

Modification proposal:	<b>Connection and Use of System Code (CUSC) CMP350: Changes to the BSUoS Covid Support Scheme</b>		
Decision:	The Authority <sup>1</sup> directs that that WACM6 of this modification be made <sup>2</sup>		
Target audience:	National Grid Electricity System Operator (NGESO), Parties to the CUSC, the CUSC Panel and other interested parties		
Date of publication:	13 August 2020	Implementation date:	14 August 2020

## Background

Balancing Services Use of System ('BSUoS') charges are the means by which National Grid Electricity System Operator ('NGESO') recovers the costs of balancing the system. BSUoS charges are recovered from demand customers and larger generators based on the amount of energy imported or exported onto the transmission network (in £/MWh) within each half-hour period.<sup>3</sup>

Our approval of CUSC modification CMP345 WACM2<sup>4</sup> introduced a cap of £15/MWh to the BSUoS price in each settlement period from 25 June 2020 to 31 August 2020, known as the "BSUoS Covid Support Scheme". Any under-recovery of revenue from the application of this cap will be recovered through BSUoS charges equally across all settlement periods in charging year 2021/22.

Electricity demand and BSUoS charges have been difficult to forecast for a number of years. This has been taken into account in industry decision making, with risk premia reflecting the uncertainties and risks. We recognise that demand reduction during the COVID-19 pandemic has led to increased BSUoS charges, and forecast costs for the remainder of the summer,<sup>5</sup> that can be considered 'exceptional' in nature. There is still uncertainty about demand levels and challenges for NGESO in managing the system over the coming months.

NGESO's recent forecasts, recognising this uncertainty, provided a sensitivity analysis based on different demand suppression levels.<sup>6</sup> To date, actual BSUoS costs have been lower than the 15% estimates. Actual June results were closest to the 10% suppression level estimated in June and actual July results were closer to 5% suppression. The total

<sup>1</sup> References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work.

<sup>2</sup> This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

<sup>3</sup> Larger generators are those above 100MW that are connected to either the distribution or the transmission network.

<sup>4</sup> <https://www.ofgem.gov.uk/publications-and-updates/decision-cusc-modification-panel-s-recommendation-cmp345-defer-additional-covid-19-bsuos-costs-be-treated-urgent-cusc-modification-proposal>

<sup>5</sup> <https://data.nationalgrideso.com/data-groups/balancing>

<sup>6</sup> NGESO forecasts are available here: <https://data.nationalgrideso.com/balancing/bsuos-monthly-forecast>

cost of BSUoS<sup>7</sup> for May to June was more than £120m higher than originally forecast in March.

We have acknowledged the finding of the first Balancing Services Charges Task Force that at present 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.”<sup>8</sup> Therefore, the costs included within BSUoS should all be treated on a cost-recovery basis”. Another 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”.

The second Balancing Services Charges Task Force was launched by NGENSO at our request in January 2020 and has recently published its interim report.<sup>9</sup> The report recommends that final demand should pay all BSUoS charges, and that fixing these charges *ex ante* would deliver overall benefits. There are also several other longer term reforms to BSUoS charging for storage and Smaller (sub 100MW) Distributed Generation that are either being developed by industry or are currently planned for April 2021 implementation.<sup>10</sup>

### **The modification proposal**

British Gas (‘the Proposer’) raised CMP350 on 15 July 2020. The alleged defect identified by the proposer is that:

- The current BSUoS Covid Support Scheme (£15/MWh cap on BSUoS charges in each settlement period) is set at a level that does not provide sufficient protection to market participants against the exceptional BSUoS costs caused by COVID-19.
- The end date of the scheme does not take account of the potential for exceptional BSUoS costs to occur beyond 31st August 2020.
- There is no limit to the overall amount of BSUoS charges above the cap that can be deferred. Introducing a limit will provide more certainty to market participants and facilitate the continued financeability of NGENSO.

The Proposer requested that CMP350 be treated as an Urgent CUSC Modification Proposal. We granted the request for urgency on 20 July 2020.<sup>11</sup>

CMP350 (the Original Proposal) seeks to change the BSUoS Covid Support Scheme to address the higher frequency of high BSUoS charges by:

- Reducing the current £15/MWh cap to £5/MWh.
- Extending its application from 31 August 2020 to 30 September 2020.
- Introducing a limit of £100m for the cumulative amount of deferred BSUoS costs under the BSUoS Covid Support Scheme.

