CUSC Workgroup Consultation Response Proforma

CMP345: 'Defer the additional Covid BSUoS costs'

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 to cusc.team@nationalgrideso.com by **5pm** on **3 June 2020**. Please note that any responses received after the deadline or sent to a different email address may not receive due consideration by the Workgroup.

If you have any queries on the content of this consultation please contact Paul Mullen at paul.j.mullen@nationalgrideso.com or cusc.team@nationalgrideso.com.

Respondent details	Please enter your details
Respondent name:	Jenny Doherty & Grahame Neale
Company name:	National Grid ESO
Email address:	jennifer.doherty@nationalgrideso.com Grahame.Neale@nationalgrideso.com
Phone number:	Jenny Doherty = 07771 938569 Grahame Neale = 07787 261242

CMP345

For reference the applicable CUSC Charging objectives are:

Relevant Objective
(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) To promote efficiency in the implementation and administration of the CUSC arrangements

Please express your views regarding the Workgroup Consultation in the right-hand side of the table below, including your rationale.

CMP345 - Standard Workgroup Consultation questions		
1	Do you believe that the CMP345 Original Proposal better facilitates the Applicable CUSC Charging Objectives?	Overall, we do not believe the CMP345 Original proposal is better than the current CUSC baseline. We believe the Original is negative against Applicable CUSC Objective (a); whilst the Proposal would assist with short term liquidity issues by providing financial support to Suppliers/Generators during Covid19, this is offset by fact that it transfers BSUoS costs from those parties who should be liable (as they were generating/consuming in that settlement period) to others (who may not have been generating/consuming in that settlement period). This is a particular issue, in the case of new industry participants entering the market or growing their business over the course of the next financial year. As such we do not believe the Original Proposal facilitates effective competition. In addition, under the Original Proposal any firms who were able to account for Covid-19 (in full or part) in their pricing during the short-term would be unfairly disadvantaged because they will be uncompetitive compared to firms who didn't account of Covid-19 despite reacting to the market. We believe that the impacts of these disadvantages are reduced if applied over a shorter timescale i.e. within year. This is discussed in further detail in our response. We also believe the Original is negative against Applicable CUSC Objective B as the application of the BSUoS methodology would no longer reflect the high system management costs of NGESO and industry as they are incurred. We believe the proposal is neutral against Applicable CUSC Objectives C and D. Finally, we believe the Original Proposal is negative against Applicable CUSC Objective E as it will change the BSUoS charging methodology in a way that will subsequently need CUSC modifications to remove or revise a short-term change. This is compounded as the

		effects of this proposal will need to be managed for longer than the effects of Covid-19.
2	Do you support the proposed implementation approach for CMP345?	We support implementing alternative proposals to the Original Proposal as we discuss further below as soon as possible after an Ofgem decision. This needs to take into account the time required to implement any necessary process changes across the market. We do not believe retrospectively applying the modification to 1st May 2020 would be beneficial for the following reasons; 1. All BSUoS liable users have continued to date to meet their payment obligations through the Covid period to date, and therefore the requirement for backward looking financial support is not clear. 2. All of May's BSUoS charges should be paid by 23rd June and so those who are able to pay will already have done so by the time the mod is implemented. 3. The calculations and processing of the above will all need to be done manually, whilst the team are already stretched. We would need to ensure that SOx controls and appropriate governance were in place around such an approach. The cost of doing this additional activity will be significant and, with Ofgem's agreement, would be passed back to users in future charges. Overall, we believe a more pragmatic and efficient solution, if Ofgem approve a solution by 23rd June 2020, is to retrospectively apply this modification to 1st June 2020. If an Ofgem decision is made after 23rd June 2020 then the retrospectivity will also need to be delayed by the same number of days – e.g. if Ofgem approval is made on 24th June, retroactivity will apply back to 2nd June 2020. We are working towards a plan to have the IT solution ready for the 23 June, however deploying the change midweek means that we have to consider implications on batch jobs and system downtime. Achieving this deadline is also dependent on resolving all design queries and finalising detailed requirements in a timely manner. More information on the SF settlements run can be found on Elexon's website[1] or

