**CMP317/CMP327 Implementation Issues**

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**Mar 2020**

## 1. CMP317/CMP327 Implementation Issues Introduction

1.1. This note explores issues of implementation associated with CMP317 and CMP327 in the context of the ESO request of 25th March 2020[1] to delay implementation of Connection and Use of System Code (CUSC) Modification Proposal (CMP) 332 "Transmission Demand Residual bandings and allocation (TCR) (the ESO Letter) and the subsequent Ofgem confirmation of the request on 31st March 2020[2] (the Ofgem Decision).

1.2. The reasons for delay cited in the ESO Letter and the Ofgem Decision raise issues for implementation of the other related Targeted Charging Review (TCR) Modifications, particularly CMP317 and CMP 327.

## 2. Background

2.1. The ESO Letter establishes the reason for the proposed delay of CMP332. These relate to two specific issues:

i) **Lack of visibility to the workgroup of modelled tariffs and consideration of alternatives:** The ESO stated the following: "*Through the Workgroup deliberations and consultations a full set of modelled tariffs under the intended transmission demand residual charging methodology has not been available due to the necessary data being unavailable until very recently from market participants. This has meant that Suppliers and users of the system have not been able to understand the effects of the methodologies that have been put forward and are unaware of the full impacts on them of the changes. This has also meant that full consideration of any alternative proposals has not been possible. As such NGESO consider more time to consider these and make market parties aware of impacts is appropriate*"; and

ii) **Short term realisation of consumer benefits:** The ESO stated the following: "*Suppliers and demand users will only know the full extent and impact of the changes to the demand residual charges they face after Ofgem publish their decision on the TCR SCR modifications in the summer and the ESO and DNOs have used the new methodology to produce final tariffs. This means that they will receive invoices in April-21 following notification of approximate final charges late in 2020. This provides very little time for parties to truly understand the impacts on them, adjust their business models in response to the new tariffs and for suppliers to pass the consumer benefits through bills. In addition, due to the uncertainty created by these charging structures, NGESO consider that Suppliers may feel they have to include risk premia or other mitigating elements within consumer contracts*".

2.2. In the ESO Letter, the ESO states that "*In the code change process and through the SCR more generally, NGESO consider that although the changes envisaged for Suppliers being charged based on gross demand for BSUoS and the removal of the transmission generation residual are substantial there has been clear indication to, and awareness within, the industry of the likely impacts on market parties. NGESO are supportive of these modification proposals to continue to progress at this time*".

2.3. The Ofgem Letter confirms that CMP322 implementation can be delayed from April 2021 to April 2022. In reaching its decision Ofgem highlighted that the difficulties in deriving tariffs and delivering the benefits created two key areas of concern:

i. How this is affecting suppliers and non-domestic consumers; and
ii. Potential consumer impacts and our decision to delay implementation of TDR charges

[1] The ESO request can be found at: https://www.nationalgrideso.com/document/166296/download
[2] The Ofgem consent letter can be found at: https://www.nationalgrideso.com/document/166626/download

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2.4. Under the first area of concern Ofgem highlighted that "*most suppliers fix their electricity prices for many of their non-domestic customers in advance, through contracts. The current uncertainty means that energy suppliers are not able to accurately estimate the charges they will incur in 2021 for these customers*".

2.5. Ofgem described the associated supplier issues raised for CMP322 as follows:

> *"We understand there is a significant variation in how suppliers are dealing with this [uncertainty], in setting prices for their 2021 contracts. Some suppliers have signed, or are continuing to sign, a significant number of non-domestic contracts for 2021 that do not take account of the expected changes to TDR charges. On average, TDR charges will increase for non-domestic consumers and decrease for domestic consumers. Hence, suppliers continuing to contract with non-domestic consumers without taking account of the TDR reforms will lead to: 1) these suppliers incurring losses, or 2) these suppliers triggering re-opener clauses with non-domestic customers to increase these charges.*
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> *This contracting activity could lead to significant disruption for some non-domestic consumers. If a significant number of contracts do not account for these increases, suppliers may need to re-open a significant number of their non-domestic contracts to recover the additional charges, when the new TDR charges become available in late 2020.*
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> *This could lead to a significant level of disputes, re-contracting and switching in the non-domestic supply market, which is typically based on longer-term contracts than other parts of the market. This could put some suppliers under financial strain, particularly those whose portfolios lack diversity or those who are reliant on a small number of large contracts for a significant portion of their revenue".*

2.6. Under the second area of concern Ofgem stated that "*There is a risk that the impacts outlined above could lead to significant costs for some non-domestic consumers. As explained above, this risk is difficult for industry to manage comprehensively*". Ofgem concluded that: "*Balancing this risk against the expected benefits of the introduction of new TDR charges in 2021 compared to 2022, we now believe that a delay of one year is in the best interests of consumers*".