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<sup>7</sup> Using definition total cost = Total BSUoS + Internal BSUoS + Profit/loss + ALoMCP

<sup>8</sup>

[https://www.ofgem.gov.uk/system/files/docs/2019/11/open\\_letter\\_on\\_the\\_balancing\\_services\\_charges\\_taskforce.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/11/open_letter_on_the_balancing_services_charges_taskforce.pdf)

<sup>9</sup> <http://www.chargingfutures.com/media/1456/second-balancing-services-charges-task-force-interim-report-and-consultation.pdf>

<sup>10</sup> <https://www.nationalgrideso.com/industry-information/codes/connection-and-use-system-code-cusc/modifications>

<sup>11</sup> <https://www.nationalgrideso.com/document/173346/download>

The Proposer considers that the Original Proposal is positive in terms of Applicable CUSC Charging Objective (ACO) (a) as it will provide some further mitigation against the exceptional losses likely to be incurred by parties as a result of COVID-19. In the Proposer’s view deferring costs to a future period would allow parties to reflect these exceptional costs into future tariff offerings. The Proposer considers that such protection, for exceptional events, that are high impact and low probability, such as COVID-19, would reduce the level of risk that would need to be factored into future tariffs and facilitate effective competition in the generation and supply of electricity. The Proposer also believes this modification would have a positive impact on consumers as it enables the recovery of a greater portion of the exceptional costs associated with COVID-19, reducing the adverse impacts on competition of significant losses related to balancing costs that could not have reasonably been anticipated. The Proposer also considers that the Original Proposal is positive in terms of ACO (c) as the introduction of a limit to the overall amount of BSUoS charges above the cap that can be deferred would help to ensure the continued financeability of NGESO.

Seven alternative solutions were put forward and debated by the Workgroup. These were identical to the Original except for variations of the price cap and/or expiry date. All seven were taken forward and are set out in the table below:

Other Solutions	Limit to amount deferred under BSUoS Covid Support Scheme	BSUoS Price Cap	Expiry Date of BSUoS Covid Support Scheme
<b>CMP350 Original</b>	£100m	£5/MWh	30 September 2020
<b>WACM1</b>	£100m	£6.60/MWh	30 September 2020
<b>WACM2</b>	£100m	£10/MWh	30 September 2020
<b>WACM3</b>	£100m	£15/MWh	30 September 2020
<b>WACM4</b>	£100m	£5/MWh	25 October 2020
<b>WACM5</b>	£100m	£6.60/MWh	25 October 2020
<b>WACM6</b>	£100m	£10/MWh	25 October 2020
<b>WACM7</b>	£100m	£15/MWh	25 October 2020

The Workgroup’s detailed discussions are described in the Final Modification Report (FMR).<sup>12</sup>

### **CUSC Panel<sup>13</sup> recommendation**

The CUSC Panel considered CMP350 at a meeting on 6 August 2020. The Panel recommended by majority that WACM3 would better facilitate the ACOs as compared to the Baseline. There was also support (4 out of 9 votes) for the CMP350 Original solution and all other WACMs. The following table summarises the Panel votes:

Proposed solution	Of the 9 Panel Members, how many considered this option to be	Of the 9 Panel Members, how many considered this option to

<sup>12</sup> <https://www.nationalgrideso.com/document/174566/download>

<sup>13</sup> The CUSC Panel is established and constituted from time to time pursuant to and in accordance with the section 8 of the CUSC.

	better than the Baseline?	best meet the ACOs?
<b>Baseline</b>	N/A	4
<b>CMP350 Original</b>	4	0
<b>WACM1</b>	4	0
<b>WACM2</b>	4	1
<b>WACM3</b>	5	2
<b>WACM4</b>	4	2
<b>WACM5</b>	4	0
<b>WACM6</b>	4	0
<b>WACM7</b>	4	0

### The CUSC Panel's assessment

The table below summarises the Panel Members' assessment of the options against the ACOs. There was a range of views amongst Panel Members as to whether each of the options supported ACO (a), the impact on competition. Panel Members who positively assessed proposals agreed with the Proposer's comments that reducing the cap on BSUoS charges and extending its application would facilitate effective competition in the generation and supply of electricity. A full definition of each ACO is provided below under 'Our Assessment'.