[1] Slide 5 of this presentation - https://www.elexon.co.uk/wp-content/uploads/2017/03/Beginners-Guide-to-Settlement-Performance-for-Suppliers-FINAL.pdf

		specific dates can be found on Elexon's Portal[2] by using the "SAA Settlement Calendar".
3	Do you have any other comments?	We have provided numerous comments in the questions below, in addition we'd also like to highlight the following; **ESO position** For the avoidance of doubt, we want to clarify that the ESO's preferred option is "extended payment terms – ESO" as: - We believe that this best aligns with the support for TNUoS and DUoS as set out in Ofgem's letter[3] published on 2nd June 2020. - It targets and makes financial support available to those that consider they need it, whilst being available to everyone should they choose to opt in. - It ensures that those parties who incur the BSUoS costs remain liable to pay them, therefore reduces any gaming or market distortion and achieves objectives (a), (b) and (e) - The cost to the consumer would be minimised as only parties who "opt in" will receive the support, costs will be recovered over a shorter timescale and for a lesser total value due to the risk being shared between the ESO and BSUoS liable users - It provides certainty for those who "opt in" as the 30% of costs including VAT being deferred is set ex-ante, and therefore parties can factor that into their upcoming bills - Our current view from IT is that this is implementable in the time frames, although still with some risks, and aligns with the ESO's red lines, as set out below If Ofgem decided that a deferral of costs was the most suitable route, our preference would be for "within year cost deferral" for the reasons as outlined above. We note that this option would also provide certainty for BSUoS liable users, as the value to be deferred each month is set ex-ante, the proposal is for £62.5m a month.

2 https://www.elexonportal.co.uk/news/latest?cachebust=ga7i273ckk

3 https://www.ofgem.gov.uk/system/files/docs/2020/06/open_letter_on_relaxing_network_charge_payment_terms_1.pdf

		ESO requirements to support this modification To enable the ESO to facilitate any of the options set out above the ESO will need to raise additional funds. To do this, we have a set of requirements which, if met, we believe will allow us to raise the finances, without this we are not in a financial position to support the scheme: - There needs to be a cap to the total level of funding that the ESO is providing as a result of this modification - The total level of finance must be below £300m and must be recovered within year. The within year recovery minimises our VAT and accounting concerns - The ESO would remain NPV neutral, with any costs associated with implementing this modification including interest on additional external funding, bank facility arrangement and ongoing fees, IT system changes to implement revised processes and internal management of the new processes being covered. These costs would be agreed with Ofgem. Should there be any over or under-recovery, this would be passed back or charged to users through future BSUoS charges. - Bad debt recovery must be confirmed in writing by Ofgem that, where ESO follows the CUSC debt collection liquidation process, the ESO will be able to fully recover outstanding bad debt within the year 2021/22 **ESO's ability to implement the original and alternates** We believe that one of the key considerations is how the ESO can implement the proposed solutions under CMP345 within the timescales required to be of benefit i.e. a matter of weeks. It is worth noting that the BSUoS charging and billing is a daily process. As such, our systems are designed to automate the end to end process as much as possible for the purpose of efficiency, accuracy and compliance. All the balancing mechanism data and customer volume data come from Elexon and feeds into our charging calculation system automatically which is then interfaced with the SAP system to generate and issue the bills to customers automatically on a daily basis. There is only limited manual intervention we could apply to the systems. To identify COVID and non-COVID cost at real time and

		apply different charging methodology or payment terms, it would require significant systems changes within both Elexon and the ESO. We discuss each option set out in the consultation below: <u>Original</u> Although we do not support this option, as set out in this consultation response, our systems will allow us to defer some costs to a different charging year. We do however have significant concerns over the calculation of “Covid costs” as set out in response question 5. The current configuration of our charging system, gives us only limited ability to alter actions manually. The costs of actions taken within the BM cannot be manipulated. Therefore an IT system solution to deliver the necessary change to our charging and billing system will not be possible in these timescales. It is worth noting that any changes to BM data would also require a change to Elexon’s data flows to the ESO and therefore also a BSC change, we believe that such changes again would not be possible in the timescales as identified by the Proposer. This proposal would recover the £500m of deferred BSUoS costs through 2021/22 tariffs, which would result in a financial loss of £500m for the ESO in 2020/21. This could have a negative impact on ESO’s credit rating and increase future cost of debt. The ESO could only raise such a large amount of additional financing with an assumption of parental support, which is contrary to the objective of legal separation. <u>Within year cost deferral</u> Under this option, the proposal is to set the cost deferral at £62.5m a month. This is a simple change to implement, as we will be able to defer recovery of £62.5m (of non BM costs) manually from our charging and billing system and re-enter the values for later this year, with all other processes continuing as normal. It also does not require any separate calculation of BSUoS. We have currently proposed this option as fixed over the timeframes, however we appreciate that further consideration is needed about whether this amount should be reduced if the effects of Covid are no longer being felt. We would also need to consider the practicalities of implementing any variation of this. <u>Cost deferral to 2022/23</u>

