Please use this Pro-Forma when responding to the Interim Report and Consultation of the second Balancing Services Charges Task Force.

The Taskforce will take all responses into its consideration when producing the final report. When providing a response please supply a rationale, particularly in respect of any specific questions detailed below.

Please send your responses to chargingfutures@nationalgrideso.com by 5pm on **26 August 2020.** Please note that any responses received after the deadline or sent to a different email address may not be taken into account by the Taskforce.

If you have any queries on the content of this consultation, please contact us at chargingfutures@nationalgrid.com .

Question	E.ON/npower Response
1. Do you agree with the Task Force's recommendations on who should pay Balancing Services Charges (Deliverable 1)? Please state your reasoning and evidence behind your answer.	While we do not disagree with the task force recommendation that it should be Final Demand (via suppliers) who pay BSUoS, the method of charging BSUoS needs to change at the same time, if not before. BSUoS is an extremely volatile charge, which is difficult to predict. Given it is not providing a forward-looking signal that customers can react to, BSUoS needs to be set ex ante with an over/under recovery mechanism. We understand the distortions BSUoS can create in the context of the wider European energy markets, and the previous determinations that the energy markets are efficient. In a truly efficient market, these reductions in the generation cost stack would be passed on through lower wholesale prices. However, we would urge Ofgem to revisit their analysis from CMP201 which showed that only half the cost reduction in BSUoS to

	generation would flow through into lower wholesale prices, as this would appear to contradict true market efficiency. There is a danger that by enabling closer convergence to European wholesale prices and encouraging more energy to be exported through the interconnectors, marginal prices in GB may increase and cause second order increases to the BSUoS price if the increased income from Europe is insufficient to stimulate new investment in GB generation or until such new generation is brought online. A mechanism should be introduced to monitor the wholesale price in order to verify that the full cost reduction is being passed through and pursue enforcement where it can be shown that generators are holding onto cost savings at the expense of the end customer. Another caveat to only final demand paying BSUoS is that securities required by NGESO from suppliers do not just double but that a holistic view is considered, taking into account the change from BSUoS being an ex-post to an ex ante charge and that a fixed charge is inherently more stable and easier to factor into customers' tariffs. Therefore E.ON & npower would expect supplier collateral requirement for BSUoS charges to rise, but not dramatically.
2. The Task Force have discussed how the recommendation on Deliverable 1) for Final Demand only to pay Balancing Services Charges could impact on large energy users and the potential for 'grid defection'. Do you think 'grid defection' is a possibility and to what extent would the Task Force's recommendations impact on your answer?	We do not believe charging to demand only means there will be grid defection. It is not who pays BSUoS, but how it is charged that would increase the possibility of grid defection. We believe that grid defection due to BSUoS price increases is a possibility but is unlikely given the low proportion that BSUoS makes of the overall electricity bill. Annual BSUoS costs are currently ~£1.8b p.a. across a total electricity demand of 450TWh giving an average cost of 0.4p/kWh. This therefore makes up ~3% of a domestic bill and ~4% of an industrial bill. Therefore, even if generators do not pass on BSUoS savings which would lead to a doubling of BSUoS without any reduction in wholesale price, it would only have the effect of increasing bills by 3-4% overall. If BSUoS doubles and wholesale

	energy prices do reduce by an offsetting amount, as would be expected in a truly efficient market, then there would be no additional charges to customers **<u>should the charging basis (£/MWh) remain the same.</u>** However, there may be additional pressure for grid defection should the basis of charging BSUoS change to a TDR residual banding based charge, particularly those with onsite generation who maintain a connection to the grid primarily for security of supply. This would become an additional unavoidable cost which would be significantly larger for some energy users. We have seen examples under the TCR banding methodology that some of the largest increases are seen by low consuming sites (vacant sites that remain energised for security/lighting requirements in HV Band 4 are seeing the costs rise from a few £ a year to best part of £200k). There are other cost movements (such as wholesale and network charges) which have a much greater impact which have not resulted in significant numbers of customers defecting from the grid.
3. Do you agree with the Task Force's recommendations that an ex ante fixed charge would deliver overall industry benefits? Please state your reasoning and evidence behind your answer.	We believe that an ex ante fixed charge for BSUoS is a much fairer charging methodology for what has already been shown to be a cost that cannot be charged in a cost reflective manner by the first BSUoS taskforce. As such we also believe this element could be delivered before implementing any change on who pays BSUoS. BSUoS currently does not provide a meaningful market signal. Conversely it currently provides a perverse signal to demand users, particularly pumped storage, at times of low demand where footroom issues occur on the transmission network. Removal of within day shape could help to reduce overall costs by removing such signals, and this would be improved further by smoothing the costs over longer time periods either ex ante or ex post. However, only by setting BSUoS ex ante would such signals be removed completely. There has been much discussion about the risk premia added by current market participants who recover the cost of BSUoS

