

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

Respondent details	Please enter your details
Respondent name:	Iwan Hughes
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I wish my response to be:
(Please mark the relevant box)

Non-Confidential

Confidential

[Confidential annex provided to Authority]

For reference the Applicable CUSC (charging) 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 *; and*
- e. *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.*

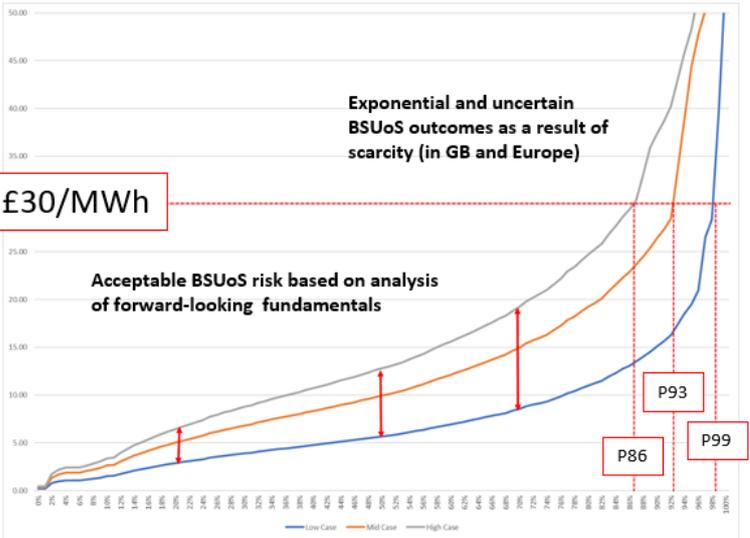
Please express your views in the right-hand side of the table below, including your rationale.

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> <table border="1"> <tr> <td>Original</td> <td><input checked="" type="checkbox"/>A</td> <td><input type="checkbox"/>B</td> <td><input type="checkbox"/>C</td> <td><input type="checkbox"/>D</td> <td><input type="checkbox"/>E</td> </tr> </table> <p>VPI will submit an alternative to CMP395. Conceptually however, CMP395 would result in reduced BSUoS risk premia (being factored into achieved wholesale prices by both GB generators and suppliers) as well as contribute to increasing the efficiency in GB wholesale markets. Increased certainty will result in a better outcome for GB consumers via both the cost of energy and the cost of balancing the system.</p>	Original	<input checked="" type="checkbox"/> A	<input type="checkbox"/> B	<input type="checkbox"/> C	<input type="checkbox"/> D	<input type="checkbox"/> E
Original	<input checked="" type="checkbox"/> A	<input type="checkbox"/> B	<input type="checkbox"/> C	<input type="checkbox"/> D	<input type="checkbox"/> E			
2	Do you support the proposed implementation approach?	<p><input checked="" type="checkbox"/>Yes <input type="checkbox"/>No</p> <p>VPI support the implementation approach.</p>						
3	Do you have any other comments?	<p>The cap and deferral fund should be set at an appropriate level to remove inefficient BSUoS risk premium being applied by both Generators and Suppliers this winter.</p> <p>The settlement period cap should be set at a level which does not defer BSUoS below what can be considered in 'business as usual'.</p> <p>The size of the theoretical deferral fund is important – and Ofgem should communicate to market participants that the cap is set at a level whereby the deferral fund will not be breached. VPI believe a hard £250m is too low, and a £420m deferral fund will result in risk premium being removed from the market, based on a current range of gas prices.</p> <p>A supplier only approach will not impact inefficient premium being factored in by GB generators.</p>						
4	Do you wish to raise a Workgroup	<p><input checked="" type="checkbox"/>Yes <input type="checkbox"/>No</p>						

<p>Consultation Alternative Request for the Workgroup to consider?</p>	<p>VPI has shared internal analysis with the Authority (this is confidential due to the use of forward-looking assumptions around market fundamentals).</p> <p>VPI is seeking to mitigate risks around very high priced ESO actions during peak periods of the day.</p> <p>We believe that a £25/MWh to £30/MWh BSUoS cap better reflects the inflection point whereby BSUoS costs can rapidly increase.</p> <p>VPI is proposing an alternative £30/MWh BSUoS cap with an <u>initial</u> deferral fund of £250m (in line with modification timescales) <u>along with a clear Ofgem communications to the market that it will work with the ESO to increase this amount to £420m if necessary.</u></p> <p>This communication should be binary, as it is unlikely that adding further ad-hoc incremental amounts of balance sheet support will send a clear enough signal to the market (e.g. we advise against stating that “<i>Ofgem will seek to increase the deferral fund by a further £[50]m before reviewing again</i>”).</p> <p>The outcome of the above will be that market participants should have enough confidence to remove inefficient BSUoS risk premium from the wholesale market (i.e. in settlement periods assumed to be above an average BSLD BSUoS cost of £30/MWh per day).</p>
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Specific Workgroup Consultation questions

