

To: All persons listed in section 170(2) of the Energy Act 2023¹

**Energy Act 2023
Section 170(1) and (3)**

Notice of statutory consultation on a proposal to modify the (i) Special Conditions ('SpCs') of the Electricity Transmission Licence ('the Licence') held by National Grid Electricity Transmission Plc ('the Licensee') and; (ii) the ET2 Price Control Financial Instruments.

1. Pursuant to section 169 of the Energy Act 2023, the Gas and Electricity Markets Authority ('the Authority')² proposes to modify the SpCs of the Licence held by the Licensee granted or treated as granted under 6(1)(b) of the Electricity Act 1989 with the addition of the following SpCs:
 - a. SpC 3.42 (Consequential Costs recovery from the separation of the ESO term (CCt)) included in Annex 1.
 - b. SpC 9.21 (Termination of the Operational Services Agreement) included in Annex 2.

Additionally, the Authority proposes to modify the ET2 Price Control Financial Instruments as outlined in Annex 3.

2. This document operates as a notice published by the Authority for the purposes of section 170(1) of the Energy Act 2023.
3. The reason for these proposals is to:
 - a. Implement our policy decision on funding National Grid plc's consequential costs from the separation of the Electricity System Operator³; and
 - b. Set out the requirements on the Licensee in respect of changes to and termination of the Operational Services Agreement ('OSA')⁴ and to promote alignment with OSA requirements applicable to National Energy System Operator Limited (NESO)⁵.
4. The effect of these proposals is to:
 - a. Enable the Licensee to recover appropriate consequential costs over the RIIO-2 period; and
 - b. Ensure the Authority is notified of any changes to, and consulted on the termination of, the OSA.
5. A copy of the proposed modifications and other documents referred to in this Notice have been published on our website (www.ofgem.gov.uk) alongside this Notice. Alternatively they are available from information.rights@ofgem.gov.uk.

¹ In this particular case, the Authority does not consider it appropriate to send a copy of this notice to the General Consumer Council for Northern Ireland given that Northern Ireland has a separate electricity market overseen by the Utility Regulator and therefore the proposals in this notice would not appear to affect consumers in Northern Ireland.

² The terms "the Authority", "we" and "us" are used interchangeably in this document.

³ [Funding National Grid's consequential costs from the separation of the Electricity System Operator | Ofgem](#)

⁴ For more information on the OSA, please see NESO's BP3 Enabling functions annex:
<https://www.neso.energy/document/349081/download>

⁵ Please see Condition B1 Part C of NESO's Electricity System Operator licence and its Gas System Planner licence.

6. Any representations with respect to the proposals must be made on or before 12 February 2025 to: David Beaumont, Office of Gas and Electricity Markets, 10 South Colonnade, Canary Wharf, London, E14 4PU or by email to NESORegulation@ofgem.gov.uk.
7. We normally publish all responses on our website. However, if you do not wish your response to be made public then please clearly mark it as not for publication. We prefer to receive responses in an electronic form so they can be placed easily on our website.
8. Following consideration of the responses to this consultation, if the Authority decides to make the proposed modifications, they will have effect from the date set out in the subsequent notice published under s170(4) of the Energy Act 2023.
9. This will be on a date after the consultation closes on 12 February 2025.

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David Beaumont
Head of NESO Framework Development
Duly authorised on behalf of the
Gas and Electricity Markets Authority

15 January 2025

Annex 1

National Grid Electricity Transmission Plc

Electricity transmission licence

Special Conditions

We have set out the proposed addition of Special Condition 3.42 (Consequential Costs recovery from the separation of the ESO term (CC_t)) to Chapter 3: Totex Allowance adjustments. This is shown below in double underlined text.

Special Condition 3.42 Consequential Costs recovery from the separation of the ESO term (CC_t)

Introduction

3.42.1. The purpose of this condition is to specify the value of the term CC_t (the Consequential Costs recovery from the separation of the ESO term). This contributes to the calculation of the Totex Allowance.