	on behalf of the ESO, and how much it may cost the ESO to manage any under or over recovery of BSUoS through offering an ex ante fixed price. Market participants are subjected to a real risk with BSUoS - if they charge too much they will lose out in their respective competitive market, and if they charge too little they will not recover their costs and will not have an opportunity to recover any losses in the future. As such, their risk premia are likely to be set to a point where they are aiming to ensure that, as a minimum, they recover costs, simply for survival. Ad hoc events (e.g. Western Link out of service, extreme weather and Covid-19) can be a regular, but unpredictable, occurrence. These can very quickly cause extreme prices which could not have been anticipated or recovered. Market participants therefore need to apply risk premia which would protect against such events. Significant industry benefits of a fixed ex ante BSUoS charge include the potential to remove these risk premia from supplier tariffs to cover the uncertainty in BSUoS. This can be significant in terms of a % of overall BSUoS charges. As BSUoS increases in magnitude and possibly volatility, these premia are likely to increase in both absolute and % size unless changes are made. The funding for fixed ex ante charges that would be required by the ESO on the other hand, will be based on a guaranteed reconciliation. Whilst we acknowledge that the ESO is an asset light business that must be financially independent of its parent and therefore cannot easily obtain large amounts of finance, we believe that the ESO is better placed to manage this risk due to its guaranteed payment, even in the event of under recovery. We believe that it will be cheaper for the industry (and hence for customers), if ESO (or another organisation) were to fund BSUoS over/under recovery than for market participants to manage the risk of recovering their costs for them.
4. How long do you think the fixed period should be and what in your opinion is the optimal notice period in advance of the fixed charge coming into effect? Please state your reasoning and evidence behind your	It can be demonstrated that longer notice periods allow better predictability for suppliers pricing longer contracts than longer fixing periods do. Please see attachment 1. For a supplier, a 12 month notice of a six-

answer.	month fix (M+13 to M+18) would be preferable to 6 months' notice of a 12-month fix (M+7 to M+18). In both cases ESO would be forecasting up to 18 months out, but in the former, there would be less certainty with their forecast (as it is biased more in the future) and hence the under and over recovery may be larger. There is a trade-off between certainty for suppliers and certainty for ESO - a trade-off between risk premia charged by suppliers or risk held by the ESO. Fixes that focus on April and October contract rounds are not as useful for SME or residential customers who can lock into a contract at any time of the year. Overall it was felt that a 15-month notice is optimal, with a fix of either 3, 6 or 12 months. (DUoS is set with a 15 months notice for 12 months so there is precedence). In terms of optimal notice for implementing change, fixed price ex ante BSUoS could be introduced straight away as it does not introduce windfall gains and losses. This option would be helped if it remained a £/MWh volumetric charge as generators could not be charged on the TDR residual style methodology. It is only a change to 'who pays BSUoS' which requires an implementation lead time of at least two years after the April following decision.
5. Which approach discussed by the Task Force (TDR banded £/site/day or volumetric £/MWh) do you feel is most appropriate for Balancing Services Charges? Please consider your answer against the TCR principles and state your reasoning and evidence to support your answer.	We understand why the basis for the TNUoS residual TCR decision was based on a banded capacity basis. However, apart from constraint costs caused by lack of network infrastructure, there is less of a clear rational for applying this banded approach to balancing service costs. This would raise a question of fairness and proportionality, as some users will see their costs increase, possibly significantly, and others see their costs decrease, again, potentially significantly. Additionally, since BSUoS is already charged on a volumetric basis this would be simpler and cheaper to implement. If BSUoS remains at a fixed volumetric rate (£/MWh) it would be simpler to allow fixed price BSUoS to be introduced ahead of any changes to who pays BSUoS as TDR residual banding is not applicable to generators.

