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	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.	The Task Force has relied on a principles-based assessment to arrive at its recommendations for Deliverable 1, and we broadly agree with this assessment. We welcome that the Task Force has included, as part of the recommendations for Deliverable 1, requirements for: • A notice period of at least 2 years • Justification through a robust quantitative assessment These are necessary given the materiality of the issue. Moving BSUoS to final demand is a significant transfer of costs with the potential for short-medium term detriment to consumers and windfall gains/losses.
	The risk of grid defection is mitigated by maintaining BSUoS as a £/MWh charge. This

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?	is because any increase in the direct £/MWh BSUoS charge should be at least offset by a reduced £/MWh commodity charge i.e. large energy users should face lower (or at least no higher) retail tariffs. However, if BSUoS moves to a fixed charge there would be an impact on the incentive to defect from the Grid as the redistribution associated with a fixed charge will inevitably increase costs for some large energy users. The possibility of Grid defection increases if more charges – TCR, potentially FLC and BSUoS also, move to a fixed charge.
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 agree that an ex ante fixed charge would deliver overall industry benefits. An ex ante fixed charge moves a financing cost from the industry to the ESO and reduces the risk faced by the industry. Therefore, whether there is an overall benefit to industry and consumers will depend on the change in financing costs and the value of the risk removed from industry. If we consider an unexpected increase in BSUoS cost of £50m. Under the current ex-post regime the size of the risk faced by industry is the full value of the £50m principal sum (as well as the financing cost associated with borrowing to fund the payment) since the cost will not have been factored into tariffs. Under an ex-ante regime, the ESO would need to finance the immediate payment of the £50m, with the principal sum and financing costs recovered from industry in a future charging period. The delay in the recovery of the unexpected £50m will allow industry to factor it into future tariff offerings – reducing the size of the industry risk associated with the principal sum. Also, the ESO should be able to access a lower cost of financing of the principal sum since it will have a regulatory guarantee of recovering it in a later period. Therefore, since the cost to industry is reduced for both the principal sum (ability to pass-through into future tariffs) and the financing cost

	associated with the principal sum (ESO able to obtain lower cost of finance), there should be a reduction in overall industry, and therefore consumer, costs. We note the timing of the recovery may have an impact on the statutory P&L reporting for the ESO, but consider financial markets are fully aware of the timing issues associated with over/under recoveries for regulated entities and do not consider this should be a barrier. We also recognise that if the length of the fixed period is too long, then the potential financing cost on the ESO could act to increase its long term cost of capital. This would begin to reduce the consumer benefit.
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 answer.	From a supplier perspective, the longer the combination of notice period and fixed period the more risk can be removed from tariffs, but it is difficult to identify the optimum combination that will maximise consumer benefits. We suggest charges are set ex-ante: • on a six-monthly basis • with 9 month's notice • with cost true up lagged by 6 months e.g. tariff for Apr-Sep in year t published by 1st July in year t-1, with any deficit/surplus included in the rate for Apr-Sep in year t+1. We believe a charge set 9 months in advance to apply for 6 months with a 6-month lag in cost true up is a proportionate balance between reducing industry risk and ESO financing costs. This will allow suppliers to price the majority of 12-month contracts with certainty for both of the main April and October contract rounds. A longer fixed period with shorter notice (e.g. 3 months notice with 12 months fixed) risks distorting retail market with contracts starting in October carrying more over/under recovery risk than those starting in April.
5. Which approach discussed by the Task Force (TDR banded	We believe that a fixed ex-ante £/MWh would be the most appropriate approach. This

£/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.	scores well against the TCR principles and carries far less risk of unintended consequences than the TDR approach. **<u>Volumetric £/MWh:</u>** The volumetric approach scores well against all three TCR criteria of reducing harmful distortions, fairness and proportionality and practicality. *TCR criteria* **Reducing harmful distortions**: would remove or reduce the majority of existing distortions (e.g. it would remove any time of day signal). **Fairness**: would ensure that the benefits of the change are realised by all consumers (through lower combined commodity/BSUoS £/MWh rates). **Proportionality and practicality**: would have limited practical implications. We recognise that this approach will retain some opportunity for behind the meter generation to reduce BSUoS costs. We consider the scale of this activity to be limited and we note that the potential arbitrage opportunity for behind the meter generation is significantly reduced by the adoption of a flat BSUoS rate. **<u>TDR banded £/Site/Day:</u>** We believe this approach brings a significant risk of unintended consequences and performs less well against the TCR principles. *TCR criteria* **Reducing harmful distortions**: limited improvement on the distortions reduced or removed by the volumetric approach. **Fairness**: some customers would see significant increases compared to the volumetric approach. This is less likely to be perceived as fair than with the TCR as the cost recovery is not driven by ‘sunk costs’. It is reasonable that all customers should make a fair contribution to ‘sunk costs’. This is not case with BSUoS and so may not be viewed as fair.