<p>1</p>	<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>Yes. We believe that a cap would result in reduced risk premia for generators and suppliers, resulting in reduced overall costs for consumers this Winter.</p> <p>As stated, the BSUoS cap should be a set at a level which mitigates inefficient risk premium being applied in response to the potential for very high-priced ESO actions (e.g. interconnection actions and GB scarcity).</p> <p>VPI analysis suggests that above £30/MWh BSUoS, the total volume of very high cost ESO system actions is extremely uncertain (e.g. incurred by a price-taker ESO at times of GB and European system stress).</p> <p>VPI analysis supports a target £420m deferral fund being created (£250m approved immediately in line with modification timescales).</p>
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		<p>The below chart shows that in VPI’s internal seasonal modelling a £30/MWh cap would defer costs in 1.5%, 7% and 14% of hours in a low, medium and high BSUoS case respectively (under a range of gas price scenarios).</p> 
<p>2</p>	<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>No. The primary consumer benefit of the BSUoS cap lies in de-risking wholesale market participation as a result of greater certainty in BSUoS charges for generators.</p> <p>Varying the cap throughout the season removes certainty achieved by the cap and therefore will not reduce risk premia across in the market.</p> <p>As an example, if a maximum and minimum cap of £40 and £30/MWh respectively was set, a new £10/MWh inefficient risk premium could simply be created (potentially applied by both generators and suppliers).</p>
<p>3</p>	<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.</p> <p>Although generators will ultimately pass through BSUoS to consumers, VPI supports recovery from generators being in line with previous BSUoS caps.</p> <p>VPI notes that there will be a redistributive effect across generators however believe this is preferable to the potential impact of no BSUoS cap at all.</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>Our view is that the recovery mechanism should achieve two objectives:</p> <ol style="list-style-type: none"> 1) Ensure that there is a reduction of risk premia being applied by both generators and suppliers. 2) Be feasible to implement by 01 April 2023 <p>ESO have noted that option 1 and 2 are not feasible.</p> <p>Option 3a only results in a deferral of BSUoS costs for generators on a like-for-like plant specific basis, and therefore will not result in any reduction in risk premia (i.e. the generator will simply seek to recover the full BSUoS cost during winter 22, with the view of paying from April 23). BSUoS deferral is not about cash management, it is about removing inefficient risk premia from the wholesale market.</p> <p>Only option 3b (manual billing of aggregate generation based on per MWh charge over the billing period) achieves these two objectives.</p> <p>In a perfect scenario, some shaping of recovery by settlement period demand may be prudent to avoid disproportionate costs being carried by generators operating overnight – however we do not believe this is likely given precedent set by other BSUoS caps (and timescales available).</p>
5	<p>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>	<p>No, a supplier only BSUoS cap will not reduce risk premia being applied by generators. The result is unnecessary higher wholesale and balancing market costs, just charged by suppliers, and paid for by consumers, from April 2023.</p> <p>Secondary benefits of introducing the cap to both Generators and Suppliers may include increased liquidity, resulting in further market efficiencies and reduced overall costs for consumers.</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</p>	<p>VPI understand that the proposed £250m deferral limit has been derived by the ESO Board according to assumptions around the capability of its balance-sheet (and forecast views around BSUoS deferral at a £40/MWh cap).</p> <p>As stated, we believe Ofgem should approve an initial £250m deferral fund (available within modification timescales) however clearly communicate to the market that it will work with the ESO to increase this amount to</p>

	rationale for your response.	£420m if necessary). This should be a sufficient deferral signal at a £30/MWh cap.
7	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.	Yes. There is value in market participants having ready access to the utilisation level of the deferral limit, enabling price planning through the Winter season.
8	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 Ofgem's Urgency Criteria.	Yes. We are an independent GB generator with 3.3 GW of CCGT capacity. This will influence our BSUoS risk premium factored into short-run marginal cost. Other evidence: <ul style="list-style-type: none"> - Summer 22 has already seen BSUoS charges exceeding £170/MWh. - Current spreads indicate a high level of interconnection buy backs will be required (with the underlying fuel price and European scarcity pricing already trading French peaks to ~EUR2000/MWh) - Tight margins in both Europe and GB this winter <p>[Confidential assessment has been provided to Ofgem]</p>
9	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. Confidential Information can be shared with Ofgem directly particularly where it relates to Ofgem's Urgency Criteria.	We believe that CMP395: <ol style="list-style-type: none"> 1. Applied to generators and suppliers 2. With a sufficiently fair cap 3. With a sufficiently high/ certain level of deferral fund 4. And the correct cost recovery mechanism <p>would result in reduced risk premia realised in wholesale markets.</p> <p>This has a two-fold benefit to consumers. The first is an overall reduction in inefficient wholesale market costs (due to the financial impact of risk premia removed from pricing, and because increased liquidity will result in more efficient markets), paid by Suppliers to secure power for their customers.</p>

		<p>There is therefore a transfer of value away from generators and suppliers to consumers (i.e. inefficient BSUoS risk premium will not be retained in gross margin).</p> <p>The second is an overall reduction in BSUoS costs (as a result of generators and suppliers behaving less conservatively to mitigate the risks from high BSUoS costs which result in more efficient wholesale prices).</p>
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