

CUSC Code Administrator Consultation Response Proforma**CMP350 'Changes to support the BSUoS Covid Support Scheme'**

Industry parties are invited to respond to this consultation expressing their views and supplying the rationale for those views, particularly in respect of any specific questions detailed below.

Please send your responses to cusc.team@nationalgrideso.com by **5pm** on **4 August 2020**. Please note that any responses received after the deadline or sent to a different email address may not receive due consideration by the Panel.

If you have any queries on the content of this consultation, please contact Paul Mullen paul.j.mullen@nationalgrideso.com or cusc.team@nationalgrideso.com.

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For reference the applicable CUSC objectives are:

- a. *That compliance with the use of system charging methodology facilitates effective competition in the generation and supply of electricity and (so far as is consistent therewith) facilitates competition in the sale, distribution and purchase of electricity;*
- b. *That compliance with the use of system charging methodology results in charges which reflect, as far as is reasonably practicable, the costs (excluding any payments between transmission licensees which are made under and accordance with the STC) incurred by transmission licensees in their transmission businesses and which are compatible with standard licence condition C26 requirements of a connect and manage connection);*
- c. *That, so far as is consistent with sub-paragraphs (a) and (b), the use of system charging methodology, as far as is reasonably practicable, properly takes account of the developments in transmission licensees' transmission businesses;*
- d. *Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency. These are defined within the National Grid Electricity Transmission plc Licence under Standard Condition C10, paragraph 1 *; and*
- e. *Promoting efficiency in the implementation and administration of the use of system charging methodology.*

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

Please express your views in the right-hand side of the table below, including your rationale.

Standard Code Administrator Consultation questions		
1	Do you believe that the CMP350 Original solution, WACM1, WACM2, WACM3, WACM4, WACM5, WACM6 or WACM7 better facilitates the Applicable CUSC Objectives?	<p>We agree with the Proposer of CMP350 that the Original and the seven WACMs (to a greater or lesser extent – see below) do better facilitate the Applicable CUSC Objectives in terms of (a) and (c) whilst being neutral in terms of (b), (d) and (e) when compared with the current baseline CUSC (i.e. a £15/MWh level for BSUoS, no explicit cap on the BSUoS Covid Support Scheme and a scheme end date of 31st August 2020).</p> <p>In terms of Applicable Objective (a) we agree that CMP350 Original and the seven WACMs (to a greater or lesser extent – see below) provides some mitigation against the exceptional losses likely to be incurred by Parties as a result of the unprecedented Covid pandemic in terms of the impact of higher than reasonably foreseeable BSUoS costs.</p> <p>In this respect it is important to recognise that the effects of the Covid pandemic, whilst currently in abeyance in parts of GB (notwithstanding the possibility of local '<i>hot spots</i>'), have not concluded. Indeed, it has been credibly argued that the pandemic could re-ignite, from its current low levels in GB, in a second or third wave in the future (the timings of which is uncertain). Therefore, the economic effects of Covid and the associated electricity demand suppression effects over the next three months or so (till the clock change in October) and beyond that date remain a '<i>known unknown</i>' in terms of BSUoS costs over that period of time.</p> <p>The deferral of some of the recovery of BSUoS costs arising from Covid in 2020/21 into 2021/22 charging year will allow Parties to reflect the impact of these unforeseeable costs into future tariff offerings and wholesale prices in a manner that ensures that the cost recovery nature of BSUoS (as recognised by the BSUoS taskforce) is to maintained without the risk that greater risk premiums are built into generation and retail commercial decisions.</p> <p>In this way CMP350 Original and the seven WACMs provides market participants with some protection, for exceptional events, that are high impact and low</p>

probability, such as a pandemic, and this, in turn, reduces the level of risk that will need to be factored into future tariffs and prices which facilitates effective competition in the generation and supply of electricity. As the proposer noted, and we concur, in their (and our) view this will, as a result, lower the long-term costs to consumers.

In terms of **Applicable Objective (c)** we agree that the introduction, with CMP350 Original and the seven WACMs, of a (£100M) limit to the amount of Covid costs that are recovered via BSUoS that can be deferred will help to ensure the continued financeability of the ESO, consistent with Ofgem's CMP345 decision.

