

1 Workgroup Consultation Response Proforma**CMP395: Cap
BSUoS costs and
Defer payment to****2023/24 to protect GB customers**

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 01 September 2022**. Please note that any responses received after the deadline or sent to a different email address may not receive due consideration.

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

Respondent details	Please enter your details
Respondent name:	Scott Keen
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I wish my response to be:

(Please mark the relevant box)

☒ Non-Confidential☐ Confidential

Note: A confidential response will be disclosed to the Authority in full but, unless agreed otherwise, will not be shared with the Panel or the industry and may therefore not influence the debate to the same extent as a non-confidential response.

For reference the Applicable CUSC (charging) 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 *; and*

- e. Promoting efficiency in the implementation and administration of the system charging methodology.

*The Electricity Regulation referred to in objective (d) is Regulation (EU) 2019/943 of the European Parliament and of the Council of 5 June 2019 on the internal market for electricity (recast) as it has effect immediately before IP completion day as read with the modifications set out in the SI 2020/1006.

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

Standard Workgroup Consultation questions		
1	Do you believe that the Original Proposal or any of the potential alternative solutions better facilitates the Applicable Objectives?	<p>Mark the Objectives which you believe each solution better facilitates:</p> <p>Original <input checked="" type="checkbox"/> A <input type="checkbox"/> B <input checked="" type="checkbox"/> C <input type="checkbox"/> D <input type="checkbox"/> E</p> <p>BSUoS has been increasing in volatility in the past year. The result is that an ever-increasing risk premia is having to factored into wholesale market and BM offer prices by generators. For generators who get this wrong, on a settlement period basis, or on an average seasonal basis, the loss could be catastrophic. They have no choice but to add the risk premia to their prices. This ends up being charged to suppliers, and eventually consumers. Industrial consumers see the impact of this immediately.</p> <p>The following chart shows the standard deviation for monthly BSUoS. The high level in July reflects the two settlement periods in which BSUoS was at or near £170/MWh.</p> <p>Monthly BSUoS Standard Deviation (sd)</p> <p>This risk premium is unnecessary as it could be corrected for with this mod. The risk premium provides significant disbenefit to the market in terms of competition or efficiency. Parties spend less time competing on the</p>

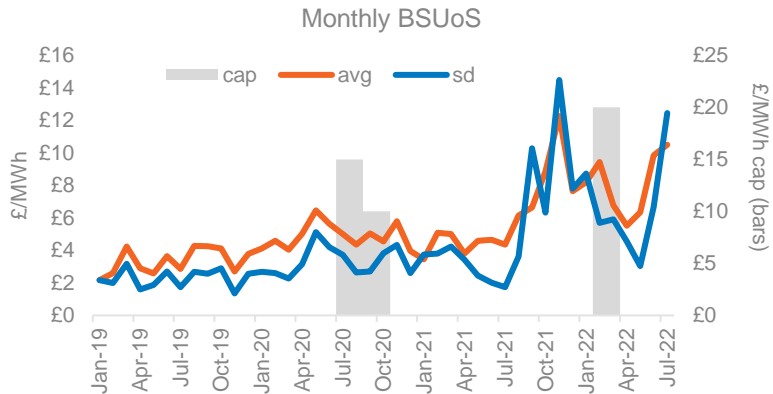
		<p>basis of lowering generation costs and more time worrying about how much unknown BSUoS cost to factor into their short run marginal costs.</p> <p>The BSUoS taskforces concluded that BSUoS is not cost reflective. Any market design that has generators factoring in a non-cost-reflective cost into SRMC is by definition inefficient. According to economic textbooks, this directly leads to less-than-optimal levels of competition, and worse outcomes for consumers.</p> <p>While one could argue that the increased volatility, as demonstrated in the chart above, could have been foreseen, given winter 2021/22, we would argue that one does not want an efficient market to be factoring in historically high volatility into a non-cost reflective charge. It only results in ever increasing BSUoS costs, which forces generators to increase their offer prices by further. No one wins from this, except perhaps the generator that factors in a higher BSUoS cost than they end up being charged. This is not a market feature that should be allowed to continue, as it directly leads to exacerbations of the cost-of-living crisis. This is a free* way to lower BSUoS costs.</p> <p>*Notwithstanding that NGESO is being asked to carry the cost of the deferral and will be compensated for their costs of doing so.</p>
2	Do you support the proposed implementation approach?	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No <p>Yes, we are supportive of implementing this mod as soon as possible and of charging Generators half of the deferred pot through the first nine months of the 2023/24 charging year.</p>
3	Do you have any other comments?	Click or tap here to enter text.
4	Do you wish to raise a Workgroup Consultation Alternative Request for the Workgroup to consider?	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No <p>Click or tap here to enter text.</p>