Part A: Formula for calculating the Consequential Costs

3.42.2. The value CC_t is derived in accordance with the following formula:

$$CC_t = (SSA_t - FTSAOSA_t - MT_t) + CSC_t + ETSAESC_t$$

where:

SSA_t has the value in Appendix 1 and represents price control income for shared services that National Grid plc ceases to receive from National Grid Electricity System Operator Limited as a consequence of its separation;

$FTSAOSA_t$ has the value in Appendix 1 and represents revenue for shared services that National Grid plc will receive from the ISOP through the Transitional Services Agreement and the Operational Services Agreement;

MT_t means shared services costs that are either directly transferred to the ISOP or that can be reasonably mitigated or avoided and has the value derived in accordance with paragraph 3.42.3;

CSC_t means capital expenditure that is stranded as a result of the separation of National Grid Electricity System Operator Limited from National Grid plc and has a value derived in accordance with paragraph 3.42.4; and

$ETSAESC_t$ means consequential costs resulting from the ISOP's early exit from a service provided under the Transitional Services Agreement which are not already recovered or mitigated through other funding

mechanisms. This term has the value zero, unless otherwise directed by the Authority in accordance with Part B.

3.42.3. The value of MT_t is derived in accordance with the following formula:

$$MT_t = TRNS_t + FXMT_t$$

where:

$TRNS_t$ means the total value of any operational costs that are directly transferred from National Grid plc to the ISOP following 1 October 2024, including but not limited to any staff or contracts moved to the ISOP.

$FXMT_t$ has the value in Appendix 1 and represents the stranded shared services operational costs that can be reasonably mitigated.

3.42.4. The Capex Stranded Costs, CSC_t can be derived in accordance with the following formula:

$$CSC_t = RESOA_t - IFTSA_t$$

where:

$RESOA_t$ means the representative value of total Indirect Investment expenditure incurred by National Grid plc following 1 October 2024 that would have been allocated to National Grid Electricity System Operator Limited and which should be calculated in accordance with the methodology in Appendix 2.

$IFTSA_t$ means the revenues received from the ISOP through the Transitional Services Agreement and Operational Services Agreement to support Indirect Investments by National Grid plc.

Part B: Revising the value of ETSAESCT

3.42.5. On receipt of a request by the licensee, the Authority may direct changes to the value of ETSAESCT in Part A of Special Condition 3.42 where sufficient information is provided by the licensee to justify such a change.

3.42.6. The licensee must submit the following information to allow the Authority to review a request to direct changes to the value of ETSAESCT:

- (a) the proposed new value;
- (b) an explanation of how the requested costs have been calculated; and
- (c) justification and evidence for why these costs are unavoidable additional costs and how they have not been remunerated through other funding routes, including but not limited to the Transitional Services Agreement, Operational Services Agreement, the Day 2 CTA Contract, and any allowances the licensee receives through this licence.

- 3.42.7. A request under this Part B must be confined to costs incurred or expected to be incurred by National Grid plc no later than 31 March 2026 and which are a consequence of the ISOP exiting a service which is provided under the Transitional Services Agreement at a date which is earlier than the date at which the Transitional Services Agreement is due to expire.
- 3.42.8. The licensee must notify the Authority that it intends to make a request under this Part B as soon as practically possible once it becomes aware that a change in the value is likely to be required.
- 3.42.9. The Authority may only make modifications to the licence under this Part B by direction where:
- (a) the requirements in paragraphs 3.42.6 to 3.42.7 have been met; and
 - (b) the Authority is satisfied that the request under Part B is sufficiently well evidenced and justified and that the licensee and National Grid plc are unable to recover economic and efficient costs as a result of the ISOP exiting a service early provided under the Transitional Services Agreement without a change in the value for ETSAESCT.
- 3.42.10. For the purposes of this condition "National Grid Electricity System Operator Limited" means the company of that name which held a Transmission Licence immediately prior to the designation of the ISOP and the Electricity System Operator Licence coming into effect.

