

**CUSC Code Administrator Consultation Response Proforma****CMP345 'Defer the additional Covid -19 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](mailto:cusc.team@nationalgrideso.com) by **3pm on 12 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 Panel.

If you have any queries on the content of this consultation, please contact Paul Mullen [paul.j.mullen@nationalgrideso.com](mailto:paul.j.mullen@nationalgrideso.com) or [cusc.team@nationalgrideso.com](mailto:cusc.team@nationalgrideso.com).

| Respondent details      | Please enter your details |
|-------------------------|---------------------------|
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**For reference the applicable CUSC objectives 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).*

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

| Standard Code Administrator Consultation questions |  |
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| 1  | <p>Do you believe that the CMP345 Original solution, WACM1, WACM2, WACM3, WACM4, WACM5, WACM6, WACM7 or WACM8 better facilitates the Applicable CUSC Objectives?</p>   |
|  | <p>Additional and unexpected BSUoS costs have arisen as a result of low demand largely due to COVID-19. It is unlikely parties will be able to recover the costs unless they were already forecasting these extraordinary higher levels of BSUoS.</p> <p>We agree that if done correctly a deferral could help both generators and suppliers recover the additional cost, where this has not been factored into fixed consumer contracts or forward power sold by generators in the wholesale market.</p> <p>If these costs cannot be recovered it may contribute to some parties failing. When suppliers exit the market, other suppliers and market participants have to pick up any shortfall in costs, which will ultimately be borne by consumers. If done appropriately, a deferral of BSUoS costs could reduce the likelihood of parties exiting the market in a disorderly manner and leaving large debts.</p> <p>However, we are very concerned that some of the solutions offered introduce significant market distortions that would lead to adverse distributional impacts due to the way costs would be deferred. These adverse impacts outweigh any potential benefit for all of the solutions except for WACM5.</p> <p>It is our view that WACM5 addresses the defect in a proportionate and non-discriminatory way that minimises distortion in the market and unintended consequences. By adopting a practical and proportionate methodology, WACM5 minimises any distributional impacts while giving relief to suppliers and generators. As such, we believe this solution offers a clear benefit to consumers. Moreover, we believe that only WACM5 better facilitates the CUSC objectives.</p> <p>To assess the options, we categorised and analysed them based on their different characteristics and summarise our views below.</p> <p><b><u>Amount to be deferred</u></b></p> |

**COVID-related costs up to £500 million (Original, WACM8)**

It is difficult to accurately determine COVID-related costs. While COVID has been responsible for reduced demand, high renewable generation (driven by weather conditions) combined with more fundamental issues regarding system stability and the ESO's contracting strategy have had a compounding effect to produce the spike in balancing costs.

The Original and WACM8 would both place a disproportionate administrative burden on the ESO to flag costs which are COVID-related and are more complex than necessary. They are therefore negative against Applicable Objective (e). They also do not provide the degree of certainty that other options do.

**Nuclear and ODFM Costs (WACM3, WACM4)**

These costs are not transparent, and this method doesn't provide any certainty of what the deferral amount would be. This is not helpful for parties trying to forecast costs for future consumer contracts and wholesale market trades. It would also require the ESO to flag costs which are related to Nuclear and ODFM contracts which does not promote efficiency in the administration of CUSC arrangements (Applicable Objective (e)).

Also, we believe that the majority of the additional costs have arisen through increased activity in the BM and other existing services, not as a result of nuclear contracts and ODFM. As such, including these costs is unlikely to deliver meaningful benefits that better facilitate competition (Applicable Objective (a)).

**BSUoS Price Cap (WACM2)**

This method doesn't provide any certainty of what the deferral amount would be and is not helpful for parties trying to forecast costs for future consumer contracts and wholesale market trades.

WACM2 doesn't address the fundamental issue of parties being unable to recover the unforeseen increase in BSUoS costs. A BSUoS cost of £15/MWh is exceptionally high and the cap is unlikely to provide much protection or help parties recover high BSUoS costs below £15/MWh for a

prolonged period of time. WACM2 therefore does not meaningfully address the defect. WACM2 would only provide relief to those parties generating or consuming when the cap is applied and therefore does not facilitate effective competition (Applicable objective (a)).

#### **Absolute £250 million (WACM5, WACM7)**

A deferral amount of £250 million seems to be a pragmatic compromise when compared to other options which would either defer too little or an unduly high amount. Deferring a very high amount of BSUoS increases the risk of future supplier financial distress leading to supplier failures and higher mutualisation costs in future years. It would also be more challenging and costly for the ESO to finance. Whereas, deferring too little could see a greater number of suppliers exit the market in the near-term. Deferring £250 million would provide considerable relief to BSUoS payers and would mitigate the likelihood and impact of supplier failures in both current and future years.

Moreover, deferring an absolute amount of BSUoS cost, provides certainty to market participants of the change in BSUoS costs and assists forecasting for current and future years.

As such, deferring a fixed £250m of BSUoS better facilitate effective competition (Applicable Objective (a)).

It is also the simplest and least complex solution which could be easily implemented without placing an additional burden on the ESO. Therefore, in comparison to the others, WACM5 and WACM7 are better against Applicable Objective (e).

#### **Deferral methodology**

##### **Removing costs directly from the period they were incurred (Original, WACM2, WACM3, WACM4, WACM8)**

We are very concerned about the impact this approach would have and do not believe it is justified due to the clearly harmful effect on effective competition (Applicable Objective (a)).

