and 'our' are used interchangeably in this document

<sup>2</sup> <https://www.ofgem.gov.uk/consultation/funding-national-grids-consequential-costs-separation-electricity-system-operator>

proposals. Alternatively, an incentivised totex approach might be set ahead of time if earlier certainty is desired.

As with this consultation, we would value on-going engagement with Ofgem on our RIIO-3 consequential costs.

#### Clarification to published costs

While not material in terms of our proposal for consequential cost recovery, for full transparency, we would like to highlight two clarifications.

- In 3.18 (consultation document, p.15), 'departmental reorganisations' is shown as £10m. We believe this should be £7.8m which includes £7.1m for department reorganisations and £0.7m for natural staff attrition.
- In Table 1 (consultation document, p.18), departmental reorganisations (£7.8m) includes £0.7m for natural staff attrition. Departmental reorganisations should instead read 2024/25 £3.5m, 2025/26 £3.5m, and Total £7.1m.

For the avoidance of doubt, this does not change the total consequential cost of £25m.

### 3. Do you agree that the recovery of NG's consequential costs should be via an adjustment to NGET's totex allowance?

We agree that an adjustment to NGET's totex allowance will enable us to recover consequential costs. We are comfortable working with this approach as it is the basis of NGET's regulatory cost recovery.

An adjustment to NGET's totex allowance will mean NGET will recover consequential costs over 45 years. To mitigate this, Ofgem could consider making this a fast money only adjustment, however we understand this would add additional complexity into the price control financial model (PCFM).

We note that cost recovery of stranded capex (IT projects) is variable based on actual costs incurred. While this meets our need for cost recovery and to be held whole, it isn't consistent with the concept of a totex allowance which incentivises outperformance.

### 4. Do you have any comments on our specific funding mechanism for NG's consequential costs, including the proposed terms in cost recovery formula?

We welcome the use of the consequential cost recovery formula – including the use of fixed (ex-ante) and variable cost calculations – as this provides the flexibility to adapt to the changing needs of the separation programme.

We have worked with Ofgem to provide insight into the scope and scale of our consequential costs. We believe this consultation presents the results of a transparent process of cost review and appropriately reflects expected efficient costs, including the impact of cost mitigations.

### 5. Close

In summary, we support Ofgem's proposal to fund National Grid's RIIO-2 consequential costs using a consequential cost formula and totex adjustment to NGET's RIIO-ET2 business plan.

We would value certainty of the consequential cost review process in RIIO-3.

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