		The implementation impacts are the same as with the original with the main concerns over the calculation of Covid cost and feasibility to deliver within the required timescale. The ESO would also not be able to implement this option as it does not align with our red line of recovering costs within the current financial year. <u>Target Covid costs to specific settlement periods</u> The implementation impacts of this are more complicated than the original due to the requirement of identifying the covid cost and then applying those specific costs to the equivalent Settlement Periods in 2021/2022. It would require manual intervention and IT changes not only for the current year charges but also for the following year. <u>Extended payment terms – ESO</u> Under this option, Covid costs are set at 30% of a User's invoiced BSUoS charges, for users that opt in. The main change required is to apply different payment terms to a proportion of BSUoS charges (including VAT) in our SAP system which creates the invoices for customers. This will require some changes to the SAP system, which are more feasible than changing the charging methodology in the Charging and Billing system. Due to the "opt in" nature of this alternate, we also believe that if needed, a manual workaround could potentially be developed to support a subset of customers. <u>Extended payment terms – Other</u> This option requires a significant and fundamental change to the Charging and Billing system to apply and calculate two different methodologies for the "BSUoS tariff" as well as potential different data provision from Elexon to split BM actions for COVID or non-COVID. As such we do not believe that this option is achievable in the coming month. <u>BSUoS price cap</u> This option would require the ESO to identify when the BSUoS price went above a certain value for each settlement period. This means that the charging and billing system would need to flag any settlement period when the price cap is met and, we would have to go into the charging and billing system to identify and change the inputs to ensure that the BSUoS price falls below the cap. The system today does not allow the ESO to make retrospective changes for each settlement period and

		with a daily billing process, it is not feasible to have a manual process to work around it. It therefore would not be implementable in the timescales. <u>Daily rolling average calculation</u> In addition to our concerns set out in response to question 11, we will not be able to implement this option within the timescales. Such an option would be complex, costly and introduce an unacceptable and unnecessary level of risk into BSUoS processing and invoicing. Smoothing or capping the £/MWh cost will require interrupting the BSUoS data processing, manipulating the data (in accordance with the approach) and then reinserting this manipulated data back into the process. At present, BSUoS charging is a highly systemised process and so there are no natural 'break points' to perform these data changes. New breakpoints and logic would need to be created which would lengthen any potential implementation timescale. We note that a WG member suggested that these calculations could be done via a spreadsheet, however, this would not meet with our external audit and compliance requirements. Due to the scale of the revenue recovery in question it would be inappropriate and introduce significant risk to the process to attempt to manage pricing and cost recovery via a spreadsheet approach.
4	Do you wish to raise a Workgroup Consultation Alternative Request for the Workgroup to consider?	NGESO would like to raise 2 alternatives, both of which are already noted in the consultation document; 1. Our preferred option of a targeted approach which allows a user to opt-in to extend payment terms to later within the financial year without adjusting BSUoS costs/prices 2. An option that adjusts BSUoS costs/prices for all parties and defers some BSUoS costs to later within the same financial year More details are provided in the attached Alternative Proposal forms. These proposals are currently fixed over the timeframes, however we appreciate that further consideration is needed about whether this amount should be reduced if the effects of Covid are no longer being felt. We would

		also need to consider the practicalities of implementing any variation of this.
Specific Workgroup Consultation Questions		
5	Do you believe it is necessary to define Covid related costs for the purposes of BSUoS charging as a result of this Modification proposal? Please provide rationale to support your response.	We believe that defining “Covid Costs” in an ex post manner is not necessary and would be complex to implement in the timescales. We therefore think that a proxy for “Covid Costs” that is set ex-ante is the simplest option. We believe if an option looks to treat “Covid Costs” differently to normal BSUoS costs then the differences between them should be defined; there is then a separate question as to what these definitions should be. Setting this definition is challenging as some actions could increase BSUoS which is not driven by Covid, for example by fluctuations in the weather. The Original proposal looks to identify specific items as Covid Costs which, whilst good in theory, is difficult from an implementation perspective. As an example, trying to implement this for any Balancing Mechanism actions as a result of demand being less than 18GW would mean; 1. A new team would need to be established to identify each action and classify whether it was needed against a hypothetical 18GW demand. This would be a costly, manual and non-transparent process. In addition, the BM data from Elexon would also need to flag COVID and non-COVID actions. 2. There are unanswered questions as to how ‘far’ the above assessment should go. Would it only look at undertaken actions and determine if they were/were not Covid Cost or would it need to assign portions of the action to Covid Cost or would the team need to create a list of hypothetical actions (against the hypothetical 18GW demand) to determine the difference? 3. As the above process, would result in a variable amount of ‘Covid Cost’ each settlement period, industry would have no ability to know in advance how much of BSUoS would be classed as Covid Cost and would therefore be deferred. 4. The Balancing Mechanism and BSUoS billing systems are heavily integrated and so this assessment would need to be done manually (i.e. billing the BSUoS amounts and crediting Covid