We now turn to the eight options (the Original and the seven WACMs) for CMP350.

For the avoidance of doubt, our order of preference is as follows:

First – WACM4

Second – Original

Third – WACM5

Fourth – WACM1

Fifth – WACM6

Sixth – WACM2

Seventh – WACM7

Eighth – WACM3

In respect of each of these we make the following comments.

Original

With its £5/MWh level for BSUoS, along with the £100M cap on the BSUoS Covid Support Scheme and a scheme end date of 30th September 2020 provides one of the greatest benefits; in terms of better facilitating Applicable Objectives (a) and (c); of all the eight options (the Original and seven WACMs) associated with CMP350. Only WACM4 is, in our view, better than the Original.

WACM1

With its £6.60/MWh level for BSUoS, along with the £100M cap on the BSUoS Covid Support Scheme and a scheme end date of 30th September 2020 provides a high level of benefits; in terms of better facilitating Applicable Objectives (a) and (c); of all the eight options (the Original and seven WACMs) associated with CMP350. Only WACM4, the Original and WACM 5 are, in our view, better than WACM1.

WACM2

With its £10/MWh level for BSUoS, along with the £100M cap on the BSUoS Covid Support Scheme and a scheme end date of 30th September 2020 provides a degree of benefits; in terms of better facilitating Applicable Objectives (a) and (c); of all the eight options (the Original and seven WACMs) associated with CMP350. WACM4, the Original, WACM5, WACM1 and WACM6 are, in our view, all better than WACM2.

WACM3

With its £15/MWh level for BSUoS, along with the £100M cap on the BSUoS Covid Support Scheme and a scheme end date of 30th September 2020 provides the least benefits; in terms of better facilitating Applicable Objectives (a) and (c); of all the eight options (the Original and seven WACMs) associated with CMP350. WACM4, the Original, WACM5, WACM1, WACM6, WACM2 and WACM7 are, in our view, all better than WACM3.

WACM4

With its £5/MWh level for BSUoS, along with the £100M cap on the BSUoS Covid Support Scheme and a scheme end date of 25th October 2020 provides the greatest benefits; in terms of better facilitating Applicable Objectives (a) and (c); of all the eight options (the Original and seven WACMs) associated with CMP350.

WACM5

		<p>With its £6.60/MWh level for BSUoS, along with the £100M cap on the BSUoS Covid Support Scheme and a scheme end date of 25th October 2020 provides a high level of benefits; in terms of better facilitating Applicable Objectives (a) and (c); of all the eight options (the Original and seven WACMs) associated with CMP350. Only WACM4 and the Original are, in our view, better than WACM5.</p> <p><u>WACM6</u></p> <p>With its £10/MWh level for BSUoS, along with the £100M cap on the BSUoS Covid Support Scheme and a scheme end date of 25th October 2020 provides a degree of benefits; in terms of better facilitating Applicable Objectives (a) and (c); of all the eight options (the Original and seven WACMs) associated with CMP350. Only WACM4, the Original, WACM5 and WACM1 are, in our view, better than WACM6.</p> <p><u>WACM7</u></p> <p>With its £15/MWh level for BSUoS, along with the £100M cap on the BSUoS Covid Support Scheme and a scheme end date of 25th October 2020 provides the second least benefits; in terms of better facilitating Applicable Objectives (a) and (c); of all the eight options (the Original and seven WACMs) associated with CMP350 (only WACM3 is worse, of the eight options, than WACM7).</p>
2	Do you support the proposed implementation approach?	Yes, we support the proposed implementation approach as set out in the Consultation document.
3	Do you have any other comments?	[see below]

Question 3 Do you have any other comments?

Yes. We have a number of additional comments. They cover the following items that are relevant to CMP350 (the Original and the seven WACMs).

- 1) Reducing the current £15/MWh cap to £5/MWh; and
- 2) ESO Financability.

Reducing the current £15/MWh cap to £5/MWh

This item was explored, by the Workgroup, as detailed on pages 8-10 of the Consultation document. We believe that the CMP350 proposal makes it clear that reducing the cap to £5/MWh has a much greater impact in terms of addressing the original defect identified with CMP345 in that it brings average BSUoS for the period to which it applies much closer to what could have reasonably been foreseen ahead of Covid.