2.7. Ofgem therefore concluded that: " *In the current circumstances, this delay will have the additional benefit of reducing pressures on industry and consumers in the coming months, and will hence further facilitate the implementation of the more straightforward changes to the two Embedded Benefits in 2021*".

2.8. With regard to the other CUSC Modifications as part of the TCR Ofgem provided the following comment: "*The two Embedded Benefits reforms of setting TGR to zero and charging suppliers BSUoS on a gross basis at the GSP, will continue to progress for implementation in April 2021. We agree with NGESO that market participants are well-prepared for these changes, and believe that reforms to these elements of charging will deliver significant consumer benefits from April 2021*".

**3. The Ofgem CMP332 Decision and CMP317 and CMP327**

3.1. The ESO raised CMP317 "Identification and exclusion of Assets Required for Connection when setting Generator Transmission Network Use of System (TNUoS) charges" on 29th May 2019. This modification was designed to address concerns about compliance with EU Regulation 838/2010 in the light of the Competition and Markets Authority (CMA) decision on CMP261 "Ensuring the TNUoS paid by Generators in GB in Charging Year 2015/16 is in compliance with the €2.5/MWh annual average limit set in EU Regulation 838/2010 Part B" [3]. CMP261 was rejected by Ofgem on 16th November 2017 and subject to an unsuccessful appeal to the CMA.

[3] This modification can be found at: https://www.nationalgrideso.com/codes/connection-and-use-system-code-cusc/modifications/cmp261-ensuring-tnuos-paid-generators-gb

3.2. The ESO raised CMP327 “Removing the Generator Residual from TNUoS Charges (TCR) on 28th Nov 2019. This modification is designed to implement the direction from Ofgem to the ESO under the TCR to remove the generation residual.

3.3. A combined CMP317/CMP327 workgroup has been established to assess these modifications. The original modification will exclude all local charges, have no target within the limiting range under Regulation 838/2010[4] (the Regulation), include an error margin and has an implementation date of April 2021. The workgroup is currently considering workgroup consultation responses and potential alternatives.

3.4. The CMP317/CMP327 workgroup has identified 20 potential variants which address the following key elements:

i) **The definition of connection assets as required for compliance with the Regulation**: Theses definition of the connection exclusion include all local charges, charge related to Generator only spurs and charges related to local circuits, local substations except for pre exiting and shared assets;
ii) **The amount targeted within the limiting range set out in Regulation**. This includes targets at €0.0/MWh, €0.25/MWh, €0.5/MWh, €1.25/MWh as well as no target within the range; and
iii) **The inclusion or exclusion of an error margin**: This only applies for those alterative with no target in the range.
iv) **Phasing implementation**: The majority of the proposals do not include a phased implementation, but some have a two year or a three year phased approach.

3.5. The workgroup has essentially been focussed on the detailed aspects of the modification especially the definition of the connection exclusion in the context of compliance with the Regulation. The workgroup has not set out the potential impact on generator locational tariffs, which would be uplifted uniformly in the original proposal as a consequence of the removal of the generator residual. The workgroup has not considered in detail the effect on the demand residual, which will be reduced as a consequence of the recovery of additional costs associated with the removal of the generator residual.

3.6. The ESO Letter and Ofgem decision Letter highlighted areas of concern expressed in the context of CMP332. These relate to

i) Lack of visibility to the workgroup of modelled tariffs and consideration of alternatives; and
ii) Short term realisation of consumer benefits.
iii) How this [the uncertainty] is affecting suppliers and non-domestic consumers; and
iv) Potential consumer impacts and our decision to delay implementation of TDR charges

3.7. Each of these areas of concern is considered in the context of CMP317/CMP327.

**Lack of visibility to the workgroup of modelled tariffs and consideration of alternatives**

3.8. The CMP317/CMP327 has not modelled the specific impacts of the proposed changes and alternatives on the locational tariffs. It is assumed that the original proposal will result in a uniform increase of around £5-£6/kW on generation tariffs. This will result in a corresponding reduction of demand tariffs as greater costs are recovered from generation. However, the workgroup has not assessed the effect of this

[4] COMMISSION REGULATION (EU) No 838/2010 of 23 September 2010 on laying down guidelines relating to the inter-transmission system operator compensation mechanism and a common regulatory approach to transmission charging, at https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:250:0005:0011:EN:PDF

saving on demand tariffs. However, since it is a cost reduction for suppliers it has been implicitly assumed that the benefit will flow to customers under the competitive supply arrangements from April 2021.

3.9. The lack of detailed information on the tariffs and the impacts of the different variants of CMP317/CMP327 echo the concerns that were raised under CMP322 in the ESO Letter and the Ofgem Decision Letter. In particular:

i) A full set of modelled tariffs under the intended transmission demand residual charging methodology has not been available;
ii) Suppliers and users of the system have not been able to understand the effects of the methodologies that have been put forward and are unaware of the full impacts on them of the changes; and
iii) full consideration of any alternative proposals has not been possible.

