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 ESO agrees with the Task Force's recommendation that BSUoS charges should be levied on Final Demand only.** *BSUoS charges do not and cannot send useful behavioural signals to industry parties. Therefore, BSUoS should be treated as a 'cost recovery' charge.* • Ofgem's TCR decisions on network Residual charging reform support the conclusion that a 'cost recovery' charge should be levied on Final Demand only. • Transaction Costs and Risk Premia pass through from Generators, through wholesale prices, will be removed if BSUoS is levied on demand only. *Removing BSUoS from Generators enhances competition in the wholesale, ancillary services and balancing mechanism markets.*

	• The Task Force identified harmful distortions between Transmission connected GB Generators (who currently pay BSUoS) and Distribution connected, behind the meter and interconnected Generators (who don't). The ESO agrees that to achieve the highest functioning wholesale, ancillary services and balancing mechanism markets, parties in direct competition to one another should, as far as possible, compete on a level playing field. • It is currently not practical to extend BSUoS to interconnected Generators as this directly contravenes European regulation. Ofgem made the decision to remove BSUoS obligations from interconnectors through CMP202 and the reasoning behind that decision is still relevant today. • Extending BSUoS obligations to Distributed Generators would create a new distortive boundary between Generators directly connected to the network and those behind the meter. The existence of any of these distortions will prevent markets from functioning properly and should be removed. *The ESO recognises that the wrong implementation approach could lead to windfall gains and losses. Therefore, the ESO supports the Task Force's recommendation that two-year notice before implementation is required to allow sufficient time for retail and wholesale contracts to adjust and minimise windfall gains and losses.*
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'	**The cumulative effect of network charging reforms which introduce unavoidable charges may influence large energy users' view of the value of their GB connection. However, the ESO believes that 'grid defection' as a response to the Task Force's recommendations in isolation is unlikely.** *As Generators remove BSUoS and associated risk premia from their prices the overall burden of BSUoS costs to consumers, including large energy users, should reduce.* • The ESO is mindful of the cumulative effects on network users as a result of the many changes to the charging methodologies due to be implemented in the next few years. However, the ESO believes that given the right

is a possibility and to what extent would the Task Force's recommendations impact on your answer?	implementation approach GB's competitive markets will react to the change in the BSUoS charging base and wholesale prices will fall as Generators remove BSUoS and associated risk premia from their pricing strategies. • This anticipated fall in wholesale prices should offset the increase in Suppliers' BSUoS costs with a neutral impact on final retail prices. There may be an adjustment period as wholesale prices adapt to the removal of BSUoS from all Generator parties. In the long run the removal of Generator BSUoS risk premia and BSUoS related transaction costs should lead to an overall fall in the BSUoS component of retail prices compared to the status quo. *Grid defection should also be considered in the Task Force's recommendations on Deliverable 2. The ESO believes that a volumetric (£/MWh) BSUoS charge is less likely to encourage grid defection.* • The potential for grid defection will be reduced or enhanced by the decision on <u>how</u> the charge is levied (the Task Force's second deliverable). The two options considered by the Task Force are a volumetric approach (£/MWh) and a site based charge using the same banding approach as introduced through Residual charging reform (£/site). • A volumetric approach provides no incentive to defect entirely from the grid but to consider the value of reducing imported volume and therefore exposure to BSUoS costs, through installing behind the meter generators. • A site based charge can only be avoided by complete grid defection: through offshoring the business activities outside of GB or installing on site generation to completely meet the site's power requirements. The ESO expects that adding a site based BSUoS charge to the existing TDR and DDR site based charges will increase pressure for sites in the higher bands to defect. This should be taken into account by the Task Force when considering their recommendation on Deliverable 2.
3. Do you agree with the Task Force's recommendations	**The ESO agrees with the Task Force's recommendation that an ex ante fixed charge could deliver overall industry benefit. The certainty provided to Suppliers**

that an ex ante fixed charge would deliver overall industry benefits? Please state your reasoning and evidence behind your answer.	**and their customers through a fixed charge will reduce the need for BSUoS related risk premia to be included in retail tariffs. Any difference between an ex ante fixed price and actual balancing costs would need to be borne by an entity or entities (currently Suppliers and Generators) for a set period of time until a true-up. As set out in the ESO's RIIO2 Business Plan, the ESO could be part of this solution where it is remunerated for doing so, and this consultation response outlines some of the key issues which would need to be considered to ensure that the ESO could carry out this role in a way that is both financially sustainable and which delivers maximum value to consumers.** *The reduction in, or complete removal of, BSUoS related risk premia in Supplier tariffs will benefit consumers.* • The views of the Task Force are that the ESO's cost of financing any mismatch between balancing services expenditure and BSUoS revenue recovery for the duration of a fix period is lower than the 'risk premia' included, on average, by Suppliers to energy consumers' tariffs to manage uncertainty relating to their BSUoS exposure. • The ESO agrees with this position, and the conclusion that this approach would deliver consumer value. • However, it is noted that the assumptions underpinning this view have not yet been tested quantitatively. The ESO suggests that a study to quantitatively compare industry risk premia with the costs of having the ESO finance this level of risk would be a prudent step in strengthening the argument that this approach will optimise consumer value. *As an independent legal entity, the ESO has a small asset base and will require new tools and support to manage extreme cash flow volatility.* • Balancing services annual expenditure has been following a gradual upward trend and as efforts continue to decarbonise the electricity system this trend is set to continue. This means that the quantity of revenue needing to be recovered through BSUoS is also expected to increase. Under-recovery of BSUoS would pose a new risk to ESO cash flow, and would require borrowing

	to finance any shortfall. • The risk associated with transferring such a large and volatile cash risk to the ESO would need to be fully addressed in order to enable financing at a cost acceptable to consumers. A fully funded Working Capital Facility (WCF) is an example of a borrowing mechanism that could be used by the ESO. The WCF would need a financial exposure cap/break clause with a mechanism to reassess the process on a regular basis, such as setting the cap on an annual basis. • Comparing the ESO year ahead forecast of average BSUoS prices to the actual outturn values, under-recovery for the financial year 2019/20 would have been £172million. This is a large under-recovery compared to the ~£70m per annum for TNUoS under-recovery that the ESO currently provisions for in its Working Capital Facility. While investing in improved forecasting may deliver value to consumers and help to reduce this figure on average, there would still be potential for substantial under or over recovery due to the volatile nature of balancing services expenditure. • Ofgem are currently undertaking a review into the role of the system operator which was originally due to conclude in late Spring 2020[1]. Within scope is to "Review the effectiveness of current arrangements for System Operation including functions, ownership and governance and assess the case for change". Changes to ownership or governance of the ESO would require a reassessment of the ESO's ability to finance activities on a standalone basis such as those proposed by the Task Force. *The decision on how to finance and remunerate the management of BSUoS cashflow risk needs to be made alongside the code modifications required to implement Ofgem's response to the Task Force's conclusions. The ESO is keen to ensure that the remuneration for conducting this activity is sustainable and aligned with its wider RIIO2 activities and arrangements. This holistic approach will offer the best opportunity to optimise*

[1] https://www.ofgem.gov.uk/publications-and-updates/ofgem-review-gb-system-operation-terms-reference

	overall value for end-consumers. • As at draft determinations, the RIIO-2 framework does not have a clearly defined mechanism through which the ESO could assume additional BSUoS cash flow risk and how this would be funded, though we note Ofgem's proposal to re-consider elements of funding in the case of a material change in risk. • A transparent mechanism through which the ESO would be remunerated for the transfer of risk from other industry parties, should be agreed alongside any code modification. • The ESO has considered the outcome of the SONI appeal to the CMA which concluded in 2017[2]. This appeal allowed SONI to recover 0.5% of expenditure as remuneration for the risk bearing service they provided. This is for a combination of bearing low risk TNUoS and higher risk BSUoS. The ESO considers that similar discussions will be required should Ofgem decide to place risk bearing responsibility for BSUoS onto the ESO (this has been previously noted in the ESO 2021-23 RIIO Business Plan[3]). • The ESO believes that it would be appropriate for a limit or cap to be placed on the within-period shortfall in BSUoS collected. This cap should not be limited to an annual amount, since there are likely to be significant fluctuations in balancing costs compared to revenue recovered throughout the charging year. This would provide certainty for the ESO in terms of the facilities it would need to raise and would ensure that the ESO remains financeable. Limitation of the ESO's liability through any change to BSUoS arrangements must therefore be a key consideration of any arrangement. The ESO notes that Ofgem's decision on CMP345 referenced the suitability of considering total ESO exposure and that the recently approved CMP350 proposal formally implemented a cap on ESO exposure of £100m.
4. How long do you think the fixed period should be and what in	**The ESO believes that 12-month certainty over BSUoS prices will deliver the most consumer benefit. This time frame aligns with the typical Supplier contracting periods.**

[2] https://www.gov.uk/government/news/cma-publishes-ni-electricity-transmission-decision
[3] https://www.nationalgrideso.com/document/158051/download p143

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.	**The ESO has concerns over the potential negative impacts of intra-year cashflow volatility on overall consumer benefit if a single £/MWh price were to be used. The ESO would like the Taskforce to consider the possibility of setting multiple ex ante prices within the duration of the fixed period in its final report** *The ESO is supportive of a fixed price duration that delivers maximum overall consumer value.* • Suppliers typically contract with their customers for at least a one year fixed tariff. Providing a 12-month fixed BSUoS price would match up well with contracting windows and enable customers to receive annual tariffs completely free from Supplier BSUoS related risk premia. *Within year cash-flow volatility (assuming a 12-month fixed £/MWh charge) could be mitigated by the ability to fix tariffs at different levels throughout the year rather than fixing a single price for a 12-month period.* • The ESO could have an ability to set tariffs at different levels within the 12-month period, to reduce any within-period cashflow volatility. This would help to lower the cost of managing cashflows as BSUoS cost and volume changes from season to season. • Crucially, the entire 12 months of tariffs would be published with 2 months' notice before the start of the Charging Year. This means that although the BSUoS prices might differ in different seasons of the year all prices would be known and fixed in advance making it easier for Suppliers to manage and reducing the need for Supplier risk premia. *The notice period should be as short as possible, the ESO recommends publication of the tariff 2 months prior to the fix start date.* • The notice period should be as short as possible to enable more accurate forecasting whilst providing Suppliers with sufficient notice to include the price in their tariff offers. The ESO suggests that this should be a maximum of 2 months. • This suggestion is based on the example of final TNUoS tariffs, which are published 2 months before the tariff takes effect. Note that TNUoS is

	recovering a more stable charge than balancing services expenditure (as it relates to built assets) and is therefore able to be forecast further in advance. In contrast, BSUoS can be significantly impacted by shorter term influences such as weather patterns, generator outages, and other market activity. • Therefore, it seems reasonable to provide 2 months' notice of the final BSUoS tariff in advance of a 12 month fix. *A portion of balancing services expenditure is not in ESO control and is often unpredictable. Therefore, the ESO does not believe that penalty interest rates would be appropriate for over or under-recovery.* • The difficulties in forecasting total balancing services expenditure due to the volatility mentioned above mean that interest penalties for over or under recovery of BSUoS (such as those for TNUoS over and under recovery for RIIO-1) would not be appropriate. The ESO also notes that penalty rates are being removed from the RIIO 2 Transmission licences to reflect the fact that the Transmission Owners do not have control over charge setting for TNUoS, but bear the risk for any shortfall. As the ESO also does not have control over some of the key drivers of volatility for BSUoS, penalty rates would not be appropriate for this charge either.
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.	**The ESO recommends that a volumetric (£/MWh) charge is the most appropriate for BSUoS charges. The bulk of costs which comprise Balancing Services expenditure are energy related and therefore cost recovery should be made through an energy based charge. The ESO agrees that cost recovery charges should be shared more equitably between customers who have flexible loads and those which don't. A fixed £/MWh ultimately provides a very weak incentive to reduce demand and no incentive to load shift as should be the case for a cost recovery charging methodology. At the same time the fixed £/MWh charge avoids the additional volatility between fixed periods that a banded per site charge will introduce, benefiting all consumers.** *An energy based charge for an energy based service.* • BSUoS is fundamentally a service which is based on usage of the system. This is different in both principle and effect to asset recovery costs such as

	TNUoS and DUoS. As the costs are so closely linked to the usage of the system and the need to manage and balance the usage of the system it would appear more appropriate to recover it through an energy based charge. *Distributional impacts on consumers are lower as the methodology remains a £/MWh charge.* • The ESO agrees with the conclusions from the first Task Force that BSUoS should be treated as a cost recovery charge. A cost recovery charge should not send a signal and should be unavoidable. The ESO believes that both a banded methodology and a fixed volumetric methodology send negligible signals to consumers to alter their consumption behaviour. However, the ESO believes that a banded charge has greater distributional impact than a fixed volumetric charge and such distributional impacts should be minimised in a time of accelerating charging change. • A banded charge methodology will redistribute charge liability from consumers who are less able to avoid the charges by altering their consumption patterns to consumers with more flexible loads who have historically structured their operations to minimise their network charging bills. Whilst this is welcome news for small and domestic customers, large energy users are likely to experience sharp increases in their bills. As this methodology change is already being introduced for the TDR and DDR methodologies, introducing a banding methodology for BSUoS would add a further £1.5-£2billion to this pot. The ESO is concerned that overloading some industry parties with multiple changes to industry charges could have a negative impact for the UK economy as a whole. *A volumetric cost recovery charging methodology provides consumer benefits without introducing harmful distortions.* • The charge is likely to have less volatility between fixed periods. Banded charges volatility is subject to changes in the site make-up of the individual band (e.g. new connections, disconnections, disputes etc.) as well as the changes in the expected expenditure and K factor recovery fix period on fix period. Typically, we would expect demand to be more stable. • A volumetric charge avoids “step changes” between bands where similar sites either side of a boundary are treated differently. • Banding disputes are expected to lead to over or

	under recovery that is then smeared across all users through the K Factor.
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 support your answer.	**The ESO considers that a sliding scale £/kW charge could offer a useful compromise between the challenges of banded approaches and a £/MWh charge for which customers seeking to reduce their exposure could attempt to avoid by running Behind the Meter generation or reducing their consumption.** **However the ESO believes that a fixed £/MWh charge is a more appropriate way to recover BSUoS.**
7. Is 2years' notice of the changes prior to an implementation date appropriate? Please state your reasoning and evidence behind your answer.	**The ESO is supportive of 2 years' notice prior to implementation of BSUoS reforms. This time period balances the need to remove harmful distortions in the generation market with time needed for Supplier contracts to adjust to the changes in BSUoS liability avoiding windfall gains and losses.** *The majority of supply and wholesale contracts are two years or fewer in length and would expire within the notice period.* • Once Ofgem publish their decision on BSUoS reform the clock would start on a two-year notice period prior to implementation. At this point enough information will be available to market participants to agree new retail and wholesale fixed contracts which incorporate the changes. • The vast majority of existing contracts would expire during this period enabling Suppliers and generators or their customers to agree new prices which reflect the changes and avoid windfall gains or losses. *The ESO will support the timelines identified by the taskforce but are mindful of Supplier's concerns over April 2022 and that until detailed modification proposals are worked up, the full extent of changes to industry wide systems and processes will be unknown.* • Many changes to the charging methodologies are currently underway and require SME focus on fundamental overhauls of existing systems and

	processes (for both ESO and industry participants). Up until the end of 2021 (in readiness for the implementation of the TDR changes from April 2022) ESO IT teams and Charging and Billing SMEs will be working to implement expected Ofgem decisions on a number of significant CUSC modifications: CMP281, CMP333, CMP317/327, CMP335/6 and CMP343. The preparation for these enduring solutions has been progressed at a slower than expected pace as the ESO teams manage urgent BSUoS COVID modifications CMP345 and CMP350. • To ensure successful implementation of significant BSUoS change, two years' notice from the point of Ofgem's decision is advisable (given that the CUSC modifications are yet to begin). • In our RIIO 2 Business Plan 2021-23[4] we proposed a work plan that enabled delivery of the Task Force's reforms in April 2022. This recommendation was made prior to several key developments in the charging space, and changes in ways of working related to the COVID-19 pandemic. Given the backlog of CUSC modifications currently in flight it would be appropriate to target April 2023 to allow detailed and complete solutions to be developed and thoroughly consulted upon. • This would suggest that BSUoS reforms should be implemented in April 2023 (assuming Ofgem's response and subsequent direction is made before April 2021).
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	**The ESO is not supportive of interim measures. The focus for industry should be on readiness for implementation of full reform; interim measures risk creating stranded system and process change investment for both industry and the ESO as well as increasing complexity around the charging methodologies.** *"Change on change" is difficult for industry to manage.* • Industry parties are currently contending with a huge number of changes to the network and system charging methodologies. Repeated feedback from industry responses to various consultations has been that the sheer volume and materiality of change to the charging methodologies is making business planning more

[4] https://www.nationalgrideso.com/document/158051/download (p77)

losses between industry participants.	difficult. • Interim solutions create more uncertainty for these parties and require investment in system and process updates for a time limited solution. • The ESO believes this "change on change" creates additional burden and distraction from wider strategic planning and change across industry, and would like to see change efforts focused on the successful implementation of an enduring solution. *The ESO will continue to manage the TNUoS recovery risk until the end of the 2022/23 charging year and in addition support CMP350 ~£100m until the end of the 2021/22 charging year. To ensure that the ESO can access the necessary financing no movement of BSUoS financing risk from industry to the ESO should be made before April 2023.* *Early implementation of some aspects of the Task Force's recommendations risk undermining the two-year notice period.*
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.	**The ESO believes that the recommended two year notice period will provide sufficient time for the Supplier Price Cap to adjust.** *In any case, Ofgem closely monitor the domestic price caps and have provisions to update them as required, providing further opportunity to mitigate any issues if they arise.*
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 ESO believes that the existing RCRC methodology should be reviewed through a BSC issues group alongside the CUSC modifications raised to implement BSUoS reforms.** • RCRC is the mechanism to redistribute extra money that ELEXON collects through energy imbalance payments back to industry parties. RCRC redistributes this money to all parties including both generators and demand as per their traded volume. RCRC and Balancing action expenditure are closely linked. If Final Demand only are paying BSUoS the impact on RCRC needs to be considered. • RCRC relies on BSUoS being settled daily. Should the timescales for settling BSUoS move from daily billing and settlement to a longer time horizon then the existing methodology will require review. This review needs to be via the BSC issues process in combination with ELEXON. • The imbalance methodology is out of scope for the

	Task Force but changes to BSUoS both in who pays and how the charge is levied should prompt a review into the RCRC methodology.
11. Is there anything further you think the Task Force needs to consider?	**The ESO believes that the Task Force must consider how the risk - and resulting financing costs - to be placed on the ESO could be best reduced, in order to maximise consumer benefit.** An option could be to follow the lead of recently approved CUSC modification CMP350 and impose a cap on over- or under-recovery during the fix period. The cap used for CMP350 is £100m. To provide the necessary certainty to Suppliers there would need to be full visibility of expenditure and revenue recovered to determine whether there was risk of breaching the cap. The response to a breach in the cap would have to be carefully considered but could involve market notification as the cap is approached, with potential for uplift or a reduction in tariffs in the remaining months of the year should it be breached. Further development would be needed to understand the reconciliation and distributional impacts of such a recovery element. A second option could be to fix within a range providing the ESO with an option to raise or lower the £/site or £/MWh charge within this range to tackle over or under recovery within the fix period. This option would create a manageable risk burden for Suppliers and the ESO whilst reducing the temporal distributional effects of recovering mismatches in revenue from the following year. Understanding BSUoS fixing in the context of other changes to ESO financing regimes is crucial - Ofgem have lowered ESO risk in the upcoming price control through a transfer of TNUoS under-recovery risk from the ESO to onshore TOs from charging year 2023/24[5]. An uncapped risk to fund any under-recovery of BSUoS charges could increase the ESO's risk to a higher level than prior to the TNUoS decision. A lengthy fix period would also be contrary to proposals made by Ofgem to introduce new dynamic revenue recovery options which would allow the ESO to recover changes to its internal costs much more quickly than under the RIIO1 framework.

[5] https://www.ofgem.gov.uk/system/files/docs/2020/07/tnuos_decision_letter_final_0.pdf

12. Please use this box to add any further comments that you may have	