CUSC Workgroup Consultation Response Proforma

CMP306 'Align annual connection charge rate of return at CUSC 14.3.21 to price control cost of capital'

Industry parties are invited to respond to this consultation expressing their views and supplying the rationale for those views, particularly in respect of any specific questions detailed below.

Please send your responses by **08 May 2019** to cusc.team@nationalgrideso.com Please note that any responses received after the deadline or sent to a different email address may not receive due consideration by the Workgroup.

Any queries on the content of the consultation should be addressed to Shazia Akhtar at Shazia.akhtar2@nationalgrideso.com

These responses will be considered by the Workgroup at their next meeting at which members will also consider any Workgroup Consultation Alternative Requests. Where appropriate, the Workgroup will record your response and its consideration of it within the final Workgroup Report which is submitted to the CUSC Modifications Panel.

Respondent:	Matthew Paige-Stimson
Company Name:	National Grid Electricity Transmission Plc
Please express your views regarding the Workgroup Consultation, including rationale. (Please include any issues, suggestions or queries)	**For reference, the Applicable CUSC Objectives for the Use of System Charging Methodology are:** (a) That compliance with the use of system charging methodology facilitates effective competition in the generation and supply of electricity and (so far as is consistent therewith) facilitates competition in the sale, distribution and purchase of electricity; (b) That compliance with the use of system charging methodology results in charges which reflect, as far as is reasonably practicable, the costs (excluding any payments between transmission licensees which are made under and accordance with the STC) incurred by transmission licensees in their transmission businesses and which are compatible with standard licence condition C26 requirements of a connect and manage connection); (c) That, so far as is consistent with sub-paragraphs (a) and (b), the use of system charging methodology, as far as is reasonably practicable, properly takes account of the developments in transmission licensees' transmission businesses; (d) Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency. These are defined within the National Grid Electricity Transmission Plc Licence under Standard Condition C10, paragraph 1*; and (e) Promoting efficiency in the implementation and administration of the CUSC arrangements. *Objective (d) refers specifically to European Regulation 2009/714/EC. Reference to the Agency is to the Agency for the Cooperation of Energy Regulators (ACER).

Standard Workgroup consultation questions

Q	Question	Response
1	**Do you believe that CMP306 Original proposal, better facilitates the Applicable CUSC Objectives?**	We believe the Proposal better facilitates objectives (b), (c) and (e) in supporting TO licensee undertakings and doing so through efficient CUSC administration. However, it is unclear at this stage whether the Proposal better facilitates objective (a), in respect of competition in generation, for two main reasons. 1. The rate of return applied to a connection will vary by TO network, causing regional charging differences which BETTA tried to avoid on the principle of creating a level playing field for transmission connections across the whole of the Great Britain. We believe variance in rates of return and thence connection charges may undermine objective (a). 2. Customers who choose to capitally contribute to the cost of connection assets at time of commissioning, often fully, have capital contributions calculated including the prevailing year's rate of return. The Proposal may distort customer's decision making when considering whether to capitally contribute to connection assets or pay over time. Whilst the extent of generation users' connection assets is more limited than for demand and distribution users, and therefore more limited in practical impact, we believe these elements need further consideration by the Working Group.
2	**Do you support the proposed implementation approach?**	We believe the implementation needs to be earlier than 1st April 2020. We would suggest modifications for both CUSC and STC need to be made before 1st September to give certainty ahead of annual STC processes. TO Annual Charge Setting processes under the STC is requested by the SO by 1st October, with provision from the TO by the 31st October. If STC modifications, principally to STCP14-1, are also considered essential and needed before 1st October, then approval of the CUSC modification will be needed at an earlier date to give enough time for the required STC modifications for 1st September. If this CUSC change (and any corresponding STC change) cannot be implemented in time for 2020-21 Annual Charge Setting then we believe these changes should wait until the next round of Annual Charge setting a year later. We do not believe it is right for either Users or Relevant Transmission Licencees to be compelled to implement these changes during an already on-going Charging Year, given the potential confusion to Users and the procedural impacts for ESO and TOs.

