Code Administrator Consultation Response Proforma

CMP286: Improving TNUoS Predictability Through Increased Notice of the Target Revenue used in the TNUoS Tariff Setting Process

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 **05 January 2024**. 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 Catia Gomes catia.gomes@nationalgrideso.com or cusc.team@nationalgrideso.com.

Respondent details	Please enter your details	
Respondent name:	Jacqueline Wilkie/Suzanne Law - submitted on behalf of:	
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Which best describes your organisation?	☐Consumer body ☐Demand ☐Distribution Network Operator ☐Generator ☐Industry body ☐Interconnector	☐Storage ☐Supplier ☐System Operator ☒Transmission Owner ☐Virtual Lead Party ☐Other

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:

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 Code Administrator Consultation questions			
1	Please provide your assessment for the proposed solution(s) against the Applicable Objectives?	Mark the Objectives which you believe the proposed solution(s) better facilitates:	
		Original	☐A ☐B ☐C ☐D ☐E
		WA(G)CM1	☐A ☐B ☐C ☐D ☐E
		The proposer robustly demonstrates a clear benefit to justify this code change. No assessment appears to have been made of the extent of the defect, nor alternate 'non-code' measures which could enable suppliers to address it. There is also no consideration by the workgroup of other input variables in the tariff setting model which might also lead to charge volatility which could be adjusted. Ultimately the outcome of applying CMP286 in CUSC is very minor. However, the modification introduces additional material risks for the Onshore TOs' Price Control arrangements agreed with Ofgem, without appropriate consideration by the workgroup of the resulting impact also imposed on end consumers. ***Therefore, from our perspective this modification is not an improvement on the baseline, with applicable***	

		objectives A, B, C, and E demonstrably worse should it be approved. **Objective A: Charging Methodology facilitates effective competition in generation and supply of electricity** The workgroup has been unable to evidence whether the CMP286 defect affects a subset or the totality of suppliers, and/or whether the proposed solution will tangibly benefit their customers. Consequently, we believe that this modification erodes competition by removing an incentive for suppliers to innovate their commercial offerings or business practices to protect their customer base. Competition is further impacted by providing a 'lowest common denominator' route for all suppliers to mitigate what might only be a 'potential' issue - for which some may have already innovated their own low-cost solutions. As we mention further on in our response, we believe it is vital in this context that suppliers are formally obligated by Ofgem to transparently pass on any cost-saving benefit to their customers realised by implementing CMP286, if approved. **Objective B: Charges which are cost reflective** Resolving the proposer's defect leads to the revenue forecasting process between ESO and Onshore TOs diverting to the use of a far less accurate long-term forecast, as compared to the baseline. Consequently, our assessment is that the proposal objectively reduces cost reflectivity of charges, which is inconsistent with the intent of our licence, Price Control arrangements and CUSC Objective B. A clear unintended consequence of the CMP286 solution is the introduction of entirely new swings in Onshore TO revenues, as true-ups flow through the 'K' and or 'Adj' terms in the Special Conditions of the transmission licence to adjust us to what our target revenue should have been (as per the baseline). Any 'true-up' fluctuations are clearly not in the best interest of end consumers, particularly as there is insufficient data to accurately assess their potential materiality in advance.

		In our view, imposing an entirely new form of charge volatility to mitigate an issue which has not been demonstrated as being material for the supplier community as a whole, undermines the overarching principle of charges being cost reflective and fair. **Objective C: Charge methodology reasonably takes account of the transmission licensee's businesses** The transmission network licensees always bear a higher level of inherent risk on behalf of industry given the large-scale investment projects we deliver (often spanning multiple price controls) - where timescales can be influenced by a number of factors outside our direct control. This underlying 'project management' risk however has now been intensified by evolutions of the RIIO Price Control arrangements, particularly in T2. There is greater reliance on uncertainty mechanisms (which will potentially be used more in T3), plus the transfer of the TNUoS recovery cashflow risk from NGESO (as well as OFTOs and Interconnectors) to the Onshore TOs. This current situation of underlying 'allowable volatility' in arrangements has to be carefully managed by the Onshore TOs, ESO and Ofgem. This situation would be greatly exacerbated by adopting the CMP286 proposal. In respect of the Onshore TO revenue forecasting process with ESO, as governed by our licence and the STC Procedures (STCPs), this becomes even more complex in the context of the fifteen-month horizon required by the CMP286 solution. There are several forecast components which are set in the December Annual Iteration Process for the upcoming regulatory year which would be far less accurate operating on these timescales. One particular example is Ofgem's use of the Office for Budget and Responsibility (OBR) inflation forecasts and market index data to calculate the cost of debt and equity. Using 2025/6 TNUoS tariff setting as an example, cost of debt and equity would be forecast based on the OBR forecast set in November 2023 and updated to final values in the following year (November 2024) with any update to values flowing through ADJ. Forecasting revenues so far in advance to facilitate the CMP286 solution will inevitably increase the impact of this kind of external volatility. This is

<table>
<tr><td></td><td></td><td>currently minimised by following the existing baseline timeline approach.

Objective E: Promotes efficiency in implementation and administration of the charging methodology
CMP286 introduces the need for an entirely new TO revenue true-up/reconciliation to correct forecast versus actual mismatches.

To facilitate these changes, we believe the transmission licence Special Conditions may need to be modified to extend existing revenue calculation components / definitions. Additionally, the Price Control Financial Model process will need to be factor changes to revenue setting processes too.

Further inefficiency is introduced by CMP286 through the requirement to modify - to a much greater extent than CUSC - the STCPs for revenue/charge setting processes, including additional cashflow monitoring/reporting requirements between Onshore TOs and ESO.

Whilst STC Panel Members have approved these changes in principle, this approval is solely linked to Ofgem’s eventual determination of this modification. Panel members for the ESO and Onshore TOs all caveated their ‘approval’ that they view these changes are demonstrably negative in consideration of the STC’s own applicable objectives, aligning with the same assessment shared by the Onshore TOs representatives in the workgroup and our consultation responses.</td></tr>
<tr><td rowspan="2">2</td><td rowspan="2">Do you have a preferred proposed solution?</td><td>☐Original
☐WA(G)CM1
☒Baseline</td></tr>
<tr><td>Following from the reasoning outlined against Q1, viz:
Tariffs are based on a far-less accurate forecast due to the ongoing uncertainty mechanisms applied during the price control period related to large scale projects.
Linked to the decrease in accuracy and the longer term period of increased notice of TNUoS charges, there is a high probability in increased volatility due to true-up mechanisms.</td></tr>
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		• The TOs now bear the cash-flow risk due to fluctuations (longer-term forecasting and additional time for reconciliation) along with crossing time control periods. • Additional complexity in cashflow reporting and management does not provide efficiency or cost-benefit to consumers. we do not support movement from the current baseline to either of the proposals (CMP286 or WACM1)
3	Do you support the proposed implementation approach?	☐Yes ☐No
		The proposal to implement this modification during the crossover period from T2 to T3 would create further material cashflow volatility Onshore TOs to absorb, which we believe should be reflected in the wider risk profile for Onshore TO businesses during the setting of the T3 Price Control. Onshore TOs and ESO would be required to set 2026/27 and 2027/28 charges on revenue forecasts prior to final determinations and the fulfilment of T2 close out methodologies. This further increases the cashflow exposure and need for true-ups for the Onshore TOs, which on subsequent years true-up would result in excessive price volatility. We consider that this is not in the interests of end consumers, especially in conjunction with the cashflow risk which Onshore TO's are currently truing up through the correction term. Given this significant additional uncertainty, particularly considering the efforts taken by Onshore TOs and Ofgem to re-establish predictability and improved timeliness for current T2 revenue recovery arrangements, we are keen that CMP286 does not undermine this. We therefore do not support the implementation approach as proposed. Instead, we recommend this modification be implemented for the 2nd year of the T3 Price Control (if approved). This would provide Ofgem and the transmission licensees suitable time to agree and implement the necessary licence, code and process changes. This would also avoid adding instability for the Onshore TOs for the remainder of the T2 Price Control

4	Do you have any other comments?	The three Onshore TOs are all agreed that CMP286 increases the risk to our businesses considerably, even more so than the rejected CMP244 proposal given the evolutions of our T2 Price Control. In particular, the decision to transfer the collection risk of TNUoS revenues from NGESO to the Onshore TOs – where we now face the full level of TNUoS collection risk inclusive of Interconnector, OFTO and other revenues – presents a compounding level of exposure if fifteen-month lag to tariff setting is imposed via CMP286. We also note that under current arrangements for revenue collection, OFTOs and Interconnectors will collect their ‘live’ view of allowed revenues, despite CMP286 requiring a fifteen month-ahead lock-in of our forecasts. This means that Onshore TOs will also bear the allowed revenue risk for OFTOs and Interconnectors as well as the overall revenue collection risk on behalf of ESO. Ofgem has recently sought to better align Onshore TO’s revenues to follow cashflows closer to the time they are incurred. This was done acknowledging that TO revenue is made up of many diverse elements, creating significant forecasting risk - including the option to bring forward large investment projects within a Price Control period. CMP286 would delay TO recovery on large projects which are increasingly required in the current landscape to achieve Net Zero. We could face a material shortfall compared to what would be expected if revenues for such large projects were not adjusted close to when they are incurred. This additional uncertainty is exacerbated by a number of external factors outside the ESO and Onshore TOs’ control, which are more likely to impact forecast accuracy over a fifteen-month horizon than the baseline two months. In particular we are wary of fluctuations in external indices (as mentioned in Q1), wider regulatory reform, and evolutions on network development arrangement such as Holistic Network Design and Network Options Assessment (NOA). **<u>Considering the benefits case</u>** In our view there are two components to the proposer’s benefits case: (i) Reduced costs (albeit not guaranteed) for a

proportion of their customer base;

(ii) Revenue recovery cashflow volatility risk is better allocated to NGESO and Onshore TOs (as opposed to suppliers and their customers).

The justification to apply CMP286 relies on suppliers reducing their risk premia and passing on any cost savings to their customers. We note that supplier representatives in the workgroup have not made an explicit commitment to do this, nor does the proposed solution ensure that this will occur.

We would hope therefore, on behalf of supplier customers and end consumers, that some form of implementation monitoring is undertaken to ensure that the purported customer benefits are indeed realised. This is particularly important in the context of the high consumer costs in the current market, plus the significant impacts of implementing this modification by Onshore TOs and ESO.

We observe that the CMP286 solution focuses on supplier's fixed tariffs. As such, the benefit initially set out by the proposer will not now be as significant in today's rapidly changing market conditions. The proposer's analysis shows a significant drop in fixed tariffs in the market from the baseline (44%) to 31.2%. In Ofgem's Retail Market Indicators for September 22, fixed tariffs are playing a decreasing role in the market. The continuation or introduction of further BEIS-led interventions to protect end-consumers may as yet reduce the presented benefits case even further.

We know that CMP286 introduces a new form of adverse TNUoS charge volatility due to additional true-up to correct Onshore TO revenue forecast mismatches. This new issue will impact all end-consumers - as compared to the proposer's benefit being realised by only a subset of supplier's fixed price customers (who may/may not be reducing in volume over time).

Our initial assessment of the materiality of the aggregate TO cashflow impact caused by CMP286 is that it could add c.£24-25m per annum of additional volatility to TNUoS tariffs. This is based on the proposer's own data analysis in the consultation and referencing the latest average RIIO-T2 Time Value of Money true-up levels. In reality this value

		could fluctuate significantly, potentially rising as high as £39m especially in the context of wider market volatility and forecasted inflation. Ultimately Ofgem is best placed to determine whether this code modification, as justified by the proposer, presents an overall benefit for industry and end consumers when considered against the challenges our response seeks to highlight.