

Stage 02: Workgroup Consultation

Connection and Use of System Code (CUSC)

CMP267

‘Defer the recovery of BSUoS costs, after they have exceeded £30m, arising from any Income Adjusting Events raised in a given charging year, over the subsequent two charging years’

CMP267 aims to defer any unforeseen increases in BSUoS cost arising from an Income Adjusting Event (IAE) by two years when those unforeseen costs exceeds £30m in a charging year.

This document contains the discussion of the Workgroup which formed in August 2016 to develop and assess the proposal. Any interested party is able to make a response in line with the guidance set out in Section 7 of this document.

Published on: 19 August 2016
Length of Consultation: 6.5 Working days
Responses by: 1pm 31 August 2016



The Workgroup concludes:

To be completed following the Workgroup Consultation



High Impact:

All parties paying BSUoS

What stage is this document at?

01	Initial Written Assessment
02	Workgroup Consultation
03	Workgroup Report
04	Code Administrator Consultation
05	Draft CUSC Modification Report
06	Final CUSC Modification Report

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Any Questions?

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About this document

This document is a Workgroup consultation which seeks the views of CUSC and interested parties in relation to the issues raised by the Original CMP267 CUSC Modification Proposal which was raised by Binoy Dharsi, EDF Energy and developed by the Workgroup. Parties are requested to respond by **1pm on 31 August 2016** to CUSC.team@nationalgrid.com using the Workgroup Consultation Response Proforma which can be found on the following link:

<http://www2.nationalgrid.com/UK/Industry-information/Electricity-codes/CUSC/Modifications/CMP267/>

Document Control

Version	Date	Author	Change Reference
1.0	19 August 2016	Code Administrator	Workgroup Consultation to Industry

1 Summary

- 1.1 This document describes the Original CMP267 CUSC Modification Proposal (the Proposal), summarises the deliberations of the Workgroup and sets out the options for potential Workgroup Alternative CUSC Modifications (WACMs). Prior to confirming any alternative proposals the Workgroup are seeking views on the options they have identified, what is the best solution to the defect and also any other further options that respondents may propose.
- 1.2 CMP267 was proposed by EDF Energy and was submitted to the CUSC Modifications Panel (Panel) for its consideration on 19 July 2016. A copy of this Proposal is provided within Annex 1. The Panel voted by a majority view that CMP267 should be treated as urgent because the proposal seeks to address an imminent (date-related) issue that could have a significant commercial impact on market participants. The Authority provided confirmation on the 1 August 2016 that CMP267 should be progressed on an urgent basis. This is provided in Annex 2.
- 1.3 The Panel decided to send the Proposal to a Workgroup to be developed and assessed against the CUSC Applicable Objectives. The Workgroup is required to consult on the Proposal during this period to gain views from the wider industry (this Workgroup Consultation). Following this Consultation, the Workgroup will consider any responses; vote on the best solution to the defect and report back to the Panel at the special CUSC Panel meeting in October 2016.
- 1.4 CMP267 aims to defer any unforeseen increases in BSUoS cost arising from an IAE by two years when those unforeseen costs exceeds £30m in a charging year. This Workgroup Consultation has been prepared in accordance with the terms of the CUSC. An electronic copy can be found on the National Grid Website, <http://www2.nationalgrid.com/UK/Industry-information/Electricity-codes/CUSC/Modifications/CMP267/> along with the Modification Proposal Form.

2 Background

- 2.1 Currently, all costs incurred by the System Operator (SO) in balancing the system are recovered via BSUoS charges in the regulatory year in which costs are incurred. This is explained in further detail in paragraph 3.58.
- 2.2 Under the Balancing Services Incentive Scheme (BSIS), a target cost for balancing the system is calculated. This is then compared to actual costs incurred by the System Operator. The difference between these 2 costs is then subject to a 30:70 'sharing factor' – meaning that any profit or loss made by the SO is shared with consumers with the SO taking 30% of any profit or loss, and consumers taking 70%. In addition there is a cap and floor mechanism such that the System Operator's maximum profit and loss is limited – the current value is +/- £30m.
- 2.3 An Income Adjusting event is when the System Operator is able to apply for the target cost to be revised so that unforeseen costs (or profits) beyond the reasonable control of the SO do not impact the BSIS incentive scheme. Income adjusting events under Balancing Services Activity are defined in National Grid's special licence condition 4C. An IAE is therefore not about whether costs incurred can be recovered, but rather how these costs will be factored into the BSIS incentive scheme.
- 2.4 The Proposer explained that the purpose of the CMP267 proposal is to look at how unforeseen price shocks impacting BSUoS can be best managed. The submission of an IAE, although looking specifically at impact on the SO incentive scheme, acts as a signal that a particular price shock was not foreseen by the System Operator, and so the CMP267 proposal therefore seeks to examine how costs submitted as an IAE can be managed. In May 2016 an IAE was notified by National Grid to consider recently awarded Black Start contracts, to a maximum value of £113m. Across chargeable volume of 521.9TWh¹ this would equate to an annualised cost of £0.22/MWh to industry participants for the 2016 – 2017 BSIS year and could lead to recovery of these charges through the 2016 -2017 BSUoS charges.
- 2.5 Historically any black start contracts have been a relatively small component of Balancing Services costs at £20-£40m/year for ~16-18 plants. The recovery of up to £113m for two plants is an unprecedented amount and if the IAE is approved, may have a significant commercial impact on market participants, and ultimately customers.
- 2.6 The Proposer considers that the potential for such a material short notice impact on BSUoS charges to occur in these circumstances represents a defect to the CUSC and has raised CMP267 to address the defect.
- 2.7 Ofgem is due to make its determination of the IAE by the 24 August 2016.
- 2.8 The proposal is referenced in Annex 1 and seeks to defer unforeseen increase in BSUoS costs arising from an IAE by two years. This proposal will only apply to IAE's which, in their total in any given charging year, have a combined effect on "raw BSUoS" of over £30m.
- 2.9 The Proposer considers that most market participants will be able to manage unforeseen price shocks in a charging year with a combined effect on BSUoS of under £30m (i.e. the same amount as the floor on National Grid's incentive scheme) in the year it is incurred.
- 2.10 It is the view of the Proposer that this Modification will enable market participants to spread out the unexpected cost over this threshold over a two

¹ Using the March 2016 MBSS report for the 2015/16 period

year period and reduce the financial exposure some customers and industry parties (discussed in section 3.43 onwards of this report) may encounter if this Modification is not approved. A clear mechanism for deferral of cost recovery in these specific circumstances would provide a better forward view of BSUoS, thereby improving predictability.

2.11 The Proposer considers that its proposal is better than the current baseline and with respect to the applicable CUSC Objectives:

- 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:

2.12 This Modification will mitigate the impacts of the unprecedented and unforeseen BSUoS charges on market participants. By allowing the costs to be known in advance and be recovered over a two year period, the proposal facilitates effective competition in the generation and supply of electricity, by removing the uncertainty that comes from short-notice, unforecastable, changes in BSUoS of materiality above this threshold. These short-notice, unforecastable, changes create risks that are hard for any participant to finance efficiently, adding to consumer costs; they may also have more adverse impacts on some categories of participant than others.

2.13 Since the Modification will apply to future IAEs as well as the current potential IAE, it provides clarity going forward if a similar event occurs again and it provides the clarity that market participants need.

2.14 For Objectives b – d the proposer believes that the proposal is neutral against applicable charging objectives.

3 Workgroup Discussions

3.1 This section provides information regarding what the Workgroup have discussed in relation to this proposal. The points discussed concerned a number of different areas as presented below.

Forecasting for an IAE

3.2 The Workgroup discussed how, as an industry, it could have been expected to forecast the magnitude of these additional costs that are included in the current IAE.

3.3 The Workgroup agreed that the purpose of the Workgroup was not to investigate why the costs have been incurred, but to focus on the mechanism for cost recovery through BSUoS as an IAE can, by its definition, happen at any time. The defect as raised has been triggered by the event of the black start contracts but it could be other actions that prompt an IAE.

3.4 The National Grid representative noted to the Workgroup that with or without an IAE the recovery of extra costs will take place and that under current licence / codes should be recovered in the year in which they are incurred. The Proposer confirmed that this Modification was acting as stabilisation Modification to minimise the impact on market participants by reducing volatility, increasing predictability, stabilising BSUoS charges and providing industry time to pass these costs on in future years.

3.5 The Workgroup requested historic materiality information on IAEs and it was confirmed that in the period since 2011 there had been four submitted IAEs², submitted during the 2011-2013 BSIS incentive scheme period. Table 1 details these.

Table 1

Event	Cost impact	Potential Impact on incentive scheme	Final allowed impact on incentive scheme
Tx losses	£107.9m	£27.0m	£0
FMJL replacement	£28.9m	£7.2m	£2.2m
Closure of Alcan	£38.3m	£9.6m	£0
Moyle outage	£29.2m	£7.3m	£5.1m
		Total - £51.1m	

3.6 The National Grid representative noted that the cap and floor and sharing factors of the 2011-2013 incentive scheme were different, namely a +/- £50m cap and floor (across the whole 11-13 scheme) and a 25% sharing factor.