Q	Question	Response
3	**Do you have any other comments?**	Yes. 1. There are other instances within CUSC Section 14, at least clauses 14.3.10, 14.3.13 and 14.4.4, that have references to 6% and 7.5%. For example, the rates of return apply to One-Off Works and as proposed, the rate of return applied to One-Off Works would still be 6% under this current Proposal. We believe that an explicit review and acknowledgement needs to be made by the Working Group of all other occurrences of 6% and 7.5% rates of return within Section 14 that, unless further amended, will be unchanged by this Proposal, with explicit recognition of the consequences of doing so, given the distortions inconsistency would create. 2. The proposed legal text "*as specified in the **latest published Ofgem price control financial model (PCFM)** relating to the relevant year*" will use the published PCFM WACC rate that is available at the time of Annual Connection Charge Setting. STCP 14-1 requires the conclusion of Annual Connection Charge Setting by 31st October in the year preceding the year for which charges are being set. Unlike the setting of TO Maximum Revenues, which is revised by 25th January with revised RPI assumptions, the STC does not *currently* require explicit revision of Connection Charges during January, ahead of the charging year. Some latitude exists within STCP 14-1 for the SO to request updated information at its discretion but there is no formal connection charge setting beyond 31st October Without further STC modifications, the Annual Connection Charge Setting will be concluded by 31st October each year and the forecast WACC for the charging year will therefore be the rate from the November PCFM two years before the charging year. More generally, the PCFM WACC rates for future years are only "**forecasts"**, subject to change until the relevant years' WACC rates become historical fact. Ofgem will need to fully consider how the TO will be able to recover its permitted return, per out-turned WACC rates, given that connection charges will be made on a forecast WACC basis that will differ from out-turned WACC whatever rate model is chosen for this Proposal. This aspect must be considered further potentially by a consequential STC modification workgroup (see Q6), as this appears to be primarily a Relevant Transmission Licencee and Regulator issue.
4	**Do you wish to raise a Workgroup Consultation Alternative Request for the Workgroup to consider?**	We do not wish to formally submit an Alternative Request at this time. However, as noted in our response to Q3, the Working Group needs to account for all other occurrences of 6% and 7.5% rates of return within Section 14 outside of clause 14.3.21 and the consequences of the Proposal not including amendments to these other occurrences.

Specific questions for CMP306

Q	Question	Response
5	**Do you agree with the approach proposed by CMP306 to the MEA uplift?**	Yes, we agree that any change to the basis of rate of return for MEA assets should be addressed under a separate change proposal if considered necessary. We note from our experience that MEA asset based indexation is a choice that is rarely exercised, with our most recent MEA indexed asset being commissioned in 2009. We believe therefore that any future review of MEA based charging should first start by considering the merits of removing the choice of MEA indexation, to promote efficiency in administration of the CUSC arrangements.
6	**Do you think that the TOs should publish their individual WACC's/rate of return for MEA assets? If so, do STC modifications need to be raised to achieve this?**	Our connection charge statement already sets out the rates of return for both RPI and MEA indexed assets and we would intend to continue to publish relevant rates of return within our statement. We would expect the inclusion of our WACC rates will form part of Ofgem's considerations when approving our charging statement. Although the ESO can obtain the TO specific rates through these two mechanisms we believe an STC requirement for the TO passing its WACC rates to the SO as part of TO Annual Charge Setting would be reasonable. We believe such an STC change is necessary for CMP306 to not present a disconnect between the CUSC arrangements which only impact the ESO directly, and our own arrangements with the ESO through the STC, which we would expect to concern the ESO first and foremost. It should be noted that under current STC arrangements Annual Connection Charge Setting is concluded by 31st October, meaning that any rates of return published in TO charging statements would be those utilised in Annual Connection Charge Setting and not the PCFM rates confirmed in the following month, by 30th November, of the year preceding charging year (see our response to Q3 point 2).

Q	Question	Response
7	**Do you agree with the approach to use regional TO WACC's? If not, do you think that the average model is better, or do you have any other suggestions?**	In respect of TO Connection Charging a key element that Ofgem must consider alongside this Proposal is how it intends to make a TO whole for the out-turned rate of return, inclusive of timing adjustments, allowed in the TO's licence. It is unclear whether true-up mechanisms, at least at the end of the current price control period, in respect of Excluded Services will provide for connection revenues made upon forecast rates of return to be adjusted to connection revenues entitled to be recovered by a TO on out-turned PCFM WACC rates. Excluded Services sit outside of the k factor adjustment of revenues. This need to make Excluded Services revenue adjustments to match TO allowed out-turned WACC rate of return applies to managing the consequences of using either a forecast TO WACC rate or an ESO averaged rate of return. Notwithstanding out comments in Q1 regarding objective (a), we consider that utilising TO specific forecast WACC rates is clearer in alignment to licence arrangements exercised through the PCFM. An SO averaging of TO specific WACCs to derive a singular GB rate of return does not so clearly tie back to TO price control arrangements and would need added formalised arrangements to recognised SO specified rates in the true-up to TO price control out-turned WACC allowed return. Having underlying TO specific rates averaged to a singular SO published connection charge WACC rate would be counter to the expected cost reflectivity of charges for a specific connection to a specific network. We believe that the basis of weighting such an average WACC rate across differently sized TO connection asset portfolios would introduce added complexity with reduced transparency. Though STC modifications are consequent to any Proposal, we consider that the TO should be able to continue to recover its return according to its own forecast WACC. Were an average rate of return approach adopted by the SO in respect of connection charges to customers, we believe that the recovery of the balance of connection revenues and TO connection charges, should be managed by the SO. This needs further consideration. We note that there may be an impact upon competition due to the differential in connection charges arising from different rates of return applying to different connections in different locations. Ostensibly this risk appears to be of low materiality with WACC rates across TO licensees appearing to be relatively close, but this is a matter we feel the Working Group does need to consider further.