

Workgroup Consultation Response Proforma**CMP395: Cap BSUoS costs and Defer payment to 2023/24 to protect GB customers**

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 01 September 2022**. Please note that any responses received after the deadline or sent to a different email address may not receive due consideration.

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

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I wish my response to be:

(Please mark the relevant box)

 Non-Confidential Confidential

Note: A confidential response will be disclosed to the Authority in full but, unless agreed otherwise, will not be shared with the Panel or the industry and may therefore not influence the debate to the same extent as a non-confidential response.

For reference the Applicable CUSC (charging) Objectives are:

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.

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);

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;

*Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency *; and*

Promoting efficiency in the implementation and administration of the system charging methodology.

**The Electricity Regulation referred to in objective (d) is Regulation (EU) 2019/943 of the European Parliament and of the Council of 5 June 2019 on the internal market for electricity (recast) as it has effect immediately before IP completion day as read with the modifications set out in the SI 2020/1006.*

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

Standard Workgroup Consultation questions		
1	Do you believe that the Original Proposal or any of the potential alternative solutions better facilitates the Applicable Objectives?	<p>Mark the Objectives which you believe each solution better facilitates:</p> <p>Original <input checked="" type="checkbox"/>A <input type="checkbox"/>B <input type="checkbox"/>C <input type="checkbox"/>D <input type="checkbox"/>E</p> <p>The overall objective of the modification is to protect consumers over winter from volatile BSUoS prices through providing a cap on BSUoS. Beyond this objective, the proposal has a mixed impact on the applicable objectives.</p> <p>Objective a) Facilitate effective competition - this modification is aimed to facilitate the protection of the industry from exceptional costs over winter. NGESO believe that this modification will enable suppliers to remain competitive over winter by protecting them from exceptional costs, and therefore ensuring competition is maintained in the retail landscape. For generators, we are yet to be presented with clear evidence that supports the same argument. It is our understanding that generators are able to participate in a wider range of markets and products and are therefore less exposed to these exceptional costs as they can flex their pricing within the shorter-term priced products. Compared to the majority of consumers, who are locked into long-term contracts, generators are much less exposed to these. Therefore, we do not think that the modification is necessary to ensure effective competition within the generation market.</p> <p>Objective b) compliance with use of system charging - NGESO have no comment against this objective.</p> <p>Objective c) transmission businesses - NGESO believe that this modification has a negative impact on objective c it affects our ability as a transmission licensee to conduct our business. This is because it adds administration tasks and raises extra capital risk for the organisation for the rest of this financial year and next year.</p> <p>Objective d) compliance with the electricity regulation - NGESO believe this modification has a neutral impact on</p>

		<p>objective d as there is no "extra" and no "less" compliance to the Electricity Regulation.</p> <p>Objective e) efficiency in the implementation and admin of the charging methodology - NGENSO believe this will have a negative impact on objective e as it will create additional processes for a manual workaround if a generator payback option is approved. This will also increase the amount of work required for implementation of the systems required for CMP308/361 as this will change the inputs required. Therefore, this reduces the efficiency in the implementation and administration of the system charging methodology.</p>
2	Do you support the proposed implementation approach?	<p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p> <p>For suppliers the proposed implementation approach is relatively simple; any BSUoS prices above the cap can be managed by deferring these to next financial year. For suppliers the deferral will be then charged back via the new fixed tariff brought in by CMP308/361 on a volume £/MWh basis.</p> <p>For generators, it is more complicated. This is because if they have costs deferred, there is no current mechanism for them to pay this back next year due to the methodology developed for implementation of CMP308/361 which is for final demand only from April 2023. Therefore, in order for generators to pay these costs back, NGENSO would need to implement an offline, manual process to administer it and a provision would need to be introduced to provide for this despite the scope of CMP308. This is explored further in the answer to question 5.</p>
3	Do you have any other comments?	<p>Yes, it is important to ensure that this modification drives the right behaviour. With that in mind, it is important to understand the impact a cap will have on a market.</p> <p>In an un-capped market, parties are likely to bid around the mid-range BSUoS forecast in order to remain competitive whilst protecting their own commercial risk. For arguments sake, if 1/20 periods are exceptionally high, then 1/20 periods will potentially result in a loss, meaning that bids will need to be sufficiently high enough to cover this loss. If the number of exceptional periods increase or the level of exceptional period increase, i.e., the number of and the cost itself, parties will then need to bid at higher than the mid-range pushing overall BSUoS costs even higher (and vice versa).</p>