Appendix 1

Consequential Cost allowance formula values (£m, 2018,19 prices)

	Regulatory Year					
	2021/22	2022/23	2023/24	2024/25	2025/26	Total RIIO-2
<u>SSA_t</u>	0	0	0	70.0	70.0	140.0
<u>FTSAOSA_t</u>	0	0	0	36.6	36.6	73.2
<u>FXMT_t</u>	0	0	0	3.5	4.9	8.4

Appendix 2

Methodology for calculation of RESOA_t

Cost term	Methodology
<u>RESOA_t</u>	<u>RESOA_t is calculated by taking the total Indirect Investment expenditure incurred by National Grid plc within the Regulatory Year after 1 October 2024, and multiplying the total values falling within each cost category for Indirect Investment by the relevant % values in the table below.</u>

Percentages to be used for the calculation of RESOA_t (%)

Cost category	Allocation (%)
Technology infrastructure	48%
IT networks	27%
Project Costs	26%
Enterprise resource allocation	15%

Definitions

The new definitions below will be included in Special Condition 1.1 Interpretation and definitions.

<u>Day 2 CTA Contract</u>	<u>means a contractual agreement between the ISOP and National Grid Plc or its Affiliates or Related Undertakings in respect of costs incurred by National Grid Plc or its Affiliates or Related Undertakings for the delivery of FSO Transition Activities carried on or after 1 October 2024, and which has met the requirements set out in any direction issued by the Authority (following consultation with the licensee and National Grid Holdings One plc).</u>
<u>FSO Transition Activities</u>	<u>means activities carried out by the ISOP and/or National Grid Holdings One plc (together with other companies in National Grid plc's group) to:</u> <u>(a) separate the ISOP's business from National Grid Holdings One plc</u>

	<p><u>and other companies in National Grid plc's group;</u> <u>(b)transform the ISOP so it has the capabilities, systems and processes needed to perform the roles and responsibilities of the ISOP (including with respect to gas); and</u> <u>(c) support the development of the governance and regulatory arrangements for the ISOP</u></p>
<u>Indirect Investment</u>	<p><u>means expenditure on information technology systems which is incurred to invest in services to all companies within the National Grid group, and which is not directly attributable to individual companies within the National Grid group. This excludes ongoing shared services costs incurred to provide business as usual services to National Grid group companies and any costs associated with SSA.</u></p>
<u>Transitional Services Agreement</u>	<p><u>means the agreement of that name entered into pursuant to the Independent System Operator and Planner Transfer Scheme made pursuant to paragraph 1 of Schedule 9 of the Energy Act 2023.</u></p>

Annex 2

National Grid Electricity Transmission Plc

Electricity transmission licence

Special Conditions

We have set out the proposed addition of Special Condition 9.21 Termination of the Operational Services Agreement to Chapter 9: General obligations. This is shown below in double underlined text.

Special Condition 9.21 Termination of the Operational Services Agreement

Introduction

9.21.1. The purpose of this condition is to set out the requirements on the licensee in respect of termination of the Operational Services Agreement.

Part A: Termination of the Operational Services Agreement

9.21.2. Prior to the licensee exercising any termination right in respect of the Operational Services Agreement, the licensee must first consult with the Authority and comply with any direction given by the Authority as to whether or not to exercise such termination right.

9.21.3. The licensee must as soon as reasonably practicable notify the Authority if it proposes to make any change to the duration, term, termination rights or the Authority's role as set out in the Operational Services Agreement (in whole or in part).

Definitions

The new definition below will be included in Special Condition 1.1 Interpretation and definitions.

<u>Operational Services Agreement</u>	<u>means the agreement of that name entered into pursuant to the Independent System Operator and Planner Transfer Scheme made pursuant to paragraph 1 of Schedule 9 of the Energy Act 2023.</u>
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Annex 3

Modifications to the ET2 Price Control Financial Instruments published alongside this document.

RIIO-ET2 Price Control Financial Handbook

We have set out our proposals in tracked changes in the Price Control Financial Handbook.

RIIO-ET2 Price Control Financial Model (PCFM)

Within the 'NGET' tab of the PCFM we propose to make the following modifications:

- Row 77 is modified in the "Variant allowances (including Real Price Effects)" table to include the addition of the Consequential Costs term (CC_t);
- Rows 583 to 588 are modified in the "Totex variant allowances allocation percentages" table to account for the addition of the CC_t term.