Specific Workgroup Consultation questions

1	The CMP395 Original proposes to set a £15/MWh cap on	Yes, the £15 is appropriate as it is in line with NGESO's latest forecast for average BSUoS charge over this winter.
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	<p>BSUoS. Do you think it is appropriate to set a BSUoS cap and if so to what value? Please provide the rationale for your response including any supporting analysis.</p>	<p>A lower cap would be more effective at lowering the risk premium and lowering the overall BSUoS cost but we recognise the limitations of NGESO's ability to finance the deferral.</p> <p>We note that the cap may seem low on first perusal compared to the cap. However, we note that in the previous BSUoS cap mods, CMP345, CMP350 and CMP381, that c.£65 million of the £400 million limit was used, suggesting (with the benefit of hindsight of course) that the caps in those mods were too conservative.</p> <p>Of course, the situation which has led to this mod versus the situations of the previous BSUoS cap mods are different. Nonetheless, for CMP381, we note that with a £20/MWh cap, c.£43 million of the £200 million limit was used over three months. All else held equal, over six months that would have meant c. £85 million use of the limit. This underutilisation of the available pot is arguably because the ESO analysis which forecasts the impact of the price cap ie the size of the pot required at a given cap level, did not take into account the effect of capping the risk premia added by generators and therefore the cap was not hit as frequently as expected and arguably the overall BSUoS cost fell.</p> <p>Factoring in higher gas prices now and more settlement periods where the cap would be binding with a lower cap, one can envisage that the £15/MWh cap could result in higher usage of the cap than in previous BSUoS cap mods, but still under the £250 million limit.</p> <p>We agree with general workgroup sentiment that it is important for the market that the limit lasts to 31 March 2022, thereby avoiding allowing BSUoS volatility to continue unchecked.</p> <p>We note that this issue will disappear naturally in April 2023, when generators no longer have to factor in an unknown BSUoS cost into their SMRC and offers to sell electricity. Therefore, this is not a case of kicking the ball into the long grass, but rather addressing an clear and present issue when it's affects are felt most, during the current crisis on cost of living.</p>
2	<p>Do you think it is appropriate to introduce a rules based re-assessment of the BSUoS cap on utilisation against the</p>	<p>No, we do not agree with this. We are concerned that it would undo the point of the mod, which is to remove the risk premia and lower the overall cost to consumers. If generators need to worry about the BSUoS cap rising, they will price that risk into their winter hedging products.</p>

	limit of the additional BSUoS costs that would be deferred. If so, on what basis? Please provide the rationale for your response.	
3	The CMP395 Original seeks to defer the additional BSUoS costs above the cap to the 2023/2024 charging year. Recovery of the deferred costs is proposed to commence from 1 April 2023. Do you agree with this approach? Please provide rationale for your response.	As noted above, yes, we agree that the BSUoS costs above the cap should be recouped during the 2023/24 charging year.
4	CMP308 comes into effect on 1 April 2023 and removes the payment of BSUoS from Generators. Against this backdrop, the Workgroup have considered options to recover deferred costs from Generators from 1 April 2023. Do you support any of the options proposed?. Please provide justification for your response.	Yes, we support the proposed approach to collect costs on a fixed rate volumetric basis across all settlement periods of generation over April to December 2023
5	Do you think it is appropriate to introduce a Supplier BSUoS cap only or a BSUoS cap for Suppliers and Generators?. Please provide the rationale for your response.	<p>Introducing a supplier only cap completely undermines the intent of the mod which is to reduce the price that generators offer into the market.</p> <p>Introducing the cap onto supplier BSUoS only would simply defer a greater amount of BSUoS costs to next year, which we presume would be picked up by consumers alone next year, if generators pay full BSUoS next year.</p>

		<p>Suppliers may benefit by being able to collect a higher amount of BSUoS next year compared to potentially being unable to collect some of it this year, but the main impact would be higher overall costs.</p>  <p>The chart, titled 'Monthly BSUoS', displays three data series over time from January 2019 to July 2022. The left y-axis represents cost in £/MWh, ranging from £0 to £16. The right y-axis represents cost in £/MWh cap (bars), ranging from £0 to £25. The 'cap' series is shown as grey bars, with notable peaks in mid-2020 and early 2022. The 'avg' series is an orange line, and the 'sd' series is a blue line. Both lines show significant volatility, with a major peak in early 2022 reaching over £14/MWh. The 'sd' line shows a sharp increase in late 2021 and early 2022, while the 'avg' line follows a similar but less extreme path.</p> <p>Generators would remain exposed to potentially getting BSUoS very very wrong, which, if BSUoS costs and volatility continue to rise (see above chart) could be catastrophic for solvency and security of supply – especially if it becomes cheaper not to run and face imbalance costs rather than incur BSUoS costs. Knowing this, generators are likely to protect themselves by taking a risk averse approach to pricing their offers to sell power – as noted above this will unambiguously increase cost to the consumer.</p>
6	<p>The CMP395 Original seeks to limit the additional BSUoS costs that would be deferred to £250m. Do you think it is appropriate to introduce a limit and if so to what value? Please provide the rationale for your response.</p>	<p>We think the limit should be higher. It would be great if the Government could step in to back a higher level of deferral (Ideally the limit should be £500 million), thereby saving the consumer the most amount.</p>
7	<p>Do you agree that reporting of the percentage utilisation of the deferred amount should be in line with that introduced for CMP381. Please provide justification for your response.</p>	<p>Yes, the approach used for CMP381 is established and easy to understand.</p>

8	<p>Does the CMP395 Original proposal or any of the potential alternative solutions impact your business and/or end consumers. If so, how?</p> <p>Confidential Information can be shared with Ofgem directly particularly where it relates to Ofgem's Urgency Criteria.</p>	<p>Click or tap here to enter text.</p>
9	<p>Do you support the view that CMP395 would mean reduced overall BSUoS costs (as a result of reduced risk premia) and therefore benefit consumers. Please provide the rationale for your response.</p> <p>Confidential Information can be shared with Ofgem directly particularly where it relates to Ofgem's Urgency Criteria.</p>	<p>Yes. Based on elementary economics, introducing more risk to generators increases cost and therefore price. The risk feeds directly into short run marginal cost, and so directly into wholesale market and BM prices. These higher prices directly increase BSUoS costs, which exacerbates the problem.</p> <p>In this situation, it is simple to introduce this measure that unambiguously reduces this risk, and thereby reduce operating costs – and it is only at the cost of NGESOs carrying the financing to next year.</p>