	We feel that a banded approach will add to the burden faced by low consuming customers who will be trying to keep their costs down by using less energy. For example, having a £/site/day charge for domestic customers would see an increase in the standing charge. Standing charges are recognised[1] as regressive and therefore the £/site/day option would impact vulnerable customers disproportionately. Secondly, some larger customers have invested in onsite generation. Should BSUoS become a fixed ex ante set via a banded approach, those large energy users would see significant increases in BSUoS (under the TDR methodology some users will see significant cost increases and others see significant cost decreases). This will be especially painful as they are the energy users who are also seeing significant increases in other network costs as a result of the TCR. The £/site/day option has already been shown to dramatically alter business customers bills using the TDR banding methodology. Some EHV Band 1 customers have seen increases of >100-200%.[2] Whilst BSUoS is a smaller part of the bill, using the same banding methodology will only serve to exacerbate the issues seen with the TDR. Another issue associated with £/site/day charges is the difficulty in factoring them into tariffs without a standing charge i.e. incorporating a fixed charge into a unit rate. Both E.ON and npower have customers who are charged on a unit rate basis and keeping the £/MWh structure will ensure that all such customers continue to be charged in a manner of their choosing.
6. The Task Force noted limitations of the approaches covered in Q5, what other methodologies or improvements to the ones in Q5 could you recommend to tackle them? Please consider your answer against the TCR principles and state your reasoning and evidence to	No response

[1] https://www.citizensadvice.org.uk/Global/CitizensAdvice/Energy/Energy%20Consultation%20responses/Tackling%20Tariff%20Design.pdf

[2] http://www.chargingfutures.com/about-charging-futures/charging-futures-forum/16-july-2020-forum-webinars/

support your answer.	
7. Is 2 years' notice of the changes prior to an implementation date appropriate? Please state your reasoning and evidence behind your answer.	Supplier contracts with customers, particularly at the larger end of the market, for three years or more are not uncommon. Due to these contracted positions we feel that any implementation date shorter than 3 years, or more importantly, within the period of market liquidity at the decision date, would cause significant harm to suppliers and customers. This is because they will have already purchased energy in the liquid market which was priced to include BSUoS - only to be charged BSUoS a second time when this energy is finally delivered. There will be offsetting windfall gains to generators who have already sold energy several years out which includes BSUoS in the cost stack if they are then not required to pay BSUoS at time of delivery. We believe that the windfall gains to generators if this is less than three years is greater than the benefits outlined under CMP308 and would be happy to share our analysis with Ofgem. Furthermore, it is not clear that the benefits of this change will feed to customers and suppliers through lower wholesale prices. No industry party should benefit from this change. If the decision is made to move payment of BSUoS solely to final demand, the implementation date needs to happen in a period that is outside of wholesale market liquidity at the time of the decision. We would suggest a rolling 3-year time horizon from the date of implementation. We can provide analysis to Ofgem showing some impacts to customers if it is helpful. In terms of optimal notice for implementing change, fixed price ex ante BSUoS could be introduced straight away as it does not introduce windfall gains and losses. This option would be helped if it remained a £/MWh volumetric charge. It is only the change to 'Who pays BSUoS' which requires careful consideration of implementation lead time.
8. Should the Task Force consider any interim measures? Please provide	We believe that it would be beneficial to deliver fixed price BSUoS earlier than any