		Costs). This would be expensive to administrate and may lead to errors and so reduce the value of any support compared to simpler solutions. We believe a more practical solution is to define Covid Costs as a proportion of total BSUoS costs. This would require an assumption that these Covid Costs relate to the overall cost of Covid rather than specific costs within a settlement period. By undertaking this proportion ex-ante, we would not require system changes and could provide certainty and transparency to the industry. It is worth noting that this proportion is achievable, however under the deferring cost options, users cannot opt out of this option which may be a disadvantage for some.
6	Do you agree with the Original Proposal (and each of the potential alternatives) as to what constitutes Covid related costs? Please provide rationale to support your response.	As stated in our response to Question 5, we agree with the principle of what constitutes a Covid Cost but believe it is impractical to implement and so a less rigorous interpretation needs to be taken for example an ex-ante proxy.
7	Do you think any deferral of Covid costs should be i) within the 2020/2021 Charging Year only, ii) deferred to the 2021/2022 Charging Year or iii) deferred to 2022/2023 Charging Year or iv) deferred equally across the 2021/2022 and 2022/2023 Charging Years? Please provide rationale to support your response.	We believe that any deferral of costs, or extended payment terms, should be fully recovered within the existing 2020/21 charging year. This is due to the following reasons: 1. The impact of market distortion by charging different users than those who incurred the costs (as per the methodology today) is minimised as the time period is reduced 2. As a result of Covid, the typical demand profile between consumer types (domestic, SMEs, Large I&C etc) is different to what would normally be expected. This could result in distributional effects should demand profiles change between financial years. 3. The cost to the consumer of financing such support will be cheaper if it is all recovered within the existing charging year, as the finance will be over a shorter period. For example, the costs to extend payment terms on £1m at 8.1% within year are £30k compared to extended throughout 2021/22 at £95k. 4. This is aligned with the ESO's requirement (as noted in response to question 3) to recover costs

		within the financial year to minimise VAT, bad debt and accounting concerns. 5. Deferral of COVID costs beyond 2020/21 increases the perception of ESO's risk which could negatively impact ESO's credit rating. This could make debt more expensive in the longer term which could increase costs for consumers. 6. Deferral of costs for more than a year could artificially support customers that were already poorly managed. Provision of support could be used to pay shareholder dividends, or management bonuses, which could reputationally damage industry and increase cost to consumers.
8	Do you consider it appropriate to smear the entire deferred Covid costs equally across the whole of a Charging Year e.g. 2021/2022 or target the deferred Covid costs to the equivalent Settlement Periods in 2020/21 in which Covid costs arose? If the charge was to be applied equally across a Charging Year should that be on a per Settlement period only basis or on a per MWh basis? Please provide rationale to support your response.	We believe that the costs should not be smeared across other charging years but should be targeted to those who were using the system at the time the costs were incurred and therefore are liable for the cost. We think that this is both fair and does not distort the market. For this reason, we prefer the extended payment terms options, as it ensures that those who have incurred the costs are liable to pay. By smearing Covid costs (over any timeframe) there will be windfall gains and unexpected losses by firms as those who generate/consume energy in a settlement period won't pay the full BSUoS charge (associated with that generation/consumption) as it will be subsidised by others in the later timeframes. We are concerned that any proposal that defers costs to a future period would effectively protect shareholders at the expense of consumers. We do not consider this to be appropriate and would urge the workgroup and Authority to consider this balance of risk and consumer cost appropriately. In addition, smearing will affect firms differently depending on how much of their business is done on long-term or short-term contracts. This is because those who trade on shorter timescales will already be factoring Covid Costs in to their prices and so if these costs are deferred, they will be uncompetitive in the short term against those who didn't factor in Covid Costs whilst then having to compete against the same firms in the longer term to recover the Covid Costs when repaying (all other things being equal).

