

Connection and Use of System Code (CUSC)

Title of the CUSC Modification Proposal

Removal of SBR/DSBR costs from BSUoS into a "Demand Security Charge"

Submission Date

10th March 2016

Description of the Issue or Defect that the CUSC Modification Proposal seeks to address

Summary of Issue

Supplemental Balancing Reserve (SBR) utilisation costs are likely to become increasingly volatile and virtually impossible to forecast in Winter 16/17 as a result of lack of transparency as to how SBR plant will be despatched and their true utilisation costs. This lack of appropriate signal is likely to result in a distortion in competition between generators resulting in inefficient despatch as a result of erroneous forecasts.

Furthermore, the result of this potential volatility across different settlement periods is:

- i) Increased costs to consumers as a result of the addition of a risk premium
- ii) Perverse incentives for generators in terms of a signal to generate
- iii) Inaccuracy of cost forecasts leads to significant suboptimal despatch of generation leading to market inefficiency
- iv) Outturn costs in excess of the forecast are irrecoverable by generators as they are recovered ex-post

Further context

Balancing Service Use of System (BSUoS) charges are the means by which the System Operator (SO) recovers the costs associated with balancing the transmission system. BSUoS charges are levied on both generation and demand on a 50:50 split basis. The value of BSUoS varies in each half hour settlement period reflecting the different costs incurred by the SO in each period.

Currently, all SBR procurement and utilisation costs are recovered via BSUoS from both Suppliers and Generators. SBR and Demand Side Balancing Reserve (DSBR) procurement costs are known ahead of time (and have almost quadrupled from 15/16 to 16/17) and are distributed across all settlement periods in the SBR/DSBR window, reducing volatility. However, utilisation costs are opaque, impossible to forecast, are not known until 16 working days after the event and are applied within the settlement period that they are incurred, driving highly volatile BSUoS prices.

Given the concerns regarding security of supply in Winter 16/17 and the likelihood that SBR will be despatched, it is likely that BSUoS will become highly volatile and increasingly difficult to predict.

The range of utilisation costs associated with SBR and DSBR, coupled with the lack of ability to predict which plant will despatched when, make it increasingly difficult to forecast what the outturn BSUoS costs will actually be. This is further exacerbated by the lack of transparency around some of the utilisation costs where there is a £ charge plus fuel and carbon costs, the latter two only known by the SBR generator itself with industry only able to make broad assumptions.

Generators are expected to recover BSUoS from the wholesale price. However, the actual cost of BSUoS will only be known ex-post, so despatch decisions can only be made on a forecast, and a very nebulous forecast at that due to the lack of transparency. National Grid only forecast an average BSUoS and we believe that this will be increasingly inaccurate going forward due to the changing nature of the market and balancing services procured.

In such circumstances, generators must add an increasing risk premium into their BSUoS forecasts resulting in far higher costs for consumers plus risk uneconomical despatch. With the information required to accurately forecast SBR requirements not available to the market in the required timescales, or at all, there is no way that parties can accurately quantify the level of SBR costs incurred. For example, the de-rated margin published as part of the cash out changes is published at 12 o'clock day ahead, yet some plant has 48 hour warming timescales. Furthermore, DSBR can be despatched on short notice with very little notice given to the market.

The costs associated with warming, starting and running SBR occur in periods of the day which are unlikely to be tight and hence SBR is not required. For example, it is likely that SBR only be required for Block 5b, yet its costs are imposed through blocks 3, 4 and 5a, up to 48 hours ahead. As a result, BSUoS may be both high and volatile for these periods. This could result in generators delaying their start until as close as possible to the periods where they know the market price is guaranteed to cover the risk of high BSUoS. Having more generation starting up just before block 5b is likely to drive even higher risk premium and hence will end up costing consumers more, notwithstanding that it comes about through a market distortion in the first place.

For non vertically integrated players who are not able to offset any higher than expected BSUoS charges against their customer base, this results in a market distortion and could become a barrier to entry for independent generators.

We propose moving all of the SBR and DSBR costs, in place to ensure security of supply rather than to balance the system, into a "Demand Security Charge", fully recovered over gross demand in the SBR/DSBR window, in line with the capacity mechanism cost recovery.

