NESO National Energy System Operator

Total Cost Allocation Methodology ("TCAM")

Introduction

1. This document summarises the methodology used to allocate the total expenditure incurred by National Energy System Operator Limited (**NESO**) between Electricity Licence Expenditure and Gas Licence Expenditure; determining whether costs will be recovered through the mechanisms set out in the Electricity System Operator Licence or the Gas System Planner Licence. This methodology is referenced in Part B of Condition F1 (Expenditure and allowed revenue) of the Electricity System Operator Licence and Part B of Condition F1 (Gas revenue calculations and notification process) of the Gas System Planner Licence.

2. In this document terms shall have the meaning set out in in Condition A1 (Definitions) of the Electricity System Operator Licence and the Gas System Planner Licence.

3. For the avoidance of doubt, we seek to recover all of our costs through either the mechanism set out in the Electricity System Operator Licence or the mechanism set out in the Gas System Planner Licence (with no double recovery). This includes recovery of NESO's costs that relate to any activities outside the electricity and gas sectors (such as costs related to other fuel types). Certain costs are required to be dealt with in a particular way in line with the Licence definitions. In particular, Gas Licence Expenditure specifically excludes any interest, other financing and corporation tax costs so any costs within those categories will be recovered via the Electricity System Operator Licence.

4. In general this document uses the terms "attribution" in respect of costs that are specifically incurred on behalf of either electricity or gas and "allocation" in respect of costs that arise either in unrelated areas or through the provision of common or shared services across the organisation. These are equivalent to the term "allocation" used in relevant licence conditions.

5. This is the first version of this document and was approved by Ofgem on 25 November 2024. It will be reviewed annually or at such other interval as Ofgem may direct in accordance with the Licence Conditions mentioned above.

Objectives of the Total Cost Allocation Methodology

6. In addition to complying with applicable licence obligations, the overriding objective of TCAM is to make the cost allocation process within NESO transparent and effective.

Attributes of the Total Cost Allocation Methodology

7. The design principle aims to strike the right balance between cost reflectivity and simplicity, the principal aims being to demonstrate:

   i a simple, transparent process;
   ii maximising the direct attribution of costs;
   iii adopting a consistent approach between gas and electricity;
   iv clear governance and ownership of the process and its results; and

National Energy System Operator Limited
Company Number 11014226
Registered office address St Catherine's Lodge, Bearwood Road,
Sindlesham, Nr Wokingham, Berkshire, RG41 5BN

v how we are complying with our licence obligations including Condition F1.9 which is to ensure there is no double recovery of expenditure through charges by allocating total expenditure as either Electricity Licence Expenditure or Gas Licence Expenditure.

A Simple, Transparent Process

8. Allocations will be reviewed as a minimum on an annual basis.

9. TCAM is designed to be sufficiently flexible to accommodate changes in departmental structures.

10. The transparency of the process makes TCAM readily auditable.

Clear governance and ownership of the process and its results

11. TCAM is the responsibility of the CFO Function within NESO.

12. Departmental cost allocations are sense checked by managers who are the relevant Subject Matter Experts.

Compliance with licence requirements

13. A fundamental requirement of TCAM is that it produces cost allocations consistent with all relevant licence obligations. TCAM should also allow us to demonstrate how we are complying with the licence obligations.

Explanation of the Total Cost Allocation Methodology

14. The process operates by attributing and allocating costs in three stages:

i Firstly, by identifying amounts that can be directly charged to either electricity or gas because they have used a specific resource for a specific purpose; and
ii Secondly teams that carry out duties across both types of fuel are specifically and individually allocated based on the responsibilities of the people in those teams.
iii Thirdly areas that:
  a. support the business as a whole
  b. have responsibilities that are unrelated to either electricity or gas
  c. are agnostic of fuel type

are allocated on a percentage basis in line with the proportions generated via stages i and ii.

Stage 1 of the process

17. Amounts that arise in teams with responsibility for solely electricity or gas activities are directly attributed using specific cost centres within the organisation's chart of accounts.

18. In accordance with the definition of Gas Licence Expenditure, any interest, other financing and corporation tax costs are excluded from Gas Licence Expenditure. In this stage these costs will be set apart to be directly attributed as an electricity cost.

National Energy System Operator Limited
Company Number 11014226
Registered office address St Catherine's Lodge, Bearwood Road, Sindlesham, Nr Wokingham, Berkshire, RG41 5BN

Stage 2 of the process

19. The second stage allocates any costs that arise in teams that work across both electricity and gas and are allocated using percentages identified in conjunction with the departmental managers as appropriate to the level of work carried out.

20. Such costs are allocated based on specific percentages that have been identified as applicable to each cost centre (and will not be the same across different cost centres).

21. The individual percentages used are reviewed on an annual basis by relevant departmental managers and finance. The percentages will normally apply for the whole of the following year unless a material change to activities occurs, which requires a revision to the relevant percentage allocation to be made and the calculations updated.

Stage 3 of the process

22. Any costs that remain after stages 1 and 2 relate to areas with support responsibility for the whole business, areas that do not cover either gas or electricity specifically or areas with generic responsibilities.

23. Stages 1 and 2 result in amounts assigned to electricity and gas. The costs considered under Stage 3 are therefore split in line with the proportion that resulted from Stages 1 and 2.

24. For example:

Stage 1 Electricity	100
Stage 1 Gas	15
Stage 1 Interest, Financing costs and Corporation Tax	5
Stage 2 Electricity	80
Stage 2 Gas	10

If there remains 100 to allocate via Stage 3, the Stage 3 allocation to Electricity is:

$$100 \times (100+80) / (100+15+80+10) = 87.8$$

and the allocation to Gas is:

$$100 \times (15+10) / (100+15+80+10) = 12.2$$

Electricity costs:

Totex costs	100+80+87.8 = 267.8
Interest, Financing costs and Corporation Tax	= 5

Gas Costs:	
Totex costs	15+10+12.2 = 37.2

Ofgem Reporting

25. The total amount of costs ultimately allocated to electricity and gas will be shown in the NESO Financial Model which is completed annually and will be published on the NESO website.

National Energy System Operator Limited
Company Number 11014226
Registered office address St Catherine’s Lodge, Bearwood Road, Sindlesham, Nr Wokingham, Berkshire, RG41 5BN