3.7 For the events above, the majority of costs across the 4 IAEs had *not* been permitted to be treated as IAEs. This meant that the SO had to absorb the

disallowed cost impact into its incentive scheme. Ahead of the IAEs being submitted, after application of the current sharing factor the SO had made a £56m loss (which would have been capped at £50m). Had all the costs that had been submitted as IAEs been 'allowed', this would have moved the SO to a position of a £4.9m loss instead (£56m – £51.1m). However only a small part of the costs submitted were allowed to be treated as IAEs, as detailed in the final column, meaning that the final position of the SO for the 2011-2013 period was a loss of £48.7m.

- 3.8 With regard to the 16/17 black start costs it was also confirmed that under the current baseline CUSC the SO could be recovering these costs now through BSUoS, but deferred including them into BSUoS costs until further engagement had taken place with stakeholders on the appropriate time to pass through these costs.
- 3.9 The Proposer confirmed that this Modification was narrow in scope and only covered instances of an IAE and would be 'triggered' when the IAE was >£30m per Charging Year.
- 3.10 One Workgroup member noted that under the Fuel Security Code, emergency costs could potentially be recovered via BSUoS. Upon further investigation, the Workgroup noted that the cost recovery mechanism in such a circumstance is subject to the Authority's discretion – but that this would not preclude such emergency costs being recovered via BSUoS.
- 3.11 It was further discussed that in the event of a valid Fuel Security claim that was recovered via BSUoS whether this Modification would capture this if it breached the £30m threshold (or when aggregated with other IAEs breached £30m). As the original proposal for this Modification specifies that an IAE should take place before costs are deferred, it was clarified that any unexpected industry costs recovered through BSUoS, such as a fuel security event, would *only* have costs recovered as per the CMP267 proposal if an IAE was raised.

Consultation Question 5:

- i) Can you provide any information to support the Workgroup on how risk-premia is applied to customers to cover an IAE event?

Triggering event – IAE notification or an IAE that has been determined

- 3.12 The Workgroup discussed what should be the trigger for the deferral of cost recovery proposed by CMP267 – when the IAE has been raised by the SO or when the IAE has been approved by the Authority.
- 3.13 There was also further discussion on whether this should or should not be linked to a Charging Year (Apr through to March) so as to capture instances when an event had happened in e.g. January but had not received Authority determination until May.
- 3.14 A Workgroup member noted that once IAE has been raised this gives clarity to industry that there is a BSUoS price impact that was potentially unanticipated.
- 3.15 A Workgroup member asked for clarity of what was meant by raised / notified. The Workgroup concluded that this would be when the System

Operator first requests an IAE from the Authority. The National Grid representative was asked to confirm how quickly this is made public. She noted that under special condition 4C.20 of National Grid's licence that 'the Authority will make public, excluding any confidential information, any notice of an income adjusting event following its receipt'. Therefore the Authority will publish the notice soon after receipt of an IAE request. (For example, when considering the Black Start costs that have been raised as an IAE this year, a letter was sent from the SO to the Authority on 24th May 2016, and the Authority published a public consultation on 8th June 2016).

3.16 The Workgroup also asked for confirmation on what was meant by 'approved'. The Workgroup confirmed that this would be when the Authority decided whether (all / some of / none) of the costs being submitted could be treated as an IAE. Again, in the case of the Black Start costs in question this decision is due from the Authority on 24th August 2016.

3.17 The National Grid representative noted that if the decision to defer costs was dependent on Authority *approval* of an IAE rather than when an IAE is *submitted* this could lead to a greater BSUoS price shock if part or none of the IAE costs are upheld:

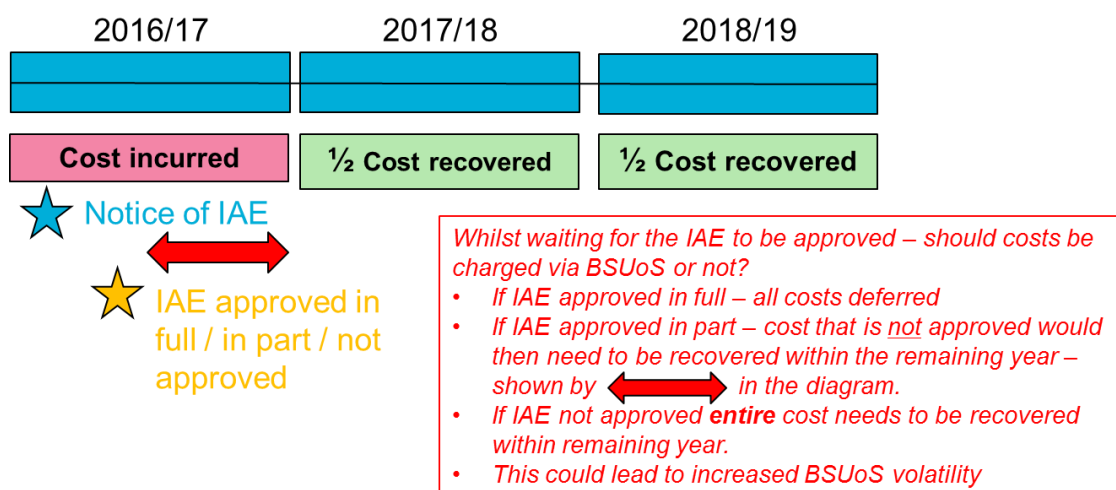


Figure 1: Potential impact of an IAE not being approved (in full)

3.18 The National Grid representative confirmed that under the current baseline version of the CUSC any recovery of balancing costs should normally begin as soon as costs have been incurred using the SF run, even though the Authority has not approved the costs as an IAE. This is because an IAE is not about cost recovery but rather the impact on the BSIS incentive scheme. The Proposer highlighted that this Modification is seeking to address these unexpected big spikes in BSUoS.

3.19 The National Grid representative also noted that even if the trigger for deferred recovery as per the CMP267 proposal was the raising of an IAE rather than a decision on the IAE, there could still be circumstances where, for example, the SO begins to recover costs and then an IAE is raised later. This could lead to complexity – should recovered costs be returned to Users, and then recovered 2 years later?

3.20 Following these discussions, the Proposer confirmed that the intention of the Modification was not just to capture instances where the Authority had upheld the IAE but also when it hadn't or had not fully upheld the IAE. **It was confirmed therefore that the 'trigger' for deferral of cost recovery would be when an IAE was raised by the SO and submitted to the Authority.** The amount *notified* as an unexpected cost in the request for an

IAE made by the SO would be the amount deferred for the purposes of cost recovery (minus the threshold amount discussed in section 3.30 onwards). The rationale for this was that it allows for the longer timeframe over 2 years to recover these costs via BSUoS, and minimises the likelihood of scenarios such as that illustrated in figure 1. As detailed previously, even if an IAE is not approved, the costs will still have to be recovered by National Grid via BSUoS – as an IAE is about the impact of these costs on the BSIS incentive scheme, not whether the costs can be recovered or not. Furthermore, at the point of submission of an IAE, the industry will know the scale of what is to be recovered via a deferral and under this Modification can begin to factor how to pass through these costs to customers.

Approach to cost recovery over the two years

- 3.21 The Workgroup discussed the different options to how costs could be allocated and recovered over the two years.
- 3.22 The first approach that was discussed was one that spread the deferred costs evenly over the two charging years following submission of the IAE (50% recovery in year t+1 and 50% recovery in year t+2).
- 3.23 The Workgroup also discussed whether there should be weighting applied so that more costs were recovered at the end of year 2 to allow for transparency and allow to recover from customers where can pass through these charges. The National Grid representative also asked whether the recovery could take place over 1 year i.e. the year following the submission of the IAE.
- 3.24 It was the view of the Proposer by deferring the payment over two years this will allow most Suppliers to recover the costs from a wider customer base over a longer duration which means impact to consumer bills will be limited. If a shorter recovery period was in place this could have a moderate to high impact on many Suppliers. Since some Suppliers will be able to absorb these costs better than others, a longer recovery period should create the least amount of distortion in Supplier competitiveness.
- 3.25 A Workgroup member noted that Ofgem have in the past, through work such as the DCUSA DCP178 Modification and the 2012 volatility consultation³, recognised the need for Suppliers to have a longer notice period (be it tariffs, allowed revenues etc) in order to reflect the charges into consumer tariffs:
- 3.26 Ofgem, in October 2012 issued a consultation⁴ following issues raised by stakeholders regarding current price control reviews around network charging volatility arising from the price control settlement. The consultation outlined five options to help mitigate volatility by improving the predictability of revenue adjustments and/or improving the stability of allowed revenues. The following changes were considered and a number of major improvements implemented to provide more transparency and predictability of costs:

Table 2

³ <https://www.ofgem.gov.uk/ofgem-publications/50572/cvdecision.pdf>

⁴ <https://www.ofgem.gov.uk/ofgem-publications/50572/cvdecision.pdf>

⁴ <https://www.ofgem.gov.uk/sites/default/files/docs/2015/02/dcp178d.pdf>

1	Improved information	Reduces overall risk Limited additional cost	Implement change
2	Intra-year charge changes	Improved balance of risk Simplifies arrangements	Implement change
3	Lagging incentive rewards/penalties	Improved balance of risk Framework not materially weakened	Implement change
4	Lagging uncertainty mechanisms	Improved balance of risk for some mechanisms May weaken signals to investors	Implement change: dependent on type of mechanism
5	A cap and collar allowed revenues	Does not improve balance of risk Adds complexity	Not implementing

3.27 Furthermore in February 2015 Ofgem approved the implementation of DCUSA Modification DCP178⁵ which extended the time frame for Distribution Network Operators (DNOs) to publish final distribution use of system (DUoS) charges for the forthcoming year (1 April – 31 March) from 40 days before it starts to a 15-month notice period (Independent distribution network operators (IDNOs) required to give 14 months' notice of charges). The rationale for this change was that by only having a 40 day window it did not give Suppliers sufficient notice and that they would have to price the uncertainty about charges into the risk premium in contracts.