Placing SBR/DSBR costs onto customers via a "Demand Security Charge" would more economically charge the parties who are benefiting from the product at the same time as aligning and being consistent with capacity mechanism cost recovery, i.e. recovery from suppliers. It would further protect generators from yet more unforeseen and unforecastable costs without increasing the overall cost burden on consumers. In fact, it should reduce overall costs to consumers.

It should also protect customers from paying for a lack of efficiency as a result of the uncertainty. The likely addition of extensive risk premia to mitigate for the uncertainty, as a result of generators will seek to manage the costs of the BSUoS charges they cannot see nor forecast, can only drive higher costs for consumers

Description of the CUSC Modification Proposal

This modification proposes to create a new cost recovery mechanism, a “Demand Security Charge” specifically for recovery of all SBR/DSBR costs, which is only levied on demand side Balancing Mechanism Units (BMUs). This is because it is the best way to reduce the risk premia applied by Generators, hence minimising costs to the consumer, and to ensure efficient despatch of plant.

Whilst we would expect the working group to develop the solution in detail, we would expect the total costs to be collected from gross demand over the SBR/DSBR window, i.e. November to February. This would ensure that the costs would not be volatile across different settlement periods.

SBR is in place to maintain longer term security of supply, similar to the capacity mechanism, and it is therefore more appropriate that all costs fall on suppliers who are better able to recover the actual costs from customers.

Given some of the costs are known ahead of Winter, National Grid could continue to forecast the SBR costs (procurement costs will be known) so that suppliers can estimate costs over the Winter period and then a Winter only charge, mirroring the SBR window, could be applied. It should reduce the cost to consumers as significant risk premia will no longer be added by generators.

Impact on the CUSC

Section 14, Charging Methodologies, of the CUSC would be impacted.

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

No, there would be no material impact on greenhouse gas emissions

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

BSC

Grid Code

STC

Other
(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

Yes, we believe that this modification should be treated as urgent

Justification for Urgency Recommendation

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

We have serious concerns that without an immediate resolution of this issue, generators will have to consider either charging very high prices on the basis of no robust information, or may go bankrupt over the coming winter turning a tight system into one with negative plant margins.

With these costs incurred from November 2016, we believe that it is essential that any change be implemented ahead of this date.

We believe that SBR utilisation costs in Winter 16/17 have the potential to have a significant commercial impact on generators who are unable to forecast SBR and DSBR utilisation costs. For generators who have already hedged their position for Winter 2016/17, this impact could be catastrophic.

This could result in plant frequently despatching at a loss due to higher than expected outturn BSUoS costs. We do not believe that accurate BSUoS costs are currently reflected in wholesale prices, as demonstrated by the lack of change in price on the back of the tender results for the Winter 16/17 SBR procurement round (£122million over 14/15 winter demand figures equates to approximately £0.5/MWh, yet there was no movement in the market).

Whilst CMP250 does address the issue of BSUoS volatility, it is not due to be implemented by November 2016 and therefore this modification is urgent.

Self-Governance Recommended: No

No, this is not a self-governance modification

Justification for Self-Governance Recommendation

- N/A

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

No

Impact on Computer Systems and Processes used by CUSC Parties:

Details of any Related Modification to Other Industry Codes

CMP250 'Stabilising BSUoS with at least a twelve month notice period'

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

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.

This proposal improves delivery against Use of Charging Methodology objectives a and c. The lack of any market signal and ability to accurately forecast the SBR/DSBR costs, coupled with potential volatility negatively impacts competition in the wholesale electricity market, distorting competition. Furthermore, the introduction of SBR and application of the costs to the generators, further putting them at risk of closure, does not properly take account of developments in the transmission business, specifically the impact of an increasing number of plant closures.

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Additional details

Details of Proposer: (Organisation Name)	VPI Immingham
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:	Mary Teuton VPI Immingham 0207 312 4469 mteuton@vpi-i.com
Details of Representative’s Alternate: Name: Organisation: Telephone Number: Email Address:	Lisa Mackay Intergen 0131 624 6769 lmackay@intergen.com
Attachments (Yes/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 and copied to cusc.team@nationalgrid.com, or by post to:

Jade Clarke
CUSC Modifications Panel Secretary, TNS
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National Grid House
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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.