details of any suggested interim solution including how it may deliver benefits to consumers or help to mitigate specific challenges facing market participants, whilst limiting any windfall gains or losses between industry participants.	potential changes to 'Who pays BSUoS'. There would be less notice required for this part of the change since it would not be significantly altering the price already built into power prices and therefore not causing windfall gains and losses. For early implementation of fixed price BSUoS, we feel that a fixed rate (£/MWh) would be required as the TDR banded approach could not be applied to the generation charges in a phased approach. Any under or over recovery should then be applied to remaining market participants as normal process dictates. Application of under or over recovery into a future charging period always detracts from the cost reflectivity and fairness of a solution but has already been accepted as part of the process for other regulated network costs. Alternatively, if it had already been determined that generation will stop paying BSUoS, then the fixed rate ex-ante BSUoS could be applied to demand only, and generation continue paying ex-post. This way, any under and over recovery accrued at the time generation stops paying BSUoS would be a result of demand under and over payment and thus be reapplied to the correct set of market participants in a future price fix.
9. Do you feel that there any interactions with the Supplier Price Cap that need to be considered? Please state your reasoning and evidence behind your answer.	We believe that currently the price cap does not allow for the volatility and year on year increase we have seen in BSUoS. The cost of BSUoS could be better modelled within the price cap if it was always known a year in advance (on an ex ante basis) and the price cap calculations were adjusted to use this information If BSUoS rate was doubled then the current backward-looking Price Cap methodology would never allow this increase in costs to be recovered. Hence, should BSUoS to be known in advance and the price cap methodology should be changed to forward looking and in synch with the setting of forward-looking tariffs. It would be beneficial to have the fixed price BSUoS mechanism built into price cap methodology ahead of any potential doubling of the BSUoS rate.

10. The Task Force's initial recommendation is that Final Demand only will pay BSUoS. If this is the case, is the current RCRC mechanism still appropriate? Please state your reasoning and evidence behind your answer.	Currently BM Bid and Offers for imbalance paid by ESO flow into BSUoS via CSOBM. Net imbalance charges paid by market participants (both demand and generation) nets off into RCRC. If generation no longer pay BSUoS, then they should not receive RCRC pay-out whilst demand is paying the offsetting BM costs as part of BSUoS. Please see (pre Single Cashout) attachments 2 and 3 as provided by NGESO. Both BM Bid/offer payments and net imbalance receipts should be netted off against each other and the residual of this become RCRC. This can still be charged/recovered as now on a HH basis or a modification raised to recover differently if the market has the appetite for this - changing the recovery of BSUoS would not affect this. Whilst the tagging of actions to distinguish balancing actions from imbalance is not perfect, it has been recognised as being fit for purpose.
11. Is there anything further you think the Task Force needs to consider?	Removal of wholesale energy market distortions should lead to GB wholesale price converging on European price. If this does drive down overall costs, the natural loser (as demonstrated by analysis from CMP308) would be the interconnectors who would see their margins on trades eroded. Ofgem need to be mindful of their targets for interconnection in the future and ensure there is still a business case for this required interconnection.
12. Please use this box to add any further comments that you may have	The current level of reporting on BSUoS and outturn at HH granularity needs to be maintained. This is to ensure no degradation in ability of market participants to forecast BSUoS. There will still be a need to forecast BSUoS to understand the under/over recovery due in future fixes, and also anticipate how ESO may set future fixes so that accuracy of tariff setting in future years, for longer contracts, does not deteriorate. The ability to forecast regulated charges is not a good basis for a competitive market. Charging BSUoS to market participants is a cost recovery exercise which, in an ideal world, the ESO would be

	able to bill themselves directly to consumers. Where it is deemed too expensive for a company to bill their end users directly and third parties used as collection agents (for "Third Party Costs") it is usual to: (a) pay the third party intermediary for this service (b) not pass a large risk to these third party agents (c) not be able to charge their third party collection agents more than these agents are collecting on their behalf - ie give clear notice of costs so agents are not unfairly charging end consumers different amounts (d) not be charging the collection agents for a cost they have already paid (in the energy markets) regardless of whether this double charging is passed on to end consumers or not If Ofgem were to penalise suppliers who contract and hedge energy further out than the average they would be signalling that all suppliers should compete in the same limited time horizon where fewer opportunities exist to create any sort of market differential If the implementation timescales are too short (i.e. falls within the period of market liquidity where energy has been traded at the time of decision date), there will be harm done to suppliers and consumers which will be offset by windfall gains to generators. Ofgem need to recognise this and provide a solution to compensate parties suffering financial losses e.g. generators pay the BSUoS paid back to Suppliers.