3.28 The Proposer confirmed that the original proposal is suggesting a 2 year cost recovery period for costs deferred under CMP267, with 50% of deferred costs recovered in the year after an IAE is raised (year t+1) and 50% of deferred costs recovered in the following charging year (year t+2).

3.29 Some examples of different scenarios (costs and timings of IAE submissions and decisions) and how these would be recovered are included at section 3.42 for clarity.

Consultation Question 6:

- i) Do you think that the 2 charging years following submission of an IAE is the right time period in which to recover any deferred BSUoS costs, or can you suggest any alternative period for the recovery of deferred BSUoS costs? Can you provide any information to support this?

⁵ <https://www.ofgem.gov.uk/sites/default/files/docs/2015/02/dcp178d.pdf>

Rationale for £30m being the activation point for triggering the delay to charging

- 3.30 The Workgroup discussed what should be the threshold value of an unexpected price shock (submitted as an IAE) used to activate a deferral in cost recovery as proposed by CMP267.
- 3.31 The Proposer had set the threshold at £30m. This was deemed an appropriate risk that industry participants were comfortable with. The current profit cap on the BSIS is set at £30m and this is a risk that participants are currently exposed to.
- 3.32 It was questioned whether this threshold value was too low based on the total BSUoS costs. Currently BSUoS costs are just under £1bn so £30m represents a circa. 3% increase in costs. However the Workgroup noted that if a £30m price shock was recovered over less than a charging year for whatever reason, the BSUoS price impact could be bigger than 3%.
- 3.33 Another Workgroup member noted that from a Generator perspective the amount should be considered as a proportion of the achieved spread rather than as a proportion of BSUoS. A Workgroup member noted that spark (gas) and dark (coal) spreads tend not to recover fixed costs but reflect short run marginal cost and therefore reflect expected BSUoS costs. Whilst not a direct impact on profitability, due to the lack of consideration of fixed costs, it is a good proxy for the money being made with Generators usually having a level of spread that they are willing to generate at and below which they are not.
- 3.34 In November 2015, before black start and SBR costs were known, Winter baseload 16/17 (i.e. this Winter) was trading at about £42 MWh which corresponds to a clean spark / dark spread of approx. £4.50/MWh and £8.60/MWh respectively given fuel costs at the time. Therefore a £113M cost impact over the Winter period, £56.5m of which would be borne by Generators, equates to about a 7% and 3% impact on gas / coal profitability respectively.
- 3.35 Whilst some risk will be factored into prices to reflect BSUoS and other volatility Generators will include a BSUoS risk premium in their prices, it is unlikely to cover a 10% increase in BSUoS costs (the impact of the £113m black start costs). In contrast, a £30m increase in BSUoS costs over the winter period is approximately a 2% and 1% impact on profitability - which the Workgroup member felt to be a more reasonable impact to manage. She also noted that where many gas / coal Generators have been losing money, any further increase in costs is an increase in losses rather than a decrease in profitability. In addition, overnight spreads can (often) be negative, and an increase in BSUoS costs over this time period falls on a smaller volume of often inflexible or must run generation – causing increased impact on profit margins / increased losses.

Table 4 details what the impacts on BSUoS costs could be at different threshold values, illustrating that a £30m addition to BSUoS costs equates to approximately £0.06/MWh on BSUoS prices based on annualised historic chargeable volumes:

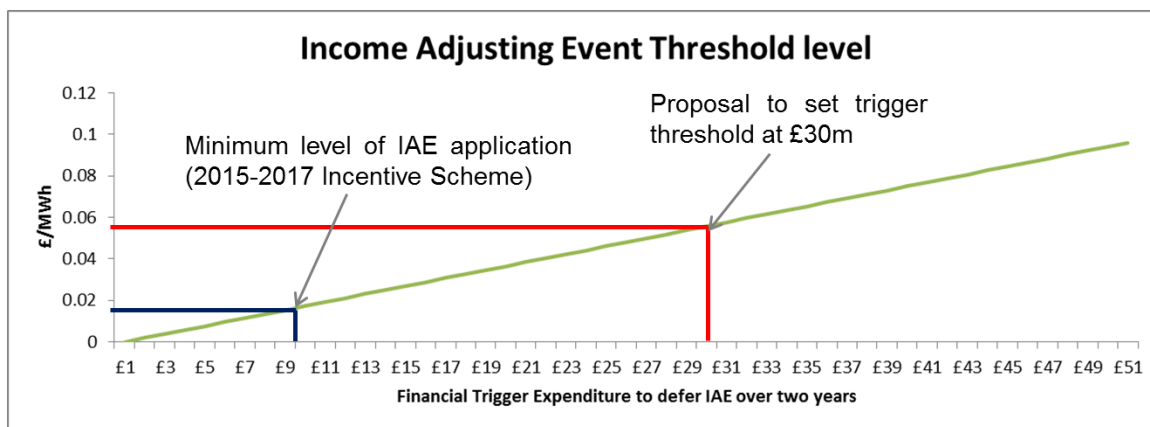


Figure 2

- 3.36 The Workgroup also discussed whether it should be a set monetary number that should act as the threshold limit or whether there should be a % factor that is used. The view of the Workgroup is that whilst a % factor could be used but this may be unduly complicated as the purpose of the Modification was about stabilising BSUoS costs *only in the context* of an IAE event and as such a set nominal value would be better than a variable % value for forecasting and adding risk-premia.
- 3.37 The Workgroup also discussed whether the value of £30m should be linked to RPI. It was agreed that whilst linking to RPI may on the surface appear to be reasonable, the application may be complex as it would have to take into account when the IAE happened and when then RPI should be applied. The view of the Workgroup was that the Modification was looking to provide stability and simplicity and that by industry being made aware that any IAE over £30m would be subject to cost recovery over two years a set static number would suffice.
- 3.38 Furthermore the Workgroup discussed whether this value (£30m) should be added directly into the CUSC or whether it could be referenced in another document to allow for publishing and consultation on amending the value rather than raising a new Modification (if CMP267 was approved). The view of the Workgroup was that it should be 'hard coded' into the CUSC to allow for formal industry consultation should a change to the £30m be required.
- 3.39 The Workgroup agreed that this would be a question to include in the consultation.

Single instance of >£30m vs. cumulative instances >£30m in a single charging year

- 3.40 The Workgroup discussed whether this Modification should cover only instances where a single IAE has exceeded the proposal threshold of £30m or whether it should take into account the scenario where there are, for example, several instances of £10m IAEs, which cumulatively can cause the same material impact.
- 3.41 The Workgroup concluded that defect was not about stopping the monies from being recovered but rather it was about ensuring that there was a sufficient timeframe for market participants to pay these additional costs (that would be included in BSUoS invoices) and that would allow participants time to recover these costs from their customers.
- 3.42 Therefore the Proposer confirmed that one or more IAEs in one charging year that have a cumulative impact on BSUoS of >£30m would trigger the

deferral of charging as per the CMP267 proposal. The Proposer gave some examples to clarify:

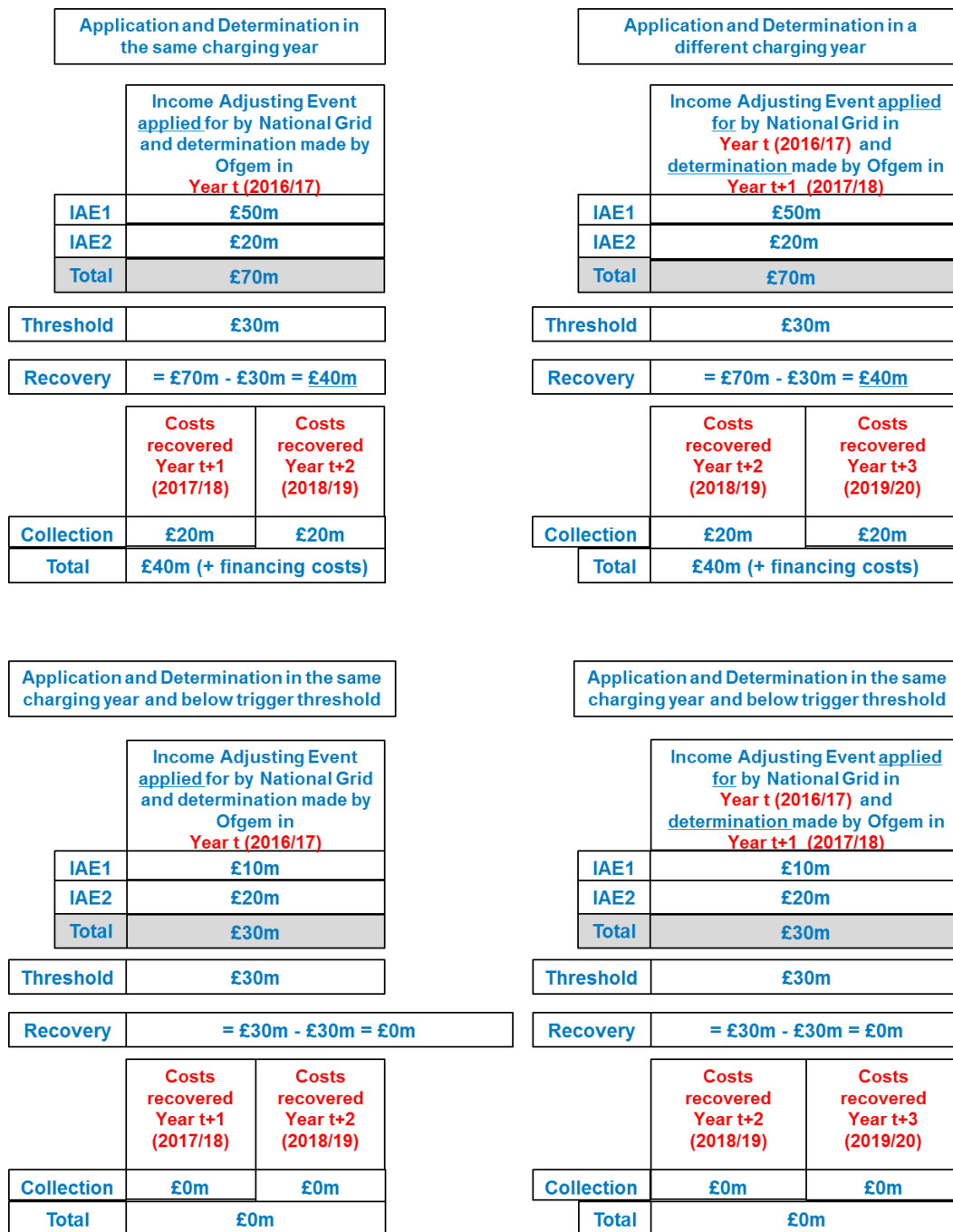


Figure 3

Consultation Question 7:

- i) Do you consider that the threshold value should be set at £30m? Can you provide any information to support this, or any other threshold value?
- ii) Do you agree that the threshold value should be a fixed value or should it be based on a % of BSUs or some other value? Please provide rationale.
- iii) Do you agree that the agreed threshold value should be included into the CUSC?

Implications on industry parties

- 3.43 The Workgroup were provided with information on how BSUoS is treated in contracts with customers from another Workgroup member.
- 3.44 **Pass through of BSUoS.** Customers on pass through BSUoS contracts (often, but not restricted to larger customers) bear the risk around BSUoS charging volatility and any subsequent unforeseen events which could cause an ex-post adjustment to BSUoS. If CMP267 is approved, all pass through customers will still be liable for the increased BSUoS charge that is deferred into later years. However, this cost will be spread over a longer period and is therefore more manageable as a result.
- 3.45 **Non-pass through of BSUoS.** Many customers agree 'fixed price' or 'non-pass through' contracts where the BSUoS charge component is incorporated into the overall rates that the customer sees on their invoice. Customers typically will sign a 1, 2 or 3 year contract with their Suppliers. It is only at the point of contract renewal that the supplier can incorporate these additional charges into customer contracts. If CMP267 is not approved most non-pass through customers will generally not pick up the increased BSUoS charge since it is charged to Suppliers over a shorter period. It is only those customers who are in the process of negotiating a contract with their supplier during that short period of time (or whose contracts can be re-opened) that will pick up the additional costs since the supplier be able to reflect it in the new contract. If however CMP267 is approved, the additional costs are spread over a longer period. More contract renewals with customers will take place during this longer period, resulting in at least partial reflection of the charges into customer contracts.
- 3.46 Some Suppliers protect themselves from unexpected price shocks by incorporating clauses with their Terms and Conditions on non-pass through contracts. The specific T&C's are readily available on Suppliers websites. Customers can be exposed to the impact of IAE if the Supplier chooses to pass some of this cost through to them.
- 3.47 It was the view of the Workgroup member that by spreading the length of time across which the additional costs are recovered through charges, means it is more cost reflective for customers since it allows Suppliers to price it into non-pass through contracts as they come up for renewal. Without the approval of CMP267, customers on pass through contracts and Suppliers bear most of the cost around this. Most consumers on non-pass through contracts will not see the charge unless their contracts are up for renewal or allows the charge to be passed through under the contract. This is unfair to different types of customer groups. Approval of CMP267 therefore promotes a fairer treatment / improved cost reflectivity across customer types.
- 3.48 A Workgroup member provided information to illustrate the possible impacts on non-pass through customers of when, in principle, the relevant amounts will be reflected in their bills following their contract renewal.

CMP267 original proposal: recovery of balance above £30M over two years

Table 3

When customer renews their contract	2016/17	2017/18	2018/19
November 2016- 31 st March 2017	Share of £30M	Share of £41.5M ⁶	Share of £41.5M
1 st April 2017- 31 st March 2018	---	Share of £41.5M	Share of £41.5M
1 st April 2018- 31 st March 2019	---	---	Share of £41.5M
1 st April 2019- 31 st March 2020	---	---	---

The status quo position (no change from baseline CUSC)

When customer renews their contract	2016/17	2017/18	2018/19
November 2016- 31 st March 2017	Share of £113M	---	---
1 st April 2017- 31 st March 2018	---	---	---
1 st April 2018- 31 st March 2019	---	---	---
1 st April 2019- 31 st March 2020	---	---	---

Recovery of balance above £30m over one year

When customer renews their contract	2016/17	2017/18	2018/19
November 2016- 31 st March 2017	Share of £30M	Share of £83M ⁷	---
1 st April 2017- 31 st March 2018	---	Share of £83M	---
1 st April 2018- 31 st March 2019	---	---	---
1 st April 2019- 31 st March 2020	---	---	---

⁶ Excludes financing costs

⁷ Excludes financing costs

- 3.49 **Impacts on Generators:** One workgroup member also raised the impact on Generators and that any Generator that had already sold power for the relevant season would take a direct hit to its profitability. Whilst it is likely that all Generators include a risk premium to cover BSUoS volatility, additional BSUoS costs (10% of total budget) of this size are generally not expected and can drive a small profit to a loss very easily for Generators, particularly in the current environment of very low to negative spreads. This can only increase costs to consumers as Generators are forced to add increasing risk premia to cover such volatility and could impact the merit order. Furthermore, increasing volatility of BSUoS is likely to reduce market liquidity as Generators are less inclined to sell power long periods ahead.
- 3.50 **Impacts on Suppliers:** If CMP267 is not implemented, Suppliers are less able to pass through these additional costs through to consumers and therefore must pay more of the costs themselves. Implementation of CMP267 means that, although Suppliers will still be impacted to an extent, costs are more accurately reflected into more customer tariffs.

Consultation Question 8:

- i) What would you consider the impact of a BSUoS price shock to be on pass through and non-pass through customers? Please provide any supporting information.
- ii) Can you provide any information about the commercial impact of a BSUoS price shock on your business / on other industry participants?

Implications if CMP250 is approved and implemented

The Workgroup also discussed what the impact would be if CMP250⁸ is approved and implemented.

- 3.51 CMP250 is seeking to eliminate BSUoS volatility and unpredictability by proposing to fix the value of BSUoS over the course of a season, with a notice period for fixing this value being at least 6 to 12 months ahead of the charging season.
- 3.52 The National Grid representative confirmed that if CMP250 was approved and implemented the price shock of any IAEs would potentially go into the fixed price period (depending on the exact final solution put forward for a fixed price period and notice period). The Proposer confirmed that had CMP250 already been approved and implemented that this proposal would have been less likely to be raised.
- 3.53 Based on the current timetable CMP250 is due to go to the Authority for decision 9th December 2016, with CMP267 timetabled to be presented to the

⁸ CMP250 <http://www2.nationalgrid.com/UK/Industry-information/Electricity-codes/CUSC/Modifications/CMP250/>

Authority on 19th October 2016. However any decision on potential licence changes are likely to be later than this (see section 3.61 onwards).

- 3.54 The Workgroup discussed when the first fixed tariff may be and whether it would be before or after April 2017. It was noted that under CMP250 the timeframe would be one year but CMP267 is seeking to expand payment to two years.
- 3.55 It was noted that the defect can only be assessed on the current baseline version of the CUSC but acknowledged the interaction this Modification may have with CMP250.
- 3.56 In the scenario where the Authority grants approval for CMP267 ahead of approval for CMP250 the Workgroup discussed that it would appear reasonable to raise a housekeeping Modification if necessary to back out the changes arising from CMP267 (which could be redundant if CMP250 goes live).

Which reconciliation run to recover costs against – SF or RF

- 3.57 It was confirmed to the Workgroup that under normal circumstances BSUoS costs are recovered using the SF⁹ mechanism 16 days after the settlement period in which they are incurred, but that a reconciliation of these charges is performed using the RF¹⁰ mechanism 14 months later to allow for any amendments to e.g. volume allocation etc. (see the CUSC section 14.31.1 to 14.31.3). The adjustment to BSUoS charges to take account of how SO incurred costs are performing against the target costs in the incentive mechanism takes place daily so as to avoid large 'jumps' in BSUoS (see CUSC section 14.30.7). The recovery of balancing costs, the SF and RF mechanisms and how incentive payments are detailed in the licence (special condition 4C) and the CUSC 14.30.
- 3.58 In the case of costs associated with an IAE, the normal procedure is therefore to start collecting the full costs immediately, and then once an IAE decision is received the impact on incentive payments that are collected via BSUoS would be reconciled via RF as necessary. The Workgroup discussed whether under CMP267 Proposal the deferred costs should be collected via the SF or RF mechanism. The Workgroup noted that the RF mechanism would be allocating costs to the previous charging year and therefore could cause problems for e.g. Suppliers in then trying to recover monies from previous customers.
- 3.59 Therefore it was agreed that the deferred recovery should take place via the SF mechanism of the 2 later charging years e.g. if an IAE >£30m is raised in 16/17 then 50% of the costs >£30m would be recovered via the SF mechanism in 17/18, and the remaining 50% of the costs >£30m would be recovered in the 18/19 SF mechanism.

Transmission License changes and changes to the CUSC charging methodology

- 3.60 The National Grid representative discussed the impacts this Modification may have on the Transmission Licence. The Workgroup discussed the timeframe for any license changes and what the constraints could be on this Modification if changes could not be incorporated into a current charging year.

⁹ SF – Initial Settlement run

¹⁰ RF – Final Reconciliation run

- 3.61 It was confirmed that there is no 'fast track' licence change process, and hence for any licence changes there would be a significant lead time with a 28 day consultation period followed by a minimum of 56 days for 'stand still' from the Authority.
- 3.62 The Workgroup discussed when this activity could take place and it was noted that whilst preliminary work could be started to identify the potential licence changes needed, as per advice received for other Modifications such as GC0086, it would not be possible to start any official consultation on licence changes until the Final Modification Report (FMR) has been provided to the Authority. Therefore this is an additional time frame to be added before CMP267 could be fully implemented.
- 3.63 CUSC changes: The National Grid representative confirmed that he did not believe any changes needed to be made to section 3 of the CUSC, therefore there should not be a need to raise an additional 'non-charging' Modification to the CUSC to implement CMP267.

Financing costs

- 3.64 The Workgroup noted that within the terms of reference they were required to consider the implications of deferring the recovery of National Grid's BSUoS income. Under the current method of recovering BSUoS costs there is no mechanism to recoup BSUoS under (or over) recoveries arising from a deliberate deferral of cost recovery. Rather, the vast majority of BSUoS costs are recovered within 16 days via the SF mechanism and hence there is currently not a large cash flow risk associated with BSUoS.
- 3.65 The Workgroup agreed that the deferral of BSUoS recovery would lead to additional cash flow costs for National Grid, mirroring discussions around financing cash flow in other industry Modifications such as CMP244, CMP250 and CMP251.
- 3.66 The exact cost of managing this new cash flow risk will be highly dependent on a number of factors, for example the exact mechanism used to finance the cash flow and the potential of an increasingly separate SO (as the SO itself has next to no assets and hence is likely to have higher cash flow costs than National Grid group).
- 3.67 As a starting point for evaluating the potential cash flow costs of deferring BSUoS recovery, a Workgroup member suggested that National Grid's regulatory Weighted Average Cost of Capital (WACC) should be used to enable industry respondents to understand the potential costs and benefits of this Modification. Regulatory WACC is National Grid's 'vanilla' WACC^[1] plus an adjustment for inflation. In 16/17 *vanilla* WACC (no inflationary adjustment) was 4.23%.
- 3.68 The National Grid representative noted that the decision around permitted financing costs for deferred BSUoS recovery would go into National Grid's licence text rather than the CUSC and hence would be negotiated bilaterally between National Grid and the Authority rather than via the CUSC Workgroup (again mirroring the approach discussed for CMP244). Therefore any figure quoted in this report can only be taken as a highly indicative cost ahead of these discussions.

^[1] See for example the National Grid TO tab at <https://www.ofgem.gov.uk/publications-and-updates/rrio-t1-directions-annual-iteration-process-november-2015-electricity-transmission>

4 Workgroup Alternatives

- 4.1 The workgroup are interested in the view of industry participants to inform the definition of potential alternatives. At this stage no alternative proposals¹¹ have been proposed by Workgroup members.
- 4.2 However it was noted that the responses received to the consultation would help to inform any alternatives put forward by the Workgroup, for example to look at any alternative options around the threshold value of £30m, options for cost deferral over a period other than 2 years etc.

5 Impact and Assessment

Impact on the CUSC

- 5.1 The Workgroup considered what changes to the CUSC may be necessary to implement CMP 267. It is likely that changes to the following paragraphs of Section 14 of the CUSC will be required:

2 – The Statement of the Balancing Services Use of System Charging Methodology	
14.29	Principles
14.30	Calculation of the Daily Balancing Services Use of System charge
14.31	Settlement of BSUoS
14.32	Examples of Balancing Services Use of System (BSUoS) Daily Charge Calculations

Impact on Greenhouse Gas Emissions

- 5.2 None identified.

Impact on Core Industry Documents

- 5.3 It is likely that changes to the transmission licence will be necessary, namely National Grid's special condition 4C.

Impact on other Industry Documents

- 5.4 None identified.

¹¹ Workgroup Alternative CUSC Modifications are only raised during the latter part of the Workgroup Process, and require a vote by Workgroup members.

6 Proposed Implementation and Transition

- 6.1 It is proposed to make changes to the charging methodology (Section 14) of the CUSC within 1 working days after the Authority determination on license changes, so that the new charging regime would take effect immediately.
- 6.2 The National Grid representative noted that for the specific case of the IAE that has been raised in relation to Black Start costs for 16/17 there could be some interactions between the timings of the CMP267 process and the timings of cost recovery. The IAE relating to blackstart costs was raised in May 2016, ahead of the CMP267 proposal being raised. The current baseline of the CUSC notes that these costs can be recovered in the 16/17 charging year. The CMP267 proposal is not due to receive a decision from the Authority until early November, and the additional timescales necessary for any licence change decision could mean that final implementation of any mod decision does not take place until up to 3 months later than this. However, under the current licence and code the System Operator could begin recovering the black start costs at any point in the 16/17 charging year.
- 6.3 There is a possible scenario in which the SO begins to recover these costs in 16/17, and that the CMP267 proposal (and necessary licence changes) are approved much later in the charging year e.g. January. At this point, the SO would then need to reconcile monies already charged to BSUoS payers, before then beginning to recover 50% of the costs (or whatever the final CMP267 proposal) in 17/18.
- 6.4 However if the SO was to wait to recover the monies, and then the Modification was not approved (but this was only confirmed at some point between early November and January) then there could be a very short period of time in which to recover a large amount of cost via BSUoS.
- 6.5 The National Grid representative also noted that there is a possibility of system changes to accommodate CMP267. Work has begun to identify these changes.

7 Responses

- 7.1 This Workgroup is seeking the views of CUSC Parties and other interested parties in relation to the issues noted in this document and specifically in response to the questions highlighted in the report and summarised below:

Standard Workgroup Consultation questions;

- Q1:** Do you believe that CMP267 Original proposal or either of the potential options for change better facilitate the Applicable CUSC Objectives?
- Q2:** Do you support the proposed implementation approach?
- Q3:** Do you have any other comments?
- Q4:** Do you wish to raise a Workgroup Consultation Alternative request for the Workgroup to consider? Please see 7.3.

- Q5:** Can you provide any information to support the Workgroup on how risk-premia is applied to customers to cover an IAE event?
- Q6:** Do you think that the 2 charging years following submission of an IAE is the right time period in which to recover any deferred BSUoS costs, or can you suggest any alternative period for the recovery of deferred BSUoS costs? Can you provide any information to support this?
- Q7 i:** Do you consider that the threshold value should be set at £30m? Can you provide any information to support this, or any other threshold value?
- Q7 ii:** Do you agree that the threshold value should be a fixed value or should it be based on a % of BSUoS or some other value? Please provide rationale.
- Q7 iii:** Do you agree that the agreed threshold value should be included into the CUSC?
- Q8 i:** What would you consider the impact of a BSUoS price shock to be on pass through and non-pass through customers? Please provide any supporting information.
- Q8 ii:** Can you provide any information about the commercial impact of a BSUoS price shock on your business / on other industry participants?

7.2 Please send your response using the response proforma which can be found on the National Grid website via the following link: <http://www2.nationalgrid.com/UK/Industry-information/Electricity-codes/CUSC/Modifications/CMP267/>

7.3 In accordance with Section 8 of the CUSC, CUSC Parties, BSC Parties, the Citizens Advice and the Citizens Advice Scotland may also raise a Workgroup Consultation Alternative Request. If you wish to raise such a request, please use the relevant form available at the weblink below:

http://www.nationalgrid.com/uk/Electricity/Codes/systemcode/amendments/forms_guidance/

7.4 Views are invited upon the proposals outlined in this report, which should be received by **1pm on 31 August 2016**. Your formal responses may be emailed to: cusc.team@nationalgrid.com

7.5 If you wish to submit a confidential response, please note that information provided in response to this consultation will be published on National Grid's website unless the response is clearly marked "Private & Confidential", we will contact you to establish the extent of the confidentiality. A response marked "Private & Confidential" will be disclosed to the Authority in full but, unless agreed otherwise, will not be shared with the CUSC Modifications Panel or the industry and may therefore not influence the debate to the same extent as a non-confidential response.

7.6 Please note an automatic confidentiality disclaimer generated by your IT System will not in itself, mean that your response is treated as if it had been marked "Private and Confidential".

CUSC Modification Proposal Form (for **nationalgrid** Charging Methodology Proposals) CMP267

Connection and Use of System Code (CUSC)

Title of the CUSC Modification Proposal
<i>Defer the recovery of BSUoS costs, after they have exceeded £30m, arising from any Income Adjusting Events raised in a given charging year, over the subsequent two charging years.</i>
Submission Date
<i>18 July 2016</i>
Description of the Issue or Defect that the CUSC Modification Proposal seeks to address
<i>National Grid notified Ofgem of an Income Adjusting Event (IAE) in relation to the 2016-2017 System Operator Incentive Scheme. Approval of the IAE would lead to the recovery of up to £113m, through 2016-2017 BSUoS charges.</i>
<i>Historically, Black Start contracts have been a relatively small component of Balancing Services costs at £20-£40m/year for ~16-18 plants. The recovery of up to £113m for two plants is an unprecedented amount and if the IAE is approved, will have a significant commercial impact on market participants, and ultimately customers. We believe this material short notice impact on BSUoS charges is a defect to the CUSC.</i>
<i>If this Proposal is not implemented, National Grid is likely to seek to recover up to £113m through 2016-2017 charges from market participants. The proposal mandates recovery of the IAE costs, instead, over the two subsequent charging years i.e. 2017-2018 and 2018-2019, which would minimise the impact on industry parties by reducing volatility, increasing predictability and stabilising BSUoS charges.</i>
Description of the CUSC Modification Proposal
<i>Under the Balancing Services Incentive Scheme (BSIS) National Grid is able to apply for the SO Incentives to be revised so as to allow them to recover costs which were beyond their reasonable control and were caused by an unforeseen event i.e. an IAE.</i>
<i>This proposal seeks to defer unforeseen increase in BSUoS costs arising from an IAE by two years. This proposal only applies to IAE's which, in their total in any given charging year, have a combined effect on "raw BSUoS" of over £30m. We believe most market participants will be able to manage IAEs in a charging year with a combined effect on BSUoS of under £30m (i.e. the same amount as the floor on National Grid's incentive scheme which reflects its maximum commercial exposure under the scheme) in the year it is incurred. This proposal enables</i>

market participants to spread out the unexpected cost over a two year period.

Shocks like the £113m Black Start contracts will increase market participant risk premia which in turn will increase prices for consumers. By deferring the payment over two years, this will allow most suppliers to recover the costs from a wider customer base over a longer duration which means impact to consumer bills will be limited. A shorter recovery period will still have a moderate to high impact on many suppliers. Since some suppliers will be able to absorb these costs better than others, a longer recovery period should create the least amount of distortion in supplier competitiveness.

Our proposal is relevant in an environment where identifying and quantifying the necessary balancing services in advance is proving to be difficult and where balancing costs are expected to increase significantly. It will provide greater certainty to suppliers and generators and support predictability of network charges which will result in consumers' benefits in the medium to long term.

Impact on the CUSC

This is an optional section. Please indicate the sections and clauses of the CUSC which would be affected by the modification or the general area in the CUSC if specific impacts are not yet known.

Do you believe the CUSC Modification Proposal will have a material impact on Greenhouse Gas Emissions? No

Include your view as to whether this Proposal has a quantifiable impact on greenhouse gas emissions. If yes, please state what you believe that the impact will be.

You can find guidance on the treatment of carbon costs and evaluation of the greenhouse gas emissions on the Ofgem's website:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=196&refer=Licensing/IndCodes/Governance>

Impact on Core Industry Documentation. Please tick the relevant boxes and provide any supporting information

BSC

Grid Code

STC

Other We believe a Transmission licence change may be needed.
(please specify)

This is an optional section. You should select any Codes or state Industry Documents which may be affected by this Proposal and, where possible, how they will be affected.

Urgency Recommended: Yes

This is an optional section. You should state whether you believe this Proposal should be treated as Urgent.

Justification for Urgency Recommendation

*Historically, Black Start contracts have been a relatively small component of Balancing Services costs at £20-£40m/year for ~16-18 plants. £113m for two plants is an unprecedented amount and if the IAE is approved, **will have a significant commercial impact on market participants, and ultimately customers** who may experience higher risk premia as a result of the IAE. Currently BSUoS costs are just under £1bn so this additional costs represents a 10% increase in costs. However, as we are already mid-way through the year effectively if recovered within year this increase costs for parties by a factor of 20%.*

We have been engaging with National Grid to better understand how they intend to recover the additional costs (if approved by Ofgem) and also the merits of other options to address the issue / defect. We are raising our proposal now so that the industry can consider our proposal in parallel with any other proposals National Grid might put forward in the near future.

*Since **Ofgem has to determine on the level of cost pass-through by 24 August 2016** (i.e. 3 months from the date of National Grid's notification), we would like our CUSC modification to be considered as an Urgent modification. **It is time sensitive to Ofgem's determination of the IAE.***

Self-Governance Recommended: No

This is an optional section. You should state whether you believe this Proposal should be treated as Self-Governance.

Justification for Self-Governance Recommendation

If you have answered yes above, please describe why this Modification should be treated as Self-Governance.

A Modification Proposal may be considered Self-governance where it is unlikely to have a material effect on:

- Existing or future electricity customers;
- Competition in generation or supply;
- The operation of the transmission system;
- Security of Supply;
- Governance of the CUSC
- And it is unlikely to discriminate against different classes of CUSC Parties.

Should this CUSC Modification Proposal be considered exempt from any ongoing Significant Code Reviews?

Yes. We are not aware of any current Significant Code Review (SCR) whose scope overlaps with the scope of this modification.

Impact on Computer Systems and Processes used by CUSC Parties:

There should be no impact on computer systems and processes used by CUSC Parties.

We note that the potential IAE is up to £113m and the exact amount will not be known until post event. While National Grid will have to calculate the exact amount to be deferred, this should not have an impact on their computer system.

Details of any Related Modification to Other Industry Codes

None. CMP 250 (stabilising BSUoS with at least a twelve month notification period) could have achieved a similar impact but it has yet to be approved by the Authority and even if approved is prospective and therefore would not address this issue.

Our modification would stabilise unforeseen BSUoS which results from an IAE over a two year period.

Justification for CUSC Modification Proposal with Reference to Applicable CUSC Objectives for Charging:

Please tick the relevant boxes and provide justification for each of the Charging Methodologies affected.

Use of System Charging Methodology

- (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 in accordance with the STC) incurred by transmission licensees in their transmission businesses and which are compatible with standard 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.
These are defined within the National Grid Electricity Transmission plc Licence under Standard Condition C10, paragraph 1.

Objective (c) refers specifically to European Regulation 2009/714/EC. Reference to the Agency is to the Agency for the Cooperation of Energy Regulators (ACER).

Full justification:

Charging Objective (a)

This modification will mitigate the impacts of the unprecedented and unforeseen BSUoS charges on market participants. By allowing the costs to be known in advance and be recovered over a two year period, the proposal facilitates effective competition in the generation and supply of electricity, by removing the uncertainty that comes from short-notice, unforecastable, changes in BSUoS of materiality above this threshold. These short-notice, unforecastable, changes create risks that are hard for any participant to finance efficiently, adding to consumer costs; they may also have more adverse impacts on some categories of participant than others.

Since the modification will apply to future IAEs as well as the current potential IAE, it provides clarity going forward if a similar event occurs again next year. It provides the clarity that market participants need.

Charging Objective (b)

The proposer believes that the proposal is neutral against applicable charging objective (b).

Charging Objective (c)

The proposer believes that the proposal is neutral against applicable charging objective (c).

Charging Objective (d)

The proposer believes that the proposal is neutral against applicable charging objective (d).

Connection Charging Methodology

- (a) that compliance with the connection 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 connection 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 in accordance with the STC)

incurred by transmission licensees in their transmission businesses and which are compatible with standard condition C26 (Requirements of a connect and manage connection);

- (c) that, so far as is consistent with sub-paragraphs (a) and (b), the connection charging methodology, as far as is reasonably practicable, properly takes account of the developments in transmission licensees' transmission businesses;
- (d) in addition, the objective, in so far as consistent with sub-paragraphs (a) above, of facilitating competition in the carrying out of works for connection to the national electricity transmission system.
- (e) compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency.
These are defined within the National Grid Electricity Transmission plc Licence under Standard Condition C10, paragraph 1.

Objective (c) refers specifically to European Regulation 2009/714/EC. Reference to the Agency is to the Agency for the Cooperation of Energy Regulators (ACER).

Full justification:

Additional details

Details of Proposer: (Organisation Name)	EDF Energy
Capacity in which the CUSC Modification Proposal is being proposed: (i.e. CUSC Party, BSC Party or "National Consumer Council")	CUSC Party
Details of Proposer's Representative: Name: Organisation: Telephone Number: Email Address:	Binoy Dharsi EDF Energy 020 3126 2165 binoy.dharsi@edfenergy.com
Details of Representative's Alternate: Name: Organisation: Telephone Number: Email Address:	Mari Toda EDF Energy 07875 116520 mari.toda@edfenergy.com
Attachments (Yes/No): No If Yes, Title and No. of pages of each Attachment:	

Contact Us

If you have any questions or need any advice on how to fill in this form please contact the Panel Secretary:

E-mail cusc.team@nationalgrid.com

Phone: 01926 653606

For examples of recent CUSC Modifications Proposals that have been raised please visit the National Grid Website at <http://www2.nationalgrid.com/UK/Industry-information/Electricity-codes/CUSC/Modifications/Current/>

Submitting the Proposal

Once you have completed this form, please return to the Panel Secretary, either by email to jade.clarke@nationalgrid.com copied to cusc.team@nationalgrid.com, or by post to:

Jade Clarke
CUSC Modifications Panel Secretary, TNS
National Grid Electricity Transmission plc
National Grid House
Warwick Technology Park
Gallows Hill
Warwick
CV34 6DA

If no more information is required, we will contact you with a Modification Proposal number and the date the Proposal will be considered by the Panel. If, in the opinion of the Panel Secretary, the form fails to provide the information required in the CUSC, the Proposal can be rejected. You will be informed of the rejection and the Panel will discuss the issue at the next meeting. The Panel can reverse the Panel Secretary's decision and if this happens the Panel Secretary will inform you.



Making a positive difference
for energy consumers

Michael Toms
CUSC Panel Chair
c/o National Grid Electricity Transmission plc
National Grid House
Warwick Technology Park
Gallows Hill
Warwick CV34 6DA

Direct dial: 020 7901 7000
Email: Mark.Copley@ofgem.gov.uk

Date: 1 August 2016

Dear Mr. Toms,

CUSC Modifications Panel views on urgency for CMP267 'Defer the recovery of BSUoS costs, after they have exceeded £30m, arising from any Income Adjusting Events raised in a given charging year, over the subsequent two charging years'

On 18 July 2016, EDF Energy (the 'Proposer') raised Connection and Use of System Code (CUSC) modification proposal CMP267 with the aim of deferring unforeseen increases in Balancing Services Use of System (BSUoS) costs arising from Income Adjusting Events (IAEs). The Proposer requested that CMP267 be treated as an Urgent CUSC Modification Proposal. The CUSC Modifications Panel (the 'Panel') considered the Proposer's urgency request at a special Panel meeting on 19 July 2016.

On 27 July 2016, the Panel wrote to inform us of its majority view that CMP267 should be treated as urgent because the proposal seeks to address an imminent (date-related) issue that could have a significant commercial impact on market participants.

This letter **gives our approval** for CMP267 to be progressed on an urgent basis, following the Code Administrator's timetable set out in Appendix 1 to the Panel's letter.

Background to the proposal

Under the Balancing Services Incentive Scheme (BSIS), National Grid Electricity Transmission (NGET) is able to apply for its System Operator (SO) Incentives scheme to be revised to allow it to recover costs which were beyond its reasonable control and which were caused by an unforeseen event - an IAE.

The unforeseen costs of an IAE can be significant. For example, Ofgem is currently considering an application from NGET to recover £113m in Black Start contracts arising from an IAE.¹ The Proposer is concerned that the introduction of such significant unforeseen costs into BSUoS charges in order to recover them will increase market participant risk premia and increase prices for consumers. The Proposer suggests that deferring IAE-associated BSUoS payments over two years would allow suppliers to

¹ Our consultation on this proposed IAE is on our website: <https://www.ofgem.gov.uk/publications-and-updates/notice-and-consultation-proposed-income-adjusting-event-submitted-national-grid-electricity-transmission-plc-relation-2015-17-electricity-system-operator-incentives-scheme>

recover the costs from a wider customer base over a longer duration and thereby limit the impact on consumers' bills.

The proposal

CMP267 seeks to defer recovery of unforeseen increases in BSUoS costs arising from IAEs by spreading them over a two year period, where increases to "raw BSUoS" amounts to more than £30m in a given charging year. The Proposer considers that this would provide greater certainty to suppliers and generators and support predictability of network charges.

Panel discussion

The Panel recognised our ongoing consideration of the current IAE issue and noted that Ofgem has to determine, by 24 August 2016, on the level of cost pass-through for Black Start IAE contracts. The total level of those costs, to be charged through BSUoS, is potentially significant. As such, the Panel considered the proposal to be time sensitive.

The Panel also noted the Proposer's concern regarding the significant additional BSUoS costs incurred within year which could lead to customers experiencing higher risk premia as a result of the IAE.

In this context, the Panel considers that the proposal should be treated as urgent. The majority view of Panel members supported the Code Administrator timetable set out in Appendix 1 to its letter which includes a Workgroup consultation as part of the assessment of the proposal. The Proposer did not support the Code Administrator timetable and suggested a more accelerated timetable (Appendix 2 to the Panel's letter) to be achieved by omitting the Workgroup consultation.

Our views

We have considered the proposal, the Proposer's justification for urgency and the views of the Panel. On balance, we consider that the proposed modification does meet our criteria for urgency. Specifically, we view the proposal as "*an imminent issue or a current issue that if not urgently addressed may cause a significant commercial impact on parties, consumers or other stakeholder(s)*".²

We concur with the reasoning of the Panel that urgent consideration of this modification proposal is justified. Ofgem is currently considering a request by National Grid for recovery of £113 million in Black Start IAE contracts. This decision will have a financial impact on all parties paying BSUoS charges. This modification proposal is therefore urgent to the extent that it seeks to address the recovery by National Grid of IAE costs – such as those currently under consideration by Ofgem.

We note that the CUSC modification process is designed to allow sufficient opportunity for industry to consider, and submit their views about, a modification proposal. We consider that this should apply in the case of this proposal, albeit based on an accelerated urgent timetable as supported by the majority of the Panel (Appendix 1 to the Panel's letter).

We prefer to allow as much time as possible to industry to be consulted on the proposal, recognising that the less that industry is consulted, the greater the risk that we do not receive enough information on which to make a decision in the final modification report. This includes ensuring that potential alternative solutions are properly considered

² https://www.ofgem.gov.uk/system/files/docs/2016/02/160217_urgency_letter_and_amended_criteria_2.pdf

alongside the original proposal. We would also encourage, within the urgent timetable, that some flexibility is shown on the milestone dates set out there so as to maximise the period of the Workgroup Consultation if possible.

For the same reason, we do not consider that the Proposer's alternative urgent timetable is suitable. We note the Proposer's concerns that, if this issue is not dealt with by the end of September 2016, customers may "continue to bear the full risk on the eventual outcome". Nevertheless, the potential implications of the modification require careful consideration by a Workgroup, including the need to ensure detailed and comprehensive input from relevant stakeholders. This is not envisaged in the Proposer's preferred timetable.

For the avoidance of doubt, in granting this request for urgency, we have made no assessment of the merits of the proposal and nothing in this letter in any way fetters the discretion of the Authority in respect of this proposal.

Yours sincerely,

Mark Copley
Associate Partner, Wholesale Markets
Duly authorised on behalf of the Authority

Workgroup Terms of Reference and Membership

TERMS OF REFERENCE FOR CMP267 WORKSHOP

CMP267 aims to defer unforeseen increase in BSUoS costs arising from an Income Adjusting Event (IAE) by two years. This proposal only applies to IAE's which, in their total in any given charging year, have a combined effect on "raw BSUoS" of over £30m.

Responsibilities

1. The Workgroup is responsible for assisting the CUSC Modifications Panel in the evaluation of CUSC Modification Proposal **CMP267 'Defer the recovery of BSUoS costs, after they have exceeded £30m, arising from any Income Adjusting Events raised in a given charging year, over the subsequent two charging years'** was tabled by **EDF Energy** at the Special CUSC Modifications Panel meeting on 19 July 2016.
2. The proposal must be evaluated to consider whether it better facilitates achievement of the Applicable CUSC Objectives. These can be summarised as follows:

Use of System Charging Methodology

(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 in accordance with the STC) incurred by transmission licensees in their transmission businesses and which are compatible with standard 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.

(d) in addition, the objective, in so far as consistent with sub-paragraphs (a) above, of facilitating competition in the carrying out of works for connection to the national electricity transmission system.

3. It should be noted that additional provisions apply where it is proposed to modify the CUSC Modification provisions, and generally reference should be made to the Transmission Licence for the full definition of the term.

Scope of work

4. The Workgroup must consider the issues raised by the Modification Proposal and consider if the proposal identified better facilitates achievement of the Applicable CUSC Objectives.
5. In addition to the overriding requirement of paragraph 4, the Workgroup shall consider and report on the following specific issues:
 - a. Consider the implications of deferring National Grids income. E.g. additional financing costs and credit risks. E.g. potentially a different set of parties may be paying from those connected this year.
 - b. Consider the implications on customers (pass through and non-pass through customers) in deferring the cost recovery into different financial years to when the costs were borne.
 - c. There are potentially other costs that are not later deemed as IAEs that can cause significant increases in BSUoS costs –these should be considered by the workgroup.
 - d. Workgroup to consider stakeholder engagement.
 - e. Consider the consequential changes for other Code and license changes and the dependency of potential license changes
 - f. Consider the distributional impacts on parties (in particular but not limited to Suppliers and Generators).
6. The Workgroup is responsible for the formulation and evaluation of any Workgroup Alternative CUSC Modifications (WACMs) arising from Group discussions which would, as compared with the Modification Proposal or the current version of the CUSC, better facilitate achieving the Applicable CUSC Objectives in relation to the issue or defect identified.
7. The Workgroup should become conversant with the definition of Workgroup Alternative CUSC Modification which appears in Section 11 (Interpretation and Definitions) of the CUSC. The definition entitles the Group and/or an individual member of the Workgroup to put forward a WACM if the member(s) genuinely believes the WACM would better facilitate the achievement of the Applicable CUSC Objectives, as compared with the Modification Proposal or the current version of the CUSC. The extent of the support for the Modification Proposal or any WACM arising from the Workgroup's discussions should be clearly described in the final Workgroup Report to the CUSC Modifications Panel.
8. Workgroup members should be mindful of efficiency and propose the fewest number of WACMs possible.
9. All proposed WACMs should include the Proposer(s)'s details within the final Workgroup report, for the avoidance of doubt this includes WACMs which are proposed by the entire Workgroup or subset of members.