Some opposition to the CMP350 Original has centred on the impact the lowered cap has on the level of volatility of BSUoS and the potential for distortive effects that such a reduction in volatility might have. This however runs contrary to the observations of the first BSUoS task force, and also to the commentary made by the Authority in its Target Charging Review decision¹ and in particular the statement, in paragraph 4.66, that:

“The [First] Balancing Services Charges Taskforce concluded that useful forward-looking signals could not be sent through balancing services charges and they should be treated as cost-recovery charges. We accept this view...”

The Ofgem decision² to launch the second BSUoS Task Force and in particular the statement, on page 1, also supports the conclusion that lowering the BSUoS cap under CMP350 will not have a detrimental impact on competition through suppressing BSUoS cost signals.

“The overall conclusion of the first taskforce was that balancing services charges should be treated as cost-recovery charges. We accept that at present it is not possible to send useful forward-looking signals through balancing services charges. When we launched the TCR, we said that balancing services should be considered for reform if they are to remain cost recovery charges” [emphasis added]

These themes are covered by evidence set out in the First BSUoS Task Force Report³ and, in particular, the statements in:

(a) paragraph 2.13, that:

“The Task Force assessed all elements of BSUoS (Section 2.2) and found that elements do not provide a useful forward-looking signal, and certainly not one which influences user behaviour in an economic and efficient manner.” [emphasis added]

(b) Paragraph 2.4.1, that:

“The Task Force identified two areas where some impact of BSUoS could be expected:
- The current BSUoS methodology does lead to additional costs for consumers due to a risk premium; and

¹ <https://www.ofgem.gov.uk/publications-and-updates/targeted-charging-review-decision-and-impact-assessment>

² https://www.ofgem.gov.uk/system/files/docs/2019/11/open_letter_on_the_balancing_services_charges_taskforce.pdf

³ <http://chargingfutures.com/media/1348/balancing-services-charges-task-force-final-report.pdf>

- Certain market participants can respond to a subtle signal when overnight BSUoS prices increases.

Both of these responses are not useful as they are likely to reduce the efficiency of the market and increase prices to customers. [emphasis added]

(c) Paragraph 2.4.3, that:

“As discussed by the Workgroup for CMP3085, there is little evidence that prices of short-term markets adjust as BSUoS varies (i.e. half-hourly volatility). This gives support to the theory that BSUoS is not a significant driver to short term power prices, although with wider changes such as in respect of increases in zero marginal cost output this dynamic could change in future.” [emphasis added]

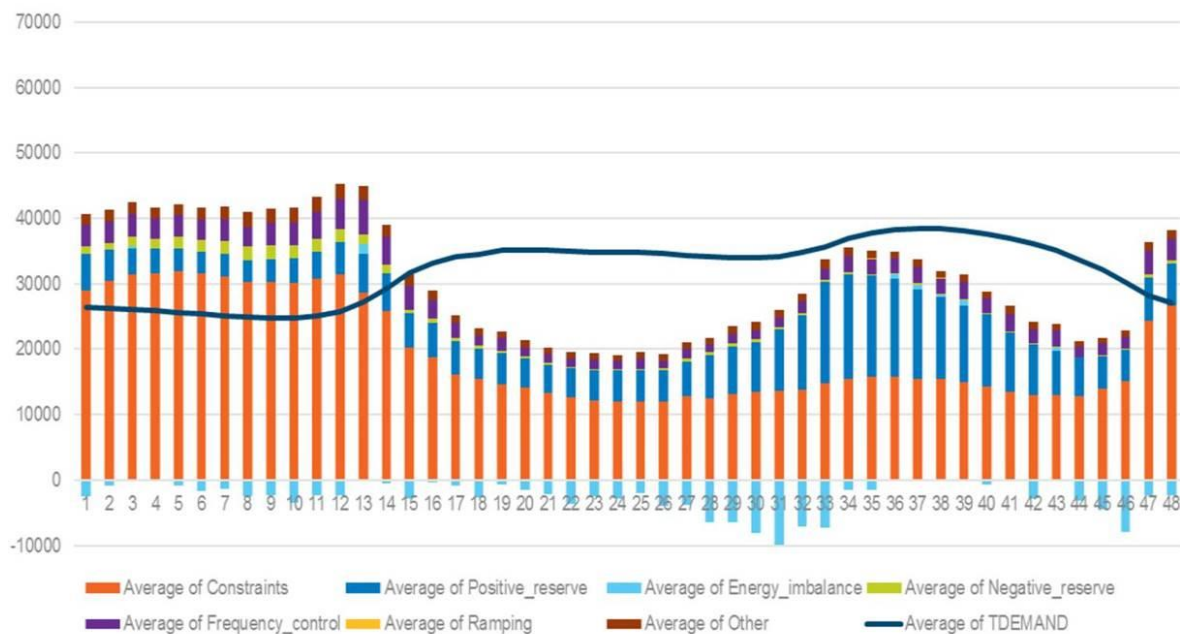
(d) Paragraph 2.4.4, that:

“The analysis also identifies that there are several products available on the market, in particular half-hourly products, where BSUoS half-hourly volatility could be reflected. However, it has been observed that the volume of APX half-hourly trades are small, so it is assumed that a risk premium must be added to prices as the way to manage the forecasting risk. The Task Force concluded that the majority of traded products effectively “smooth” BSUoS over a longer time period, via a risk premium. If this is correct then, in the long term, there will be adjustment of wholesale prices so that the long run average BSUoS costs are reflected in power prices.” [emphasis added]

(e) Paragraph 2.4.6, that:

“Figure 7 [reproduced below] illustrates that high balancing services costs mainly occur overnight. Any further reduction in demand (potentially as a result of the higher BSUoS) will further drive higher BSUoS charges due to the “denominator factor” effect i.e. lower demand levels overnight divides the HH cost by less MWs.” [emphasis added]

“Figure 7: Average daily Settlement Period pattern of costs (£) of elements of BSUoS and Average Transmission Demand”



Source: Costs (£) of elements of BSUoS (BM only) and demand (transmission system only)

We would also wish to note our agreement with the view, as set out on page 2 of the Authority's CMP345 decision letter, that:

“Alongside these reforms, in our TCR decision, we acknowledged the findings of the first Balancing Services Charges Task Force that it is not “feasible to charge any of the components of BSUoS in a more cost-reflective and forward-looking manner that would effectively influence user behaviour that would help the system and/or lower costs to customers. Therefore, the costs included within BSUoS should all be treated on a cost-recovery basis”. A key conclusion of the Task Force was that “the volatility and inability to forecast BSUoS is adding risk premia costs to all parties exposed to BSUoS”.” [emphasis added]

It is also important to note that for the most part BSUoS costs are recovered by average charges over a given period reflecting the expected range present across a season's settlement periods and any reduction in volatility has little detrimental impact on any party compared to what that party could have expected.

It is also necessary to be mindful that the £5/MWh cap does not treat all increases in BSUoS charges as “exceptional” and that the £5/MWh cap had it been implemented in April 2020 would have resulted in average BSUoS over the period April to August 2020 being in line with a value that could be considered to be a credible “worst” case within a reasonable business planning philosophy.

Given that no cap was in place up until 25th June 2020, and that a £15/MWh cap was in place from then it is not clear that the windfall losses will be significant and that they will remain significant if a cap of £5/MWh is put in place from the implementation date for CMP350 (should it be approved) of mid-August. This suggests that a £5/MWh cap still fits with the views outline in The Authority's CMP345 decision letter, as follows:

“Combining our views on the likely level of unexpected costs and the mechanisms that will allow some pass-through of those costs, our assessment of the extent of windfall losses related to system balancing costs this summer, is that they are likely to be significantly less than the full difference between actual costs, and NGENSO’s forecasts from earlier this year.”⁴ [emphasis added]

The Authority, on page 8 of its CMP345 decision letter, recognised that:

“Periods with charges over £15/MWh are rare. Had the cap been in place in May, when the COVID-19 lockdown and weather conditions drove extremely low demand on several weekends, the deferred charges would have been £8.5m, from 112 settlement periods.” [emphasis added]

We wish to point out that this is a small fraction of the additional costs (recovered via BSUoS) identified by the ESO as being due to Covid.

