Making a positive difference for energy consumers

Modification proposal:	**Connection and Use of System Code (CUSC) CMP299: Consequential changes to the CUSC to facilitate the 2018-2021 ESO Incentive Scheme (CMP299)**		
Decision:	The Authority[1] directs that this modification be made[2]		
Target audience:	National Grid Electricity Transmission PLC (NGET), Parties to the CUSC, the CUSC Panel and other interested parties		
Date of publication:	16 August 2018	Implementation date:	Up to five working days after date of publication

Background

The Electricity System Operator (ESO) has a key role in our electricity system. It has a number of different roles, from the day-to-day operation of the system, through to managing new network connections and longer-term network planning. The ESO role is currently carried out by National Grid Electricity Transmission plc (NGET).

We set financial incentives on the ESO to encourage it to innovate and drive additional value for consumers over and above our baseline expectations. These financial incentives are recovered from market participants by the ESO throughout the year through Balancing Services Use of System (BSUoS) charges, as set out in Section 14 of the CUSC.

On 1 April 2018, we introduced a new incentives framework for the ESO. The new framework involves a move away from discrete 'mechanistic' incentives, towards a broader 'evaluative' incentive approach. Under this new approach, rather than incentives being derived from formulas and model-derived targets, an incentive value is determined by the Authority following an end of year assessment of the ESO's performance. This means that the ESO will be unable to use outturn data to precisely to forecast how much incentive payment/penalty it needs to recover from (or refund to) market participants as the year progresses. As a result, the process set out in the CUSC to recover financial incentives is now inconsistent with the incentives approach detailed in NGET's licence.

The modification proposal

CMP299 was raised by NGET (the Proposer) on 23 April 2018. It proposes consequential changes to Section 14 of the CUSC to help ensure the approach to recovering incentive payments/penalties is consistent with the new ESO incentives approach. This includes:

- Updating the approach to calculating a daily incentive recovery amount to reflect the move to an evaluative incentive as opposed to one based on formulas;
- Removing out of date references, including old references to an incentive cap/floor of ±£10m;
- Removing a worked example of how BSUoS charges are calculated which is no longer relevant.

The Proposer believes CMP299 will better facilitate the CUSC charging objectives (b), (c) and (e).

The Proposer notes that the approach used to reconcile differences between forecast and actual incentive payments/penalties at the end of the year will remain the same as previously. However, it considers that changes in this area in response to the new

[1] 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. This decision is made by or on behalf of GEMA.
[2] This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

The Office of Gas and Electricity Markets
10 South Colonnade, Canary Wharf, London, E14 4PU **Tel** 020 7901 7000 **Fax** 020 7901 7066
www.ofgem.gov.uk

incentive approach could be beneficial, and it intends to develop proposals for this further with industry.

CUSC Panel[3] recommendation

At the CUSC Panel meeting on 29 June 2018, the CUSC Panel unanimously considered that CMP299 would better facilitate the CUSC charging objectives and therefore recommended its approval. All CUSC Panel members agreed that the modification better facilitated CUSC objectives (b) and (c), with a majority considering it also better facilitated CUSC objective (e).

Our decision

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 12 July 2018. We have considered and taken into account the responses to the industry consultation on the modification proposal which are attached to the FMR[4]. We have concluded that:

- implementation of the modification proposal will better facilitate the achievement of the relevant charging objectives of the CUSC;[5] and
- directing that the modification be made is consistent with our principal objective and statutory duties.[6]

Reasons for our decision

We consider this modification proposal will better facilitate CUSC charging objectives (b), (c) and (e) and has a neutral impact on the other applicable objectives. Our reasons are summarised below.

(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);

The Proposer considers that CMP299 will better facilitate relevant charging objective (b) by accounting for the changes in the costs of the transmission licensee's business as a result of the new ESO incentive framework. The Panel and consultation respondents agreed with this view.

We agree that CMP299 better facilitates this objective. It updates and removes aspects of the charging methodology which are incompatible with the new ESO incentives approach. This change means BSUoS charges can continