ESO

Workgroup Consultation

CMP420: Treatment of BSUoS Revenue Recovery, and creation of a BSUoS Fund

Overview: Currently the CUSC is silent over the treatment of BSUoS revenues which are recovered in excess of the actual BSUoS costs for a given period 'Over recovery'. The solution will allow Interest to be applied to over and under recovery amounts.

Modification process & timetable

1. **Proposal Form** 14 September 2023
2. **Workgroup Consultation** 21 March 2024 – 19 April 2024
3. **Workgroup Report** 20 June 2024
4. **Code Administrator Consultation** 03 July 2024 – 23 July 2024
5. **Draft Modification Report** 15 August 2024
6. **Final Modification Report** 05 September 2024
7. **Implementation** 01 April 2025

Have 5 minutes? Read our Executive summary

Have 20 minutes? Read the full Workgroup Consultation

Have 30 minutes? Read the full Workgroup Consultation and Annexes.

Status summary: The Workgroup are seeking your views on the work completed to date to form the final solution to the issue raised.

This modification is expected to have a: **Medium impact** on Suppliers

Governance route	Standard Governance modification with assessment by a Workgroup	
Who can I talk to about the change?	**Proposer:** Damian Clough Damian.Clough@sse.com 01738 456000	**Code Administrator Contact:** Lizzie Timmins Elizabeth.timmins@nationalgrideso.com
How do I respond?	Send your response proforma to cusc.team@nationalgrideso.com **by 5pm on 19 April 2024**	

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Executive summary

The CUSC is silent over the treatment of BSUoS revenues which are recovered in excess of the actual BSUoS costs for a given period 'Over recovery'. This modification initially sought to codify the treatment of Over recovery and allow the potential use of Over recovery to reduce the risk of reopening prices during a future Fixed Period, as well as allowing Interest to be applied. As the Modification progressed the solution evolved to; applying Interest to the Over recovery amounts. Using Over recovery as a potential fund/pot to reduce the risk of reopening prices was removed from the solution as this could potentially be superseded by changes elsewhere in Industry with regards to the FSO. The ESO and Proposer recognise the need for consistent forecasting of how Over recovery will affect future BSUoS Charges, and the ESO are developing a guidance note to include additional BSUoS forecasting.

What is the issue?

Currently the CUSC is silent over the treatment of Over recovery of Balancing Services Use of System (BSUoS) costs. Industry Users therefore have no certainty over when or how this Over recovery will affect future BSUoS charges, and whether the Over recovery will be adjusted by interest when it is offset similar to other charges (e.g., TNUoS and K).

What is the solution and when will it come into effect?

Proposer's solution: The solution will allow Interest to be applied to Over and Under recovery amounts. Please note the solution has evolved throughout the time of the workgroups in response to Industry feedback as well as other industry actions which is detailed in the Workgroup Consultation.

Implementation date: 01 April 2025

What is the impact if this change is made?

- Applying interest to Over and Under recovery should bring recovery of costs in line with other network charges.
- End charges to customers over time will reflect the actual costs and not actual costs plus risk less any interest impact.

Interactions

Ofgem has requested HM Government consider increasing the ESO's Working Capital Facility (WCF) in the transition to the FSO for effective risk management of balancing charges. The decision will be taken by HM Government in the round and, although there's no fixed date for the decision, Ofgem expects to have a position within Q1 2024.

CMP408 and CMP415 are currently with the Authority for decision. The Workgroup noted that changing the notice period may impact upon Over recovery amounts but does not negate the need for regular forecasts and for Interest to be applied; as Over recovery will be a constant feature, when forecasting and fixing a price based on a set of variable costs which historically has seen high fluctuations and is unlikely to settle in the near future.

What is the issue?

Currently the CUSC is silent over the treatment of Over recovery of Balancing Services Use of System (BSUoS) costs. This is unusual when compared to other Industry and Network Charges such as Transmission Network Use of System (TNUoS) and Distribution Use of System (DUoS) which are charged on an ex-ante basis.

Industry Users therefore have no certainty over when or how this Over recovery will affect future BSUoS charges, and whether the Over recovery will be adjusted by interest when it is offset similar to other charges (e.g., TNUoS and K). There is also a similar defect with Under recovery and the use of the ESO's WCF and the impact on future BSUoS charges.

As BSUoS charges may fluctuate, the ESO WCF may not cover sufficient forecasting risk thus increasing the chances of reopening BSUoS charges within a Fixed Price Period. This therefore increases the Supplier risk premia applied to charges.

Why change?

The ESO should not financially benefit nor be penalised for Under or Over recovery which is not the case currently.

Suppliers need to understand with a reasonable amount of certainty of how Over recovery will feed through into future BSUoS charges, as customer contracts regularly extend beyond the periods over which charges are currently fixed for. Any uncertainty requires the need for that risk to be managed via risk premia.

What is the solution?

Proposer's solution

Interest will be added to the Over/Under recovery by applying the average rate of SONIA plus 1.15% to the difference between actual daily costs and actual revenue recovery.

In terms of legal text there is nothing currently in the CUSC which defines the period in which actual and forecast Over recovery will offset BSUoS costs thus reducing a future BSUoS charge (i.e. returned to Industry), or actual and forecast Under recovery which is added to BSUoS costs thus increasing a future BSUoS charge (i.e. recovered from Industry). There is the assumption that this will be done at the first possible opportunity, but there is no certainty. Due to the Notice Period, there is an element of forecasting of potential Over and Under recovery.

Workgroup considerations

The Workgroup convened 5 times to discuss the perceived issue, detail the scope of the proposed defect, devise potential solutions and assess the proposal in terms of the Applicable Code Objectives.

Consideration of the proposer’s solution

Please note the solution evolved over time so certain elements of the initial proposed solution and Workgroup discussion around those elements will not form part of the final solution. Some elements have also been added to the solution. However, this section will aid readers in understanding why the solution has evolved and why certain parts of the original have dropped out.

<u>BSUoS Fund (now not part of the Proposer’s solution)</u>

In the initial Workgroup the Proposer discussed their concerns that the CUSC is silent on when the revenue recovered does not equal actual and forecasted BSUoS costs and how any Over and Under recovery (including forecasts and actuals) affects future BSUoS Charges.

The Proposer went on to further explain that if it is forecasted that Over recovery for a period is £200m, they propose that as part of the solution, part or all of the £200m should be placed into a BSUoS fund instead of offsetting future BSUoS charges. Believing that the fund will further reduce the risk of BSUoS charges being reopened thus further reducing the need for any risk premia.

The Workgroup discussed this part of the solution and it was highlighted that:

- BSUoS Fund was discussed within the TCMF Sub Group and that it was discounted as an option due to the fund being subject to 25% corporation tax. The ESO receives a tax allowance based on its internal activities. However, external balancing costs are outside the scope of this modification and ESO does not receive any tax allowance for this. Until this financial year this was not an issue as under the variable BSUoS tariff, costs and revenues were equal and opposite so there was no tax impact. With the introduction of a fixed tariff regime this is no longer the case. The ESO bears the tax risk for an over-collection in these circumstances on the basis that any tax payable would be offset by an equal tax loss within a couple of years (rules around utilisation of tax losses mean it may take longer for the ESO to be kept whole but the theory still applies).
- If a fund is created the ESO faces an immediate tax liability for amounts charged as a fund with no foreseeable loss to offset this liability, i.e. the tax liability (25%) would need to be added to fund invoices creating an immediate cost, with no benefit to consumers.
- The Authority representative mentioned that Ofgem has requested HM Government consider increasing the ESO’s WCF in the transition to the FSO for effective risk management of balancing charges. The decision will be taken by HM Government however there is no fixed date for the decision but Ofgem expects to have a position within Q1 2024.
- There are several dependencies to consider, first is the move to the FSO and what the BSUoS WCF could be. If the future WCF is higher than the current value of £300m then this could mitigate the need for an additional risk management method

such as that of a BSUoS Fund. Second is that of the decision on existing modifications CMP408 and CMP415, which seek to amend the notice period and/or the length of the fixed period. Therefore, when the workgroup considered a solution, there was a need to ensure that the solution worked with the potential implementation of CMP408 and CMP415.

- Analysis was provided to reinforce how the proposal to include all Over/Under recovery both forecasted and actual could be problematic and how the current methodology allows ESO the flexibility it needs to set tariffs to reduce the risk of a tariff reset (Annex 3). The analysis looked at the impact on BSUoS Fixed Tariffs and ESO cash position if all forecasted Over recovery (from Fixed Tariff 1 and Fixed Tariff 2) had been included within Fixed Tariff 3 (published June 2023). This was compared to published tariffs, where Fixed Tariff 3 included Over recovery up to the end of Fixed Tariff 1 only. The analysis showed there were larger fluctuations in final tariffs between different tariff periods and there was also a forecasted negative cash position at the end of fixed tariff 3 which would have seen some utilisation of the ESO's WCF.

The Workgroup agreed that including the BSUoS fund within the solution could result in a perverse outcome i.e. more tax and cost for end consumers, and therefore decided to replace point *(d) 'Consider the implications of a 'BSUoS Fund' on the connections'* in the terms of reference to *'Assess the implications of interest being applied to Over/Under recovery'*. The revised Terms of Reference were approved by the CUSC Panel on 26 January 2024.

<u>Forecasting</u>

The ESO currently provide regular forecasts, but this Industry need/requirement is not stated anywhere or documented, so there is the danger that these extremely important forecasts may reduce in their regularity or disappear entirely, with future organisational change such as NESO.

The Workgroup discussed in meeting 4 a proposal that increased the ESO's reporting obligations within the CUSC to increase transparency. The ESO currently provides industry a weekly report comparing Fixed Tariff Revenue vs Costs, a monthly BSUoS report and after a standard tariff release, a webinar to provide industry the background information on the tariffs. The only report within the CUSC is the monthly BSUoS report, so the proposal was to increase the reporting obligations in CUSC Section 3 to include the weekly report and webinar. As CMP420 was raised under a Section 14 CUSC change, no other section of the CUSC can be amended within the scope of this modification, so the Workgroup needed to decide if there was justification to include the additional reporting obligations within Section 14 or if a separate modification would need to raised to add them to Section 3. The Workgroup agreed not to codify the reporting obligation but the ESO agreed to draft a guidance note which will be taken to a future TCMF for engagement. It was also suggested by a Workgroup member to look into the tariff reset process, and it was agreed by the Workgroup that this could also be included within the guidance note that will be taken to a future TCMF for wider industry engagement.

The guidance note is intended to set out the processes by which the ESO monitors, evaluates and decides on whether the operation of the fixed BSUoS tariff arrangements are within operational limits. It would also set out the process for a mid-period tariff reset, if required.

Therefore, the Workgroup agreed to proceed with the interest part of the solution only.

Interest being applied to over/under recovery

In the first Workgroup meeting the interest element of the solution was discussed.

It was highlighted that currently the ESO License includes a K mechanism for BSUoS charges. This mechanism applies to a financial year and calculates interest at the average value of SONIA (Sterling Overnight Index Average) plus 1.15%. However, the CUSC makes no reference to interest and instead applies k to tariff setting. k refers to the current 6 month tariffs (rather than a financial year) and puts the principal amount only of over or under collection from prior tariffs into the tariff that is being set.

It was also discussed whether the Licence could take precedence, but the Workgroup noted that this would need to be reflected in the CUSC to allow for the Proposal to operate.

The Workgroup discussed that the solution should include the interest calculated through the K mechanism into charges and that whatever change is reflected in the CUSC on interest, should be inclusive to any future changes surrounding notice and fixed period for BSUoS to ensure a further modification is not needed. This is in reference to CMP408 and CMP415 which are with the Authority awaiting a decision. [Note: the difference in mechanisms between the License and CUSC is referred to, by case, as capital K in the License and lower-case k in CUSC].

The Proposer worked with the ESO offline to refine a different part of the solution, which seeks to clarify how Over/Under recovery is fed through into future tariff periods. The Proposer’s initial solution looked to amend the current wording from “any” to “all” in CUSC Section 14.31 to be inclusive of both actual and forecasted Over and Under recovery from previous Fixed Price Periods. This, however, would remove the ESO’s ability for flexibility when setting tariffs. It was explained that the ESO needed flexibility in assessing how much Over/Under recovery is fed into the next tariff period to reduce the likelihood of tariffs being reset mid fixed period. Please see Annex 3 for analysis.

To allow the ESO flexibility necessary to reduce the risk of reopening prices it was decided to alter the solution so that the CUSC did not codify how and when Over recovery should feed through into the future charges. The certainty would be provided through regular ESO forecasts, which the ESO currently do provide. Whether the requirement to forecast regularly is codified or not is a specific Workgroup consultation question.

The solution that has been agreed is that of how interest is reflected within the CUSC. It was therefore proposed to amend Section 14.31.5, and a new subclause created within Section 14 of the CUSC to define how interest is calculated and included within tariff periods.

Implementation

During the second Workgroup there was a discussion on how Ofgem's decision date could impact the timeline and cycles of tariff calculations. The Workgroup noted that a decision prior to tariff 5 being set would be preferable. Tariff 5 is due to be set in June 2024 and covers settlement days from 1st April 2025 to 30th September 2025.

Workgroup members also discussed the impact of CMP292 being approved (i.e. charging modifications need to be approved by 30 September 2024 for an implementation date of April 2025, unless otherwise directed by the Authority). A request therefore would be made for special consideration, as a delay in implementation (i.e. April 2026) would mean that any interest could not be paid back to consumers in a timely manner which would create difficulty for the ESO to include that interest in future tariff periods.

Draft legal text

The draft legal text for this change can be found in Annex 4.

What is the impact of this change?

Proposer's assessment against Code Objectives

Proposer's assessment against CUSC Charging Objectives	
Relevant Objective	**Identified impact**
(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;	**Neutral**
(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);	**Positive** By applying interest to Over and Under recovery this brings the recovery of costs in line with other network charges.
(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	**Neutral**

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	**Neutral**
(e) Promoting efficiency in the implementation and administration of the system charging methodology.	**Neutral**
**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.	

Standard Workgroup consultation question: Do you believe that CMP420 Original proposal better facilitates the Applicable Objectives?

When will this change take place?

Implementation date
01 April 2025

Date decision required by
30 September 2024, to allow for implementation by April 2025. If however, the decision date is after 30 September 2024, then there is a request for a special consideration from the Authority to agree to direct the ESO to implement CMP420 by 01 April 2025.

Implementation approach
A change will need to be made to the BSUoS charge setting process to facilitate this modification.

Standard Workgroup consultation question: Do you support the implementation approach?

Interactions

☐Grid Code	☐BSC	☐STC	☐SQSS
☐European Network Codes	☐ EBR Article 18 T&Cs[1]	☐Other modifications	☐Other

Ofgem has requested HM Government consider increasing the ESO's WCF in the transition to the FSO for effective risk management of balancing charges. The decision will be taken by HM Government in the round and, although there's no fixed date for the decision, Ofgem expects to have a position within Q1 2024.
There are interactions with CMP408 and CMP415 that the Workgroup has considered.

[1] If the modification has an impact on Article 18 T&Cs, it will need to follow the process set out in Article 18 of the Electricity Balancing Regulation (EBR – EU Regulation 2017/2195) – the main aspect of this is that the modification will need to be consulted on for 1 month in the Code Administrator Consultation phase. N.B. This will also satisfy the requirements of the NCER process.

How to respond

Standard Workgroup consultation questions

1. Do you believe that the Original Proposal and/or any potential alternatives better facilitate the Applicable Objectives?
2. Do you support the proposed implementation approach?
3. Do you have any other comments?
4. Do you wish to raise a Workgroup Consultation Alternative request for the Workgroup to consider?

Specific Workgroup consultation questions

5. Do you believe an obligation on the ESO to report forecasting of comparing Fixed Tariff Revenue vs Costs reporting should be codified? If so, do you think these obligations that traditionally fall within Section 3, should be added to Section 14 of the CUSC and why?
6. Do you believe a Guidance Note could be an appropriate method of providing sufficient confidence to industry regarding reporting and forecasting? If so, what do you believe should be included in it?

The Workgroup is seeking the views of CUSC Users and other interested parties in relation to the issues noted in this document and specifically in response to the questions above.
Please send your response to cusc.team@nationalgrideso.com using the response pro-forma which can be found on the CMP420 modification page.
In accordance with Governance Rules if you wish to raise a Workgroup Consultation Alternative Request please fill in the form which you can find at the above link.

If you wish to submit a confidential response, mark the relevant box on your consultation proforma. Confidential responses will be disclosed to the Authority in full but, unless agreed otherwise, will not be shared with the Panel, Workgroup or the industry and may therefore not influence the debate to the same extent as a non-confidential response.

Acronyms, key terms and reference material

Acronym / key term	Meaning
BSC	Balancing and Settlement Code
BSUoS	Balancing Services Use of System
CMP	CUSC Modification Proposal
CUSC	Connection and Use of System Code
DUoS	Distribution Use of System
EBR	Electricity Balancing Guideline
ESO	Electricity System Operator
FSO	Future System Operator
NESO	National Energy System Operator
SONIA	Sterling Overnight Index Average
SQSS	Security and Quality of Supply Standards
STC	System Operator Transmission Owner Code
T&Cs	Terms and Conditions

TCMF	Transmission Charging Methodologies Forum
TNUoS	Transmission Network Use of System
WCF	Working Capital Facility

Annexes

Annex	Information
Annex 1	Proposal form
Annex 2	Terms of reference
Annex 3	ESO Analysis on alternative over-recovery return
Annex 4	Legal Text