10. There is an obligation on the Workgroup to undertake a period of Consultation in accordance with CUSC 8.20. The Workgroup Consultation period shall be for a period of 5 working days as determined by the Modifications Panel.
11. Following the Consultation period the Workgroup is required to consider all responses including any WG Consultation Alternative Requests. In undertaking an assessment of any WG Consultation Alternative Request, the Workgroup should consider whether it better facilitates the Applicable CUSC Objectives than the current version of the CUSC.

As appropriate, the Workgroup will be required to undertake any further analysis and update the original Modification Proposal and/or WACMs. All responses including any WG Consultation Alternative Requests shall be included within the final report including a summary of the Workgroup's deliberations and conclusions. The report should make it clear where and why the Workgroup chairman has exercised his right under the CUSC to progress a WG Consultation Alternative Request or a WACM against the majority views of Workgroup members. It should also be explicitly stated where, under these circumstances, the Workgroup chairman is employed by the same organisation who submitted the WG Consultation Alternative Request.

12. The Workgroup is to submit its final report to the Modifications Panel Secretary on 16 September 2016 for circulation to Panel Members. The final report conclusions will be presented to the CUSC Modifications Panel meeting on 20 September 2016.

Membership

13. It is recommended that the Workgroup has the following members:

Role	Name	Representing
Chairman	John Martin	National Grid
National Grid Representative	Nick Pittarello	National Grid
Industry Representatives	Binoy Dharsi Robert Longden Colette Baldwin Lucas Lilja Helen Inwood Garth Graham Paul Jones Mary Teuton Lisa Waters Christopher Granby	EDF Energy Cornwall Energy EON Energy Intergen RWE Npower SSE Uniper VPI Immingham Waters Wye Infinis
Authority Representatives	Andrew White	OFGEM
Technical secretary	Caroline Wright	National Grid
Observers		

NB: A Workgroup must comprise at least 5 members (who may be Panel Members). The roles identified with an asterisk in the table above contribute toward the required quorum, determined in accordance with paragraph 14 below.

14. The chairman of the Workgroup and the Modifications Panel Chairman must agree a number that will be quorum for each Workgroup meeting. The agreed figure for CMP267 is that at least 5 Workgroup members must participate in a meeting for quorum to be met.
15. A vote is to take place by all eligible Workgroup members on the Modification Proposal and each WACM. The vote shall be decided by simple majority of those present at the meeting at which the vote takes place (whether in person or by teleconference). The Workgroup chairman shall not have a vote, casting or otherwise]. There may be up to three rounds of voting, as follows:
 - Vote 1: whether each proposal better facilitates the Applicable CUSC Objectives;
 - Vote 2: where one or more WACMs exist, whether each WACM better facilitates the Applicable CUSC Objectives than the original Modification Proposal;
 - Vote 3: which option is considered to BEST facilitate achievement of the Applicable CUSC Objectives. For the avoidance of doubt, this vote should include the existing CUSC baseline as an option.

The results from the vote and the reasons for such voting shall be recorded in the Workgroup report in as much detail as practicable.

16. It is expected that Workgroup members would only abstain from voting under limited circumstances, for example where a member feels that a proposal has been insufficiently developed. Where a member has such concerns, they should raise these with the Workgroup chairman at the earliest possible opportunity and certainly before the Workgroup vote takes place. Where abstention occurs, the reason should be recorded in the Workgroup report.
17. Workgroup members or their appointed alternate are required to attend a minimum of 50% of the Workgroup meetings to be eligible to participate in the Workgroup vote.
18. The Technical Secretary shall keep an Attendance Record for the Workgroup meetings and circulate the Attendance Record with the Action Notes after each meeting. This will be attached to the final Workgroup report.
19. The Workgroup membership can be amended from time to time by the CUSC Modifications Panel.

Appendix 1 – Indicative Workgroup Timetable (Urgent) – Proposed Code Administrator Recommended Timetable

The following urgent timetable is following is indicative for CMP267 as per the recommendation of the Code Administrator

18 July 2016	CUSC Modification Proposal and request for Urgency submitted
19 July 2016	CUSC Panel meeting to consider proposal and urgency request
25 July 2016	Panel's view on urgency submitted to Ofgem for consultation
19 July 2016	Request for Workgroup members (5 Working days) (responses by 25 July 2016)
28 July 2016	Ofgem's view on urgency provided (3 Working days)
2 August 2016	Workgroup meeting 1
9 August 2016	Workgroup meeting 2
16 August 2016	Workgroup meeting 3
19 August 2016	Workgroup Consultation issued (6.5 days)
31 August 2016	Deadline for responses (midday)
6 September 2016	Workgroup meeting 4
8 September 2016	Workgroup meeting 5 (agree WACMs and Vote)
16 September 2016	Workgroup report issued to CUSC Panel
20 September 2016	Special CUSC Panel meeting to approve WG Report

Post Workgroup modification process

22 September 2016	Code Administrator Consultation issued (5 Working days)
29 September 2016	Deadline for responses
4 October 2016	Draft FMR published for industry comment (2 Working Days)
6 October 2016	Deadline for comments
4 October 2016	Draft FMR circulated to Panel
11 October 2016	Special Panel meeting for Panel recommendation vote
13 October 2016	FMR circulated for Panel comment (3 Working day)
18 October 2016	Deadline for Panel comment
19 October 2016	Final report sent to Authority for decision
2 November 2016	Indicative Authority Decision due (10 working days)
7 November 2016	Implementation date

Appendix 2 – Proposed EDF Workgroup Timetable (Urgent without Code Administrator Consultation)

The following timetable has been suggested by EDF Energy. EDF also provide the following reason for this;

'EDF Energy believes its Proposal merits progress via an urgent modification process, as the nature of the proposal exhibits the following characteristics:

- The proposal is linked to an imminent date related event (on the 24th August 2016, after 3 months of consideration, Ofgem will make a determination as to the validity of the IAE that was raised by National Grid). Moreover a very large volume of customers (both domestic and non-domestic) will re-contract with suppliers this autumn. Uncertainty on allocation of this large cost will impact those contracts to the detriment of consumers.
- There is a significant commercial impact on CUSC parties and their customers.

We understand that, after the Authority's decision, National Grid is planning to engage with the industry to decide how best to recover these costs. Consultation and implementation could add a few months to this process – which during this time there is a significant amount of further uncertainty on how to treat the allocation of £113m of costs and what it means for suppliers and their customers.

Customers who are currently contracting with suppliers face uncertainty as to how much of the IAE event they will end up picking up. Those customers on pass-through terms may end up unfairly picking up a proportion of the Black Start costs based purely on the profiling of costs allocated by National Grid without due thought on the impact it will have to those organisations. If we are unable to obtain an implementation date within September 2016 then certain customers will continue to bear the full risk on the eventual outcome. We do not believe there is any point in extending the process further as there is unlikely to be material value gained and certainty is very critical in this case. '

18 July 2016	CUSC Modification Proposal and request for Urgency submitted
25 July 2016	CUSC Panel meeting to consider proposal and urgency request
25 July 2016	Panel's view on urgency submitted to Ofgem for consultation
19 July 2016	Request for Workgroup members (3 Working days) (responses by 22 July 2016)
25 July 2016	Ofgem's view on urgency provided (3 Working days) (response back by 28 July 2016)
2 August 2016	Workgroup meeting 1
9 August 2016	Workgroup meeting 2
16 August 2016	Workgroup meeting 3 (including legal text)
26 August 2016	Issue Workgroup Report to CUSC panel (5 days – deadline 5th Sept 2016)
6 September 2016	Issue Code Admin Consultation Report (6 days)
15 September 2016	Deadline for responses (15th September 2016)

20 September 2016	Special CUSC Panel meeting to approve WG Report and vote on CMP267
23 September 2016	Final report sent to Authority for decision
30 September 2016	Indicative Authority Decision due (5 working days)
5 October 2016	Implementation date

Annex 4 – CMP267 Workgroup attendance register

A – Attended

X – Absent

O – Alternate

D – Dial-in

Name	Organisation	Role	02/08/16	09/08/16	16/08/16
John Martin	National Grid	Chair	A	X	A
Andrew Wainwright	National Grid	Chair (Alternate)	X	A	X
Caroline Wright	National Grid	Technical Secretary	A	A	A
Nick Pittarello	National Grid	NG Representative	A	A	X
Juliette Richards	National Grid	NG Representative (Alternate)	A	A	A
Binoy Dharsi	EDF Energy	Proposer	A	A	A
Colette Baldwin	EON Energy	Workgroup member	A	A	A
Garth Graham	SSE	Workgroup member	A/D	A	A/D
Helen Inwood	RWE Npower	Workgroup member	A	A	A
Lisa Waters	Waters Wye	Workgroup member	X	X	X
Lucas Lilja	Intergen	Workgroup observer	X	X	X
Mary Teuton	VPI Immingham	Workgroup member	A	A/D	X
Paul Jones	Uniper	Workgroup member	A	X	X
Guy Phillips	Uniper	Workgroup alternate	X	A	A
Robert Longden	Cornwall Energy	Workgroup member	A	A/D	A
Chris Granby	Infinis	Workgroup member	X	A	A
Andrew White	Ofgem	Authority Representative	X	A	A
Edda Dirks	Ofgem	Authority Representative (Alternate)	A/D	X	X