These options would remove BSUoS costs out of the specific periods they were incurred. This affects the shape of BSUoS charges and would have a

particularly harmful and adverse impact on those generators which would have not been running in the high BSUoS periods where demand is very low. Peaking or flexible generation which is not likely to be generating during these high BSUoS low demand periods would end up picking up a significantly greater proportion of the costs once they are deferred than would have previously been the case. Therefore, these options reduce the BSUoS exposure of those plant running in the low demand periods and transfer it to flexible generation operating in the future. This reallocation of costs is a clear market distortion and is wholly unjustified and unfair.

**Removing the same amount equally from each day weighted per settlement period (WACM5, WACM7)**

By removing the same amount from the BSUoS pot for each day between 1<sup>st</sup> June – 30<sup>th</sup> September and weighting the amount based on the chargeable volume for each settlement period, any unintended reallocation of costs is minimised and ensures a level playing field between all generation technologies. This ensures generators and suppliers can benefit fairly and equitably from a deferral. This better facilitates effective competition (Applicable Objective (a)).

**When costs are deferred to**

All the options vary significantly in terms of when the costs are deferred to.

The costs need to be deferred to a time when they can be recovered to encourage a well-functioning market and maximise wider societal and consumer benefits.

**Within year (WACM3, WACM4, WACM7)**

If parties are unable to recover the additional BSUoS costs over the May – September period, it is unlikely they would be able to recover such additional costs between the October – January period given the short notice and contracting time horizons. As such, this approach offers little if any help to overcome the issue at hand.

We also believe a within year deferral would have an adverse impact on competition across the generation and retail market. This is because the

generation mix varies at different times throughout the year as do the demand profiles for different types of consumers. A within year deferral would therefore redistribute the costs in an inequitable way. This is clearly negative against relevant objective (a).

#### **2021/22 (Original, WACM2, WACM8)**

Many suppliers will have already agreed fixed-price contracts and generators may have already sold forward power well into 2021/22. So deferring costs to 2021/22 will not be particularly helpful for those parties. The benefits of this approach are therefore limited at best.

#### **2022/23 (WACM5)**

To realise greater benefit of a deferral, the cost should be deferred beyond 2021/22 where it can be better factored into wholesale market trades and fixed retail tariffs. That would better facilitate effective competition and positive against Applicable Objective (a). The only option which defers to 2022/23 is WACM5.

#### **Extended payment terms (WACM1, WACM6)**

We do not believe these options address the defect. The liability for the additional costs would still remain and there would be no smoothing effect in future years as there is with some of the deferral options.

Given contracting horizons in the wholesale and retail market, 5-6 month extended payment terms do not materially help parties recover the additional costs. These options are likely to only delay supplier failures and result in additional mutualisation costs which are borne by remaining parties and/or end consumers. As such, they are negative against Applicable Objective (a).

We also believe the 8.1% interest rate for WACM6 is unduly penal and not cost reflective, perversely resulting in higher costs for all those that take-up this supposed 'relief'. As such, this would be negative against objectives (a) and (b).

#### **Applicable Objective (a)**

Based on our assessment and the reasons set out above, we believe that on balance only WACM5 will address the defect and better facilitate effective

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|   |  | <p>competition. Whilst some of the others do have benefits, they are outweighed by distortions, adverse impacts and mutualisation risks.</p> <p>WACM5 will better enable market participants to recover additional BSUoS costs and will mitigate the risk of supplier default. WACM5 has a clear benefit to competition and consumers.</p> <p><i>WACM5 – Positive</i></p> <p><i>Others - Negative</i></p> <p><b><u>Applicable Objective (b)</u></b></p> <p>WACM6 proposes an 8.1% interest on extended payment terms and we do not believe this is cost reflective.</p> <p><i>WACM6 – Negative</i></p> <p><i>Others – Neutral</i></p> <p><b><u>Applicable Objective (e)</u></b></p> <p>The Original, WACM3, WACM4 and WACM8 require the ESO to flag COVID-related BSUoS costs based on certain criteria. This is inefficient and does not promote efficiency in the CUSC arrangements.</p> <p><i>Original, WACM3, WACM4 and WACM8 – Negative</i></p> <p><i>Others – Neutral</i></p> <p><b><u>Summary</u></b></p> <p>Our evaluation indicates that only WACM5 addresses the defect and better facilitates the Applicable CUSC Objectives. By removing the same amount from the BSUoS pot for each day between 1<sup>st</sup> June – 30<sup>th</sup> September, weighting the amount based on the chargeable volume for each settlement period, and then allocating this evenly across 2022-23, we believe this will help market participants recover the additional BSUoS costs and should reduce the risk of supplier failures and mutualisation costs.</p> <p>WACM5 address the defect in a way which minimises distortions, unintended consequences and can be implemented relatively easily.</p> |
| 2 | Do you support the proposed implementation approach? | Yes, the implementation approach seems reasonable.  |

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| 3 | Do you have any other comments? | <p>Different generation technologies, suppliers and consumers (e.g. domestic versus industrial) will be impacted differently by each of the options. The Workgroup did not have time to analyse this extensively. Based on our assessment, we believe that WACM5 minimises any adverse distributional impacts whilst providing competition benefits.</p> <p>The cost of financing any deferral is still unknown. We would have expected the ESO to provide an indicative figure to help parties assess the benefits and costs of a deferral.</p> <p>Fundamental issues with the BSUoS methodology and the ESO's procurement strategy / services remain a concern and must be held partly responsible for the defect CMP345 seeks to address. We recommend the BSUoS Task Force restarts ASAP and the ESO increases the pace of its Balancing Services reform programme.</p> |
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