	Proportionality and practicality: A TDR fixed charge approach could lead to additional risk premia (relative to a £/MWh charge) as suppliers are unable to accurately price customers whilst the industry determines the residual charging bands and allocates customers to them. This negative impact does not just apply at implementation but is repeated with each banding review. This is a new consumer cost introduced by the TCR banding methodology. *Unintended consequences* A further large increase the costs being recovered following the TDR approach, before the impact of the TCR can be observed, increases the risks of unintended consequences. It would be safer to adopt a wait and see approach with BSUoS recovery. We have discussed the potential to impact grid defection above. We have also identified a number of concerns with the implementation of the TDR fixed charge approach in our responses to DCP359 and DCP 360. For example, the binary approach to the definition of Final Demand could negatively affect storage in particular (when co-located with a small amount of Final Demand), whilst the dataset being used for the allocation of customers to bands could be distorted by the impact of Covid-19. Whilst we agree with the conclusions of the first BSUoS Task Force, it should also be recognised that in the medium term it may become feasible (and beneficial to consumers) to produce an effective cost reflective charge for the whole or part of BSUoS. A further unintended consequence could be that treating BSUoS as a cost recovery identical to network residual cost recovery would engrain this mentality and stifle future development and innovation in charging.
6. The Task Force noted limitations of the approaches covered in Q5, what other methodologies or improvements to the ones in	Whilst we do not support the TDR banded approach for BSUoS cost recovery, we believe that the options should be limited to either a £/MWh or the TDR banded approach. It would be too complicated to consider alternative banding approaches for a fixed charge (failing the Practicality and

Q5 could you recommend to tackle them? Please consider your answer against the TCR principles and state your reasoning and evidence to support your answer.	Proportionality principle) and a simple fixed charge would lead to an untenable increase in BSUoS costs for small users (failing the Fairness principle).
7. Is 2years' notice of the changes prior to an implementation date appropriate? Please state your reasoning and evidence behind your answer.	We would prefer longer than 2 years as many of our contracts with customers extend beyond 2 years – but we recognise that two years is a compromise position reached by the Task Force. We consider 2 years notice is a minimum requirement to prevent windfall gains and losses.
8. Should the Task Force consider any interim measures? Please provide 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.	The Task Force has recognised the importance of providing sufficient notice to industry participants before implementing any significant changes to who pays BSUoS. Therefore, there should not be any interim measure for Deliverable 1 (Who should pay), as it could have significant impacts on industry parties at very short notice, and will undermine the recommendations of the Task Force. With respect to Deliverable 2 (How should BSUoS be charged), there could be some merit in considering an interim measure ahead of full implementation of the enduring reform, but only if the interim measure is properly assessed to have no significant distributional impact on industry parties, and is considered to deliver tangible consumer benefits. However, we are cautious of interim measures being proposed by the Task Force since it has not spent any time assessing these, and does not seem to have the time to fully assess any proposals before publishing its final report.
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.	Currently Suppliers operating under the Price Cap are funded for BSUoS on a lagged pass-through basis. Therefore, there are two interactions that we have identified that would require updates to the price cap methodology: 1. A move to placing BSUoS wholly onto demand will necessitate a change to the price cap methodology to allow suppliers

	to recover the higher level of BSUoS required to finance their activities, as the current lagged pass-through approach would not achieve this until the fourth cap period post implementation. 2. Any move to setting BSUoS ex-ante would remove the need for a lagged pass-through approach. However, there will be a transitional impact as the cost true up for cap periods before the move to an ex-ante approach will also need to be factored into allowances.
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 is still appropriate? Please state your reasoning and evidence behind your answer.	The RCRC mechanism is separate to BSUoS. The relationship between the two should be considered as part of the qualitative assessment.
11. Is there anything further you think the Task Force needs to consider?	No.
12. Please use this box to add any further comments that you may have	No further comments.