		We would also note that there is disparity of the Covid impacts between Suppliers and Generators. This is due to generators having access to revenue streams which will be utilised more during Covid and so provide opportunities for additional income. For example, those who are participating in the Balancing Mechanism and providing Balancing Services may have increased revenue available to mitigate the financial impact to them of COVID and increased BSUoS. Their payments for participating in these markets are also a contributing factor for why BSUoS costs have increased. If Ofgem were to approve an option where costs are smeared, we think it should be done on a settlement day basis which is then volume weighted across the day. This would result in a larger proportion of Covid Costs being recovered during the peaks in usage and is aligned to the current process undertaken for annual costs, not specific to settlement period. This may partially mitigate (but will not fully resolve) the concerns raised earlier in the question however that those who use the system will not pay the full charge associated with when they used the system. As set out in response to question 7, we believe that the risk is also further mitigated within year.
9	Do you consider it appropriate to codify a capped figure for the Covid costs to be deferred? If so, based on the information available, what value do you believe it should be? Please provide rationale to support your response.	Yes we believe that there should be a codified cap to the support being provided by the ESO. We think that this is essential as it allows the ESO appropriately size the required financing, it allows BSUoS liable customers to be clear on the extent of the support being provided, and ensures that there is a limit to the additional costs consumers will face. We think that consumers should not be expected to pay for the whole £500m, as this is a forecast looking at the highest range of outcomes and therefore the real costs are likely to be lower, and BSUoS liable customers will have already accounted for some BSUoS volatility in their risk premia. We therefore think that a cap of £250m, which splits the forecast in half, is a fair split of the risk. Furthermore, a legally separate ESO with a RAV of £200m may find it difficult to finance a shortfall as high as £500m.
10	Do you agree that the period to be covered for deferral of Covid	Yes we agree that by 31 August 2020, BSUoS costs related to Covid would no longer be seen as

	costs should be limited to those incurred up to 31 August 2020?	“unforeseen” as parties will have accounted for this in their strategies. We do however note, that the ESO’s preferred option, as set out in response to question 3, will allow users to have access to four months’ support as set out in the original but will avoid the backdating of any changes.
11	Do you think the impact of the Covid pandemic on BSUoS is sufficient to justify a different approach to charging BSUoS in advance of the second BSUoS Taskforce completing its work? Bearing in mind the short timescale for implementation do you agree with the approach in the option outlined above? Please provide a rationale with your response.	No, we do not believe Covid is sufficient justification to implement large changes to the BSUoS methodology in short timescales. This could undermine the work undertaken to date by the BSUoS taskforce to redesign BSUoS in a way that is fair and non-distortive. We are particularly mindful that the taskforce has been discussing an implementation date of 2023 or 2024 due to the potential windfall gains and unexpected losses of any methodology change. Due to the very short timescales to implement any solution, we are not comfortable of the impacts this solution may have on the market, and if a sub-optimal solution is implemented now, it will come at a cost to consumers to revise this at a later stage. We do however think that this solution should be discussed as part of the taskforce when it reconvenes. As noted in our response to question 3 we also do not believe that we can implement this option in the short timescales.
12	Do you agree with the financing options set out above? Is there another way? Please provide rationale to support your response.	We believe the key principle is that the ESO should not benefit or lose from providing financial support. The cost of support should include facility arrangement fees, commitment fees and interest charges as well as the cost of making and maintaining any required systems and process changes. We agree that recovery of costs should be subject to Authority approval to ensure costs are efficiently incurred. We believe that where possible costs should be recharged to users in proportion to the support they receive. This could be achieved through interest charges where payment terms are extended. Where costs are deferred to future periods, costs could be recharged through an uplift to BSUoS charges. Whilst some workgroup members have commented that the 8.1% interest charge is too high, we believe that it is appropriate because:

		• It prevents users opting in solely for the purposes of accessing lower credit than they may ordinarily be able to access • It encourages take up only by those who are most in need • It is the standard CUSC rate for late payment • It would align to the rates of interest in the network support schemes, as set out in Ofgem's letter dated 2nd June 2020[4], thereby not creating an incentive for users to choose one scheme over another • The level of 8.1% is supported by the range of funding levels within the industry • The ESO will remain NPV neutral as set out in response to question 3, and therefore any over recovery, would be given back to all BSUoS liable users via BSUoS charges in future periods. We are concerned that this code modification represents a significant departure from the financing needs that have been discussed for ESO in RIIO-2 and that the consequences of any additional financing needs, profit and cash volatility would need to be taken into account.
13	Do you agree with the impacts we have set out in this Workgroup Consultation? Have we missed any impacted parties? Please provide details to support your response.	We are concerned that due to the tight timescales of this modification, there has been no analysis undertaken on the true impacts to various parties of this change and therefore how best to only target support to the parties who need it most. We believe that implementation of this Original Proposal or any of its Alternatives will carry some costs to consumers, however these costs are minimised if an option was chosen that ensured costs were wholly recovered within the year. Due to each generator and supplier having a different strategy and costing approach which is commercially sensitive, it is also difficult to quantify the benefits to industry and the consumer of providing this support.

4 https://www.ofgem.gov.uk/system/files/docs/2020/06/open_letter_on_relaxing_network_charge_payment_terms_1.pdf