		<p>However, unlike suppliers, generators also have the ability to respond differently to changing BSUoS costs/changing commercial risk. Generators are able to have both short term (including within day) and long-term trading strategies. Therefore comparatively to suppliers, generators are able to respond better to unpredictability in an uncapped market.</p> <p>In a capped market, parties are likely to account for the cap to their prices (or indeed price to the cap). When comparing a capped to an uncapped market, Generators will have the ability to reduce their bids to lower than the mid-range (depending on the value of the cap) in order to remain competitive as their risk premia is reduced. When exceptional BSUoS costs happen within a settlement period, they have less of an impact due to the presence of the BSUoS cap, and therefore theoretically will keep bids lower. However, as the fund value is used up, there could be a change in bidding behaviour (increasing bids), to ensure the whole fund is used.</p> <p>The difference with a capped market/period is that there is then a payback period for the deferral amount. The deferral methodology will then further impact behaviour beyond when the cap is in place.</p> <p>Note in the scenario where generators do not have to pay the deferred amount, there is limited incentive to bid at sensible prices. The incentive would be to bid at higher prices in a capped market in order to access the full fund (and maximise revenue), and then not have the consequence of paying it back. This does not act in the interest of consumers. Having a payback mechanism ensures this behaviour protects consumers and is essential in any solution which involves generators being able to defer costs.</p>
4	Do you wish to raise a Workgroup Consultation Alternative Request for the Workgroup to consider?	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No 1. Supplier only cap - £25/MWh price cap, £250m overall limit with final demand pay back via the fixed tariff 2. Suppliers and Generators - £40/MWh price cap, £250m overall limit with final demand payback via the fixed tariff and non-final demand payback via a variable, volume-based £/MW/h

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Specific Workgroup Consultation questions

1	<p>The CMP395 Original proposes to set a £15/MWh cap on BSUoS. Do you think it is appropriate to set a BSUoS cap and if so to what value? Please provide the rationale for your response including any supporting analysis.</p>	<p>Based on our latest forecast data a cap of £15/MWh is likely to result in a deferral of £1.04 billion for the 6-month period the scheme is aiming to cover. Based on current funding levels (£250m) this would mean that the fund available to support the scheme would likely run out in the first or second week of December and so not provide the duration of support needed by industry. A higher cap level would extend the length of support that could be offered and therefore the degree of certainty a cap provides over that same period. We have calculated that a £40/MWh cap level would likely require £242m of funding to cover that same 6-month period. It's important to note that these deferral predictions are based on historical daily volatility levels that have been upscaled to the current monthly forecast costs for the October to March 23 period the scheme aims to cover. Actual deferrals will depend on whether those volatility/daily costs are higher or lower than what we have seen previously, in short, single very high-cost days result in higher deferrals and a quicker usage of the cap.</p>
2	<p>Do you think it is appropriate to introduce a rules based re-assessment of the BSUoS cap on utilisation against the limit of the additional BSUoS costs that would be deferred. If so, on what basis? Please provide the rationale for your response.</p>	<p>In order to ensure consistency and reduce volatility, it would be preferable to have one known and clear price cap throughout the entire period. This will ensure that it protects consumers from the exceptional BSUoS costs that are being experienced. Adding a mechanism for interim price caps creates uncertainty, increases potential unknowns to the process and introduces potential further uncertainty and risk to pricing strategies. This then leads to a fundamental question as to the purpose of the proposal; is this meant to protect against exceptional events or to maximise support? It is also not aligned to the previous mods (CMP345, 350 & 381) which introduced one fixed cap across a fixed period.</p> <p>If deemed necessary, it would be relatively simple from an implementation perspective to have a change of cap. A process would need to be defined in order to reset the cap (period of time/level of usage of pot etc.). It should be noted that ESO will ensure there is full transparency across the fixed cap period of reporting to industry on the use of the funding pot - this reporting will be daily NGENSO</p>