We believe that given the extent of the windfall losses sustained by parties from April to August 2020 that reducing the cap to £5/MWh will not change the conclusion outlined in The Authority’s CMP345 decision letter, regarding the low potential for windfall gains, namely:

“Given the low likelihood that WACM2 would lead to windfall gains and the potential to promote long-term market confidence by protecting market participants from exceptionally high BSUoS charges, we believe (in these specific circumstances) it would better facilitate ACO⁵ (a).”

We also consider that the overall impact of reducing the cap to £5/MWh does not run counter to the prudent approach noted in The Authority’s CMP345 decision as the £5/MWh cap’s impact will reduce, but not eliminate, the “*significant losses related to balancing costs that could not have reasonably anticipated*”⁶ that could; if not recognised; have a detrimental impact on competition.

ESO Financability

As the Proposer of CMP350 as well as the Workgroup have noted, it was The Authority, in their CMP345 decision letter that highlighted the matter of ‘ESO Financability’ when (on page 12) they noted that at that time:

“...we recognise that there is a limit to the amount of liquidity that can be provided by NGENSO, under current arrangements. With this in mind, we think it would be efficient and appropriate, should the level of BSUoS costs being deferred approach £100m, to consider further how to mitigate the NGENSO’s exposure”

⁴ From page 8 of The Authority’s CMP345 decision letter.

⁵ Applicable CUSC Objective

⁶ From page 12 of The Authority’s CMP345 decision letter.

However, it is important to recognise that since the Authority's CMP345 decision letter was published on 25th June 2020 the "*current arrangements*" (at that time) as regard the "*limit to the amount of liquidity that can be provided by NGESO*" has, in terms of the ESO's risk and credit profiles, improved; as both Ofgem and the ESO have publicly acknowledged; materially (Ofgem⁷) and significantly (the ESO⁸) with the Authority's 9th July 2020 decision⁹ on moving the revenue collection risk associated with TNUoS charges from the ESO to the onshore Transmission Owners; whereby circa 60%¹⁰ of the ESO's total revenue collection risk has been removed entirely from the ESO.

Furthermore, since the Authority's CMP345 decision letter NGET and SHETL having agreed to support the TNUoS scheme in the immediate term by deferring a proportion of their monthly payment from the ESO.

Both these steps, since the 25th June 2020, have in our view, materially and significantly improved the ESO's financability situation (when compared with the CMP345 'baseline') such that the financial position of the ESO, as regards its risk and credit profiles, can (as noted in the Authority's CMP345 decision letter) defer more than £100M in an "*efficient and appropriate*" manner (if required to by the BSUoS Covid Support Scheme) and, therefore, the Original and the seven WACMs should be seen as being extremely prudent in advocating a £100M cap (in terms of ESO financability).

In respect of the statement, in the Code Administrator Consultation that "*other Workgroup members felt the changes to TNUoS collection risk would be seen as separate to BSUoS collection risk and would therefore have little impact on the credit profile*" we find this lacks credibility given (a) the way that the credit agencies (which Ofgem referenced in the 9th July letter) operate, i.e. by taking a holistic view of the risks faced by the ESO in totality when determining the ESO's credit rating; and (b) the clear statements to the contrary, from both Ofgem and the ESO, as to the material and significant benefits, to the ESO's risk and credit profiles, that the 9th July 2020 decision makes.

⁷ Page 5 of the 9th July decision letter: "*The ESO will benefit from this change because it will reduce a material part of the liquidity risk it would otherwise hold*".

⁸ Page 8 of the 9th July decision letter: "*The ESO agreed that the transfer of TNUoS risk under this proposal could significantly reduce the size of facility required*".

⁹ https://www.ofgem.gov.uk/system/files/docs/2020/07/tnuos_decision_letter_final_0.pdf

¹⁰ TNUoS at circa £2.9Bn, BSUoS at circa £1.8Bn as per the ESO's June Forecast and Connection Charges of circa £300M.