3.10. These concerns expressed under CMP332 are equally applicable to CMP317/CMP327.

**Short term realisation of consumer benefits.**
3.11. The ESO considers that the potential change resulting from the removal of the generator residual has been well signalled to the market and should have been taken into account. However, it is clear from the workgroup that the potential alternatives range from almost no change in overall costs to a significant and material impact on generation through the recovery of additional costs in locational charges (this is up to £6/kW). In this context if difficult to determine whether these cost uncertainties have or can be taken into account in wider market considerations such as bids in the capacity market.

3.12. It is implicitly assumed that the increased cost recovery from generators will result in reduced supplier costs which will be passed directly through the customers from April 2021. However, the workgroup has not considered in detail whether this is the case. The ESO letter raises specific concerns that are applicable to CMP317/CMP327. These include:

i) As noted in the ESO Letter "*Suppliers and demand users will only know the full extent and impact of the changes to the demand residual charges they face after Ofgem publish their decision on the TCR SCR modifications in the summer and the ESO… has used the new methodology to produce final tariffs*". This is also true for CMP317 and CMP327.
ii) "[Suppliers] *will receive invoices in April-21 following notification of approximate final charges late in 2020. This provides very little time for parties to truly understand the impacts on them, adjust their business models in response to the new tariffs and for suppliers to pass the consumer benefits through bills*". This is also true for CMP317 and CMP327.
iii) "*due to the uncertainty created by these charging structures, NGESO consider that Suppliers may feel they have to include risk premia or other mitigating elements within consumer contracts*". If this is true then suppliers will be unable to reflect to reductions in costs associated with CMP317 and CMP327 in their customer contracts.

3.13. The key risks associated with the implementation of CMP317/CMP327 in April 20201 is that generation will be unable to recover the increased costs and suppliers will not be in a position to pass through the benefits to customers. In the short term the benefits of CMP317/CMP327 will accrue to suppliers as a windfall gain rather than reduced costs for customers.

**How this [the uncertainty] is affecting suppliers and non-domestic consumers**
3.14. Ofgem highlight that most suppliers fix their electricity prices for many of their non-domestic customers in advance, through contracts. Given that the tariffs and adjustment associated with

CMP317/CMP327 are uncertain it is also true that suppliers are not able to accurately estimate the charges they will incur from April 2021 for these customers.

3.15. In the context of the Ofgem decision letters the following concerns relate to CMP317/CMP327.

i) There may be significant variation in the way that Suppliers are dealing with the uncertain outcome of CMP317/CMP327;
ii) Different contracting activity adopted by Suppliers in the context of CMP317/CMP327 could lead to significant differences in treatment for similar consumers;
iii) If a significant number of Supplier contracts do not account for the decreases in costs, suppliers may have windfall gains in relation to charges that only become available in late 2020;
iv) The uncertainty over tariffs and pass through of the benefits could lead to a significant level of disputes, re-contracting and switching in the non-domestic supply market, which is typically based on longer-term contracts than other parts of the market; and
v) The uncertainties created by implementation of CMP317/CMP327 in April 2021 could put some suppliers under financial strain, particularly those whose portfolios lack diversity or those who are reliant on a small number of large contracts for a significant portion of their revenue.

**Potential consumer impacts and our decision to delay implementation of TDR charges**

3.16. Implementation of CMP317/CMP327 in April 2020 is likely to create the potential for risks to suppliers and impacts on supplier contracts and in particular. Ofgem noted that the risks associated with implementation of CMP332 are "difficult for industry to manage comprehensively" and we believe this also applies to CMP317/CMP317 given the potential range of outcomes.

## 4. Conclusions

4.1. This note has considered the implications of the ESO letter and the Ofgem Decisions Letter on CMP332 for CMP317/CMP327. With respect to CMP332 Ofgem concluded that: "*Balancing this risk against the expected benefits of the introduction of new TDR charges in 2021 compared to 2022, we now believe that a delay of one year is in the best interests of consumers*". We believe that this is the case for CMP317/CMP327.

4.2. We do not accept that CMP317/CMP327 comprises "straightforward changes" that should progress with implementation in April 2021. There are a wide range of potential outcomes that are being considered by the workgroup, and this creates uncertainties on implementation, risks for generators and suppliers that cannot be effectively managed and uncertainties as to whether the benefits to customers will be delivered in April 2021. In particular the concerns expressed about Supplier contracting highlighted in CMP332 are also relevant for CMP317/CMP327. Consequently the benefits highlighted may not accrue to customers. They simply create windfall benefits for suppliers.

4.3. We do not agree with NGESO that market participants are well-prepared for these changes envisaged under CMP317/CMP327 given the range of potential outcomes. We do not believe that it is safe to conclude that reforms to these elements of charging will deliver significant consumer benefits from April 2021.