Proposed Solution	Applicable Charging Objective									
	A		B		C		D		E	
	+ve	-ve	+ve	-ve	+ve	-ve	+ve	-ve	+ve	-ve
Original Proposal	4	5		3	5					3
WACM1	4	5		3	5					3
WACM2	4	4		3	5					3
WACM3	5	4		3	5					3
WACM4	4	5		3	5					4
WACM5	4	5		3	5					4
WACM6	4	4		3	5					4
WACM7	4	4		3	5					4

Summary of Panel Member votes. Neutral assessments not shown.

### Impact Assessment

In our letter regarding urgency on 21 July 2020, we decided that CMP350 should be treated as an Urgent CUSC Modification Proposal.<sup>14</sup> The timeline for decision proposed in the FMR does not allow for a full impact assessment in line with our guidance.<sup>15</sup> The urgency of the matter makes it both impracticable and inappropriate for the Authority to comply with the Section 5A duty for this decision.<sup>16</sup> Within the time available, however, we did consider (to the extent practicable) the potential impacts of the proposed options on consumers, suppliers, generators and NGENSO. Recognising the limitations of the

<sup>14</sup> <https://www.nationalgrideso.com/document/173346/download>

<sup>15</sup> <https://www.ofgem.gov.uk/publications-and-updates/impact-assessment-guidance>

<sup>16</sup> Section 5A of the Utilities Act 2000 imposes a duty on the Authority (its "Section 5A duty") to undertake an impact assessment in certain circumstances.

analysis undertaken, we have taken account of those potential impacts in this decision. This builds on the work done to assess CMP345 and our other ongoing monitoring work.

## **Our decision**

We have considered the issues raised by the Original Proposal, WACMs 1-7 and the Final Modification Report (FMR). We have considered and taken into account the responses to the Code Administrator Consultation on the modification proposal that are attached to the FMR.<sup>17</sup> We have concluded that:

- WACM6 would best facilitate the achievement of the ACOs;<sup>18</sup> and
- directing that WACM6 be made is consistent with our principal objective and statutory duties.<sup>19</sup>

## **Reasons for our decision**

The £15/MWh cap introduced under CMP345 has been beneficial because:

- To date, it has deferred over £8m in charges,<sup>20</sup> allowing suppliers and generators to pass through a limited amount of the exceptional Covid-related costs this summer.
- It has mitigated 'extreme' volatility, which can send unhelpful price signals at times of very low demand.

We expect that reducing the cap to a lower level (from £15/MWh to £10/MWh) and extending it until October 2020 will provide further benefits on both of these fronts. We believe that there will be benefits to competition from this option, because it would enable deferral of exceptional BSUoS charges which prudent market participants could not have foreseen, facilitating competition in the longer term.

We consider £10/MWh represents the right balance of risk between consumers and market participants, in particular suppliers, while avoiding the market distortions likely under a lower cap. We believe that there is a risk, albeit low, of higher BSUoS charges associated with demand reduction during the COVID-19 pandemic continuing until October 2020. As such, extending the scheme until this date offers some protection, and if demand recovers, this extension of the lower cap will have little effect.

## **Our assessment**

Our assessment against the CUSC Charging Objectives, is that the solutions proposed under CMP350 better facilitate ACOs (a) and (c) and have a neutral impact on the other applicable objectives. Of these solutions, we think WACM6 best facilitates ACO (a).

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<sup>17</sup> CUSC modification proposals, modification reports and representations can be viewed on NGET's website at <http://www.nationalgrid.com/uk/Electricity/Codes/systemcode/amendments/>

<sup>18</sup> As set out in Standard Condition C5(5) of the Electricity Transmission Licence, see: <https://epr.ofgem.gov.uk/Content/Documents/Electricity%20transmission%20full%20set%20of%20consolidated%20standard%20licence%20conditions%20-%20Current%20Version.pdf>

<sup>19</sup> The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Electricity Act 1989 as amended.

<sup>20</sup> Detailed breakdown available here: <https://www.nationalgrideso.com/industry-information/charging/balancing-services-use-system-bsuos-charges>

***(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;***

#### *Impacts on competition*

Considerations of the extent to which different solutions under this modification affect competition depend on the extent to which market participants can pass through changes in costs. Our decision letter on CMP345 assessed the impacts of charge deferral on competition and this analysis informed our decision-making detailed below.

Any extension of the scope of the cap (either in reducing the cap or extending the duration of the scheme) will allow some industry participants to pass through a greater share of the exceptional costs. Each of the solutions proposed will, to some extent, further mitigate any extreme volatility in the coming weeks or months. This will help avoid perverse price signals at times of very low demand. We consider that reducing extreme volatility and perverse price signals will benefit competition and has the potential to promote long-term market confidence. However, this must be balanced against the costs to consumers of further extending the cap, and other market distortions which could arise.

#### *The level of the cap*

The majority of solutions proposed under this modification will allow a greater share of BSUoS charges to be passed through to some consumers than might otherwise be the case, because they enable market participants to factor the higher BSUoS charges into future contracts. Such higher costs can be balanced against expected longer-term benefits for consumers of maintaining a more stable and competitive market. Avoiding perverse price signals at times of very low demand also provides some protection to energy intensive users, that operate at night, from potential windfall losses.<sup>21</sup>

We have also considered the model proposed by Centrica, and published with the FMR, articulating a conceptual basis for estimating exceptional Covid costs. It highlights that there has been a marked increase in the frequency of BSUoS costs that are above £2.50/MWh. However, in practice, the model is sensitive to the period over which trends are established and the period within 2020 used to assess the frequency of BSUoS exceeding a particular level. In addition to this, we have analysed basic levels of residual volatility (Standard Deviations) of different cap levels for all Half-Hourly data between 1 April 2020 and 22 July 2020. At a level of £10/MWh, the cap reduces expected BSUoS volatility back to levels closer to those seen in 2019.

The cap on BSUoS charges will limit the exposure of larger generators to spikes in BSUoS charges. It will also reduce the potential windfall gains to small distributed generation from these high BSUoS charges.<sup>22</sup> Having assessed the evidence in the FMR we agree there is likely to be additional benefits to lowering the cap closer to the level that prudent market participants could have reasonably have foreseen.

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<sup>21</sup> See the analysis prepared by sembcorp for the CMP350 working group illustrating the difference in BSUoS charges between day and night: <https://www.nationalgrideso.com/document/174561/download>

<sup>22</sup> Lowering the cap on BSUoS charges this summer will mean reductions in payments made by suppliers to Smaller Distributed Generators. These payments are known as 'Embedded Benefits'.

In the longer term, there are also likely to be benefits in the supply market from allowing some of these exceptional costs to be passed through to end consumers. While we consider that extending the BSUoS Covid support scheme would have a relatively small effect on financial stability in the supply market, it is not negligible. We continue to monitor financial stability in the sector. However, our current view is that, under the baseline CMP345 solution, there is a low likelihood that high BSUoS costs will on their own lead to the exit of companies whose business model is otherwise viable.

We agree with the Proposer that lowering the cap on exceptional BSUoS charges and extending the scheme may reduce the level of risk that is factored into future tariffs, providing potential benefits to consumers. We think the costs of this to consumers, as a result of increased pass through are limited, even at a £10/MWh cap. On balance, we consider that this lower cap will be positive for competition in the generation and supply of electricity.

If the cap is reduced to too low a level, the number of affected periods will be high and it may have a distortive impact on market(s).<sup>23</sup> There is also the potential under some scenarios, for the £100m limit to be reached at a £5 or £6.60 cap, which could add uncertainty by creating difficult to anticipate step-changes in BSUoS levels. We also note that risk flagged by some industry members that the lower price caps could have the effect of placing non-Covid related costs into the cap.

Overall, these negatives outweigh the potential benefits to competition of deferring a greater share of the unexpected costs under these solutions and so we assessed WACM2 and WACM6 as better compared to Original Proposal, WACM1, WACM3, WACM4, WACM5 and WACM7.