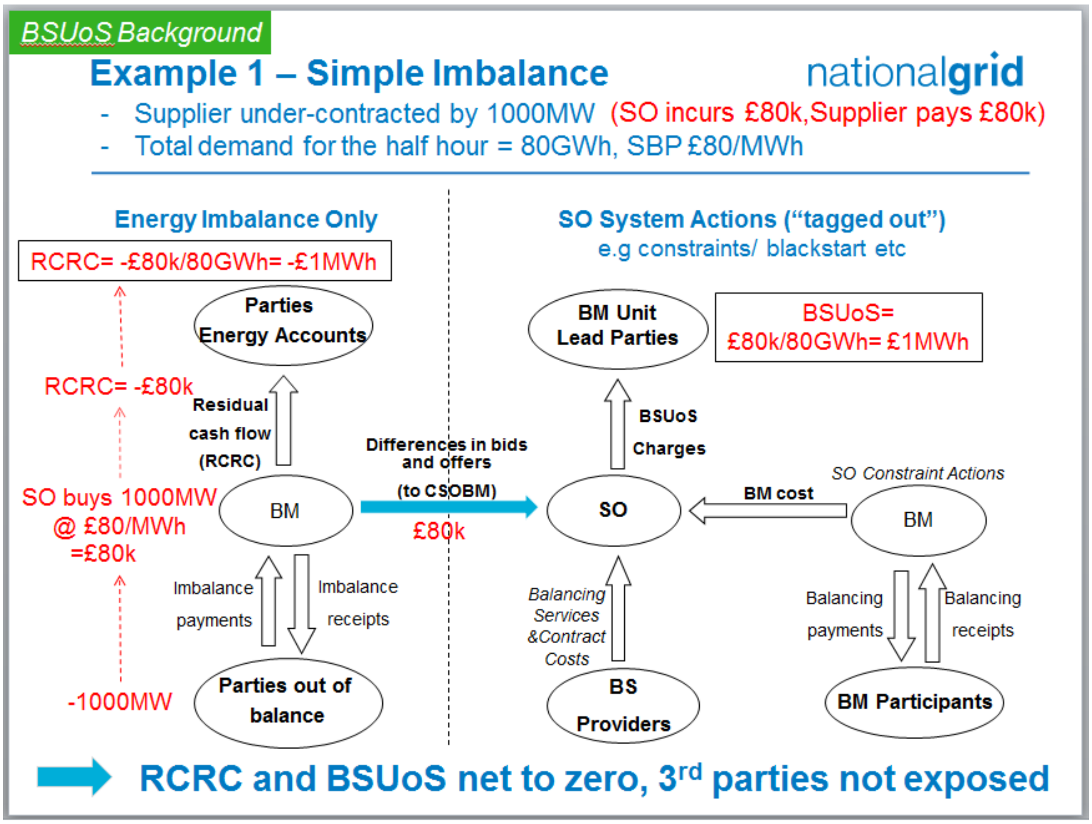
ATTACHMENT 1

Very simplistic modelling of level of uncertainty in a 2 year contract with various notice and fix periods.

Length of notice period is key e.g. 12 months notice for a 1 month fix gives greater average certainty than 6 month notice of a 12 month fix.

notice	fix	Max months certainty	min months certainty	average	average % of 2 year contact known
12	12	24	12	18	75%
12	6	18	12	15	63%
12	3	15	12	13.5	56%
12	1	13	12	12.5	52%
6	12	18	6	12	50%
6	6	12	6	9	38%
3	12	15	3	9	38%
6	3	9	6	7.5	31%
1	12	13	1	7	29%
6	1	7	6	6.5	27%
3	6	9	3	6	25%
3	3	6	3	4.5	19%
1	6	7	1	4	17%
3	1	4	3	3.5	15%
1	3	4	1	2.5	10%
1	1	2	1	1.5	6%

ATTACHMENT 2



ATTACHMENT 3