		note that there may be a risk of further urgent mods being raised if we do not have a reset mechanism.
3	<p>The CMP395 Original seeks to defer the additional BSUoS costs above the cap to the 2023/2024 charging year. Recovery of the deferred costs is proposed to commence from 1 April 2023. Do you agree with this approach? Please provide rationale for your response.</p>	<p>Yes, NGESO agree that the costs deferred should be paid back from April 2023 and should be paid back by the end of March 2024. Paying back within this time frame means that ESO will have the right level of credit facilities available to adequately manage its regulatory cash timing risks and is not reliant on support from the National Grid Group to cover any of these risks. This is particularly important because of the planned complete separation of ESO from National Grid Group by 2024, through the creation of the FSO organisation. Recovery of costs beyond the 2023/24 charging year would also limit ESO's ability to provide a meaningful level of support to BSUoS fixed tariffs which we expect will be implemented from April 2023.</p>
4	<p>CMP308 comes into effect on 1 April 2023 and removes the payment of BSUoS from Generators. Against this backdrop, the Workgroup have considered options to recover deferred costs from Generators from 1 April 2023. Do you support any of the options proposed?. Please provide justification for your response.</p>	<p>NGESO believe that parties who receive the benefit of this support should also contribute to paying it back. The complexity of this modification is the CMP308 transfers all BSUoS costs onto final demand from April 2023. In order to ensure there is a fair mechanism either (1) the cap needs to be for final demand only, or (2) generators need to contribute paying it back.</p> <p>Approving an option without generator payback risks distorting the market and generator behaviour as there is an unbalanced upside only for generators vs suppliers/final demand. It is also unclear whether an unbalanced mechanism (generators do not pay back) would truly promote the effectiveness and intent of this modification as in this scenario there is the risk that any strategic pricing set by generators may only be from a short-term perspective whereby the only priority could be to maximise short term revenue with no repercussions of paying back later. Note if generators do not have to pay the deferred amount, there is limited incentive to bid at sensible prices. The incentive would be to bid at higher prices in a capped market in order to access the full fund (and maximise revenue), and then not have to pay it back. ESO does not feel that a generator cap without payback would be the appropriate use of funding and in the interest of consumers. Having a fair payback mechanism ensures this behaviour protects consumers.</p> <p>Note that this means there are 3 potential options:</p> <ol style="list-style-type: none"> 1. Supplier only BSUoS price cap 2. Straight deferral of payment values for generators

		3. Deferral of payment for generators on a £/MWh based on volume in 23/24 portfolio
5	Do you think it is appropriate to introduce a Supplier BSUoS cap only or a BSUoS cap for Suppliers and Generators?. Please provide the rationale for your response.	<p>We believe the simplest and most effective option would be to have a Supplier only BSUoS cap. This would enable the price cap to be lower (£25/MWh), provide assistance to those in industry that have the largest direct benefit to consumers and be in the biggest need of support. It also has the simplest implementation method.</p> <p>Any deferral from one charging year to the next relies on the premise that you are then able to recover the deferred amount in the following charging year. Ideally the recovery should be from those same parties that benefited from the original deferral otherwise some parties may benefit unfairly from a scheme. With the implementation of CMP308 from April 2023 the BSUoS charge liability is passed solely to final demand and leaves us no methodology for recovering the deferred values from generators in the 23/24 charging year. If costs were to be deferred from generators as part of CMP395 then it would need to be very clearly defined in the modification how recovery from those same generators that benefitted would be achieved. We would then need to create a system to implement a pay back approach.</p> <p>We have listened to the feedback voiced during the workgroup and could support a generator payback methodology that is based on a volume and price £/MWh approach similar to how the current methodology works. For this we would propose splitting the portion of costs incurred by generators and suppliers, ensuring that each part of industry pays back the relevant share. For suppliers, this would be paid back through the normal BSUoS charges due to be levied next year, whether that was a variable tariff final demand only scheme or subject to Ofgem approval of CMP361, a fixed tariff final demand only scheme. For generators, the amount deferred would be smeared across the year so an equal amount is recovered per settlement day on a £/MWh basis for each generator. This is in line with how the majority of BSUoS costs are recovered under the current methodology. This would be implemented via an “offline” methodology, requiring NGEN resource to administer and is consistent with the approaches applied to generators under CMP345, CMP350 and CMP381.</p>

		<p>Given the complex nature of this approach, we would need to do monthly billing for generators as the effort required for daily billing would be burdensome and not cost effective. It is important to note that this approach does create "winners and losers" as those that generate (and therefore defer large costs in 22/23, may then reduce generation in 23/24 and not shoulder as much cost as they had incurred (and vice versa). However, compared to a fixed deferral, it does share the risk premia across industry and supports protection from exceptional BSUoS costs, as it shifts these costs into next year's operating costs that can be factored into pricing.</p>
6	<p>The CMP395 Original seeks to limit the additional BSUoS costs that would be deferred to £250m. Do you think it is appropriate to introduce a limit and if so to what value? Please provide the rationale for your response.</p>	<p>It is important to introduce a cap to the amount of cost that the ESO can defer to ensure that the ESO has enough available cash to manage all of its regulatory timing risks. The ESO must also continue to fulfil its licence obligations around sufficiency of resources and maintaining an investment grade credit rating. The ESO has shared with the workgroup an overview of the risks it is covering over the winter period as noted in the workgroup report and provided a rationale as to why £250m is at the limit of what the ESO can reasonably expect to fund. This value is higher than in previous BSUoS cost deferral code modifications and is provided with support from National Grid plc to be able to cover any low probability high impact risks that may emerge over the period of support being provided.</p>
7	<p>Do you agree that reporting of the percentage utilisation of the deferred amount should be in line with that introduced for CMP381. Please provide justification for your response.</p>	<p>Yes. Due to the volatility of BSUoS charges, the possibility of single very high daily costs and thus likelihood of large daily deferrals it is important to track the cumulative deferred total very closely to ensure any funding limit is not reached before this can be reported. If the cap is implemented in a similar way to the previous caps, we are comfortable we can report on daily capped values in the same way we did for CMP381.</p>
8	<p>Does the CMP395 Original proposal or any of the potential alternative solutions impact your business and/or end consumers. If so, how? Confidential Information can be shared with Ofgem directly particularly where it relates to</p>	<p>NGESO have presented empirical evidence that a £15/MWh price cap is very likely to be used up very quickly with the £250m limit. If this were to happen, it has the potential to create a market shock. We do not believe this meets the objectives and believe this will create a market distortion and trigger further volatility and risk to the market.</p> <p>Pay back options for generators complicates the CMP308 implementation and risks undoing the principles of the modification. It introduces a level of complexity and could be argued to minimise the impact of funding for the</p>

	<p><i>Ofgem’s Urgency Criteria.</i></p>	<p>parties that need it the most. In addition, there is a level of complexity in running an offline, manual process that will be required for this which requires additional resources.</p> <p>In addition to the above, there will be a need to bring forwards a license modification to facilitate the payback of deferred BSUoS charges. We will aim to do this in conjunction with Ofgem as soon as possible.</p> <p>The overall impact of this modification to consumers is that future consumers will shoulder the bill for current consumers over winter. This should enable competition to be maintained, particularly in the supplier space, who are more exposed to these exceptional BSUoS costs over winter and could be put into financial difficulty as a result. This impacts end consumers as a reduction in competition for suppliers, potentially increases costs for consumers.</p>
<p>9</p>	<p>Do you support the view that CMP395 would mean reduced overall BSUoS costs (as a result of reduced risk premia) and therefore benefit consumers. Please provide the rationale for your response.</p> <p><i>Confidential Information can be shared with Ofgem directly particularly where it relates to Ofgem’s Urgency Criteria.</i></p>	<p>BSUoS costs will reduce over the period of the price cap, but overall will not reduce. The BSUoS costs that are above the cap will simply be deferred to next financial year and will be paid for by future consumers. ESO have heard the position by generators that as a result of introducing a price cap this will reduce risk premium to generator pricing and hence reduce overall balancing costs/BSUoS. At this point in time the evidence presented is theoretical only and based on providing an opportunity for generators to provide lower bids; so it is unclear at present whether these lower risk premia will materialise.</p> <p>There is an acknowledged benefit to consumers in that protecting suppliers from potential exceptional costs will reduce suppliers going bust and hence help to enable competition being maintained over winter when costs are forecast to be high. Competition is vital to ensuring prices are fair, and that consumers have a choice of supplier, can select from a range of competitive tariffs, and therefore reduce the risk of paying an uncompetitive cost for electricity.</p>