#### *The length of the period*

Due to an expected increase in demand at that time of the year, BSUoS charges may not exceed the £10/MWh cap in October. We do recognise, however, the continued uncertainty as to the impact of the COVID-19 pandemic on demand levels and note that having the cap in place during October might usefully offer some protection in the event that there are very high BSUoS charges in October (assuming that the £100 million limit has not been reached). Some stakeholders have a view that high BSUoS charges in October can no longer be considered “unforeseen” i.e. a prudent market participant would have prepared and adjusted. However, there is and has been uncertainty about the extent of any demand reduction as the COVID-19 pandemic unfolds. NGESO’s latest forecast projects an average charge of £3.98/MWh in October.

For the reasons set out above, we consider that those WACMs that extend to 25 October best facilitate ACO (a).

***(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);***

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<sup>23</sup> CMP350 workgroup analysis published as an annex to the FMR indicating price cap comparisons: <https://www.nationalgrideso.com/document/174561/download>

The proposed solutions would all reduce BSUoS charges in higher cost periods over the coming weeks, deferring them until charging year 2021-2022. Some Panel Members took the view that this is negative against ACO (b), as distributional effects of the cap will transfer costs from those using the system at times of high BSUoS in summer 2020 to those using the system throughout 2021. We have previously accepted the findings of the Balancing Services Charges Task Force that currently the costs included within BSUoS should all be treated on a cost-recovery basis. Overall, we believe these options would have a neutral impact on ACO (b).

***(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;***

The Proposer considers the CMP350 Original Proposal to be positive in terms of Objective (c) as the introduction of a limit to the amount of BSUoS costs that can be deferred will help to ensure the continued financeability of the NGESO.<sup>24</sup> Most of the Panel agreed (5/9). Although the CMP345 WACM2 modification was very unlikely to reach £100m, we consider that the introduction of a £100 million limit is an improvement, and so agree that CMP350 is positive against ACO (c).<sup>25</sup> All solutions proposed under this modification apply a £100m limit to the amount deferred under this BSUoS Covid support scheme and so the original proposal and all seven WACMs are positive compared to the baseline.

***(d) compliance with the Electricity Regulation and any relevant legally binding decisions of the European Commission and/or the Agency;***

We believe that ACO (d) is not relevant for the modification and our decision and the impact is therefore neutral, a view shared by all Panel Members.

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

Some Panel Members considered the modification to be negative against ACO (e), for a variety of reasons set out in the FMR. Given the temporary nature of each of the proposals in response to the COVID-19 pandemic, (and the minimal further process changes required following CMP345) we believe that extending these temporary arrangements is appropriate. Our view is that they would have a neutral impact on ACO (e).

### **Assessment against the Authority's principal objective and statutory duties**

In making a decision on this modification proposal, we have to act in accordance with our Principal Objective and Statutory Duties. In this regard, we consider that WACM6 takes the most proportionate approach to the recovery of exceptional BSUoS costs in a manner which is in the best interests of future and existing consumers. We have considered the expected impacts in the short, medium and long term in the context of the more efficient pass through of costs and the reduction of potential adverse impacts on competition of

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<sup>24</sup> As detailed in our CMP 345 decision letter, we have a duty to have regard to the need to ensure the financeability of the regulated companies.

<sup>25</sup> See the analysis provided by the workgroup in support of CMP350:  
<https://www.nationalgrideso.com/document/174561/download>



significant losses related to balancing costs that could not have reasonably anticipated. We consider that WACM 6 is consistent with our overall response to the COVID-19 pandemic.

### **Implementation**

The implementation date for CMP350 WACM6 is 14 August 2020 taking account of the importance and urgency of the modification for the reasons set out in this letter.

### **Other issues**

We note that some stakeholders expressed concern at having two successive modifications with a common scope, CMP345 and CMP350, within very short timescales and that this may undermine regulatory certainty and investor confidence. We agree it is important to provide as much regulatory predictability as possible but also note that these urgent modification proposals have been designed to tackle exceptional BSUoS charges in the context of COVID-19, as the landscape has developed. In this context, there has been a need to develop solutions quickly at a time of unprecedented uncertainty.

### **Decision notice**

In accordance with Standard Condition C10 of the Transmission Licence, the Authority, hereby directs that WACM6 of modification proposal CMP350: *Changes to BSUoS Covid Support Scheme* be made.

### **Andrew Self**

#### **Deputy Director, Energy Systems Management & Security**

Signed on behalf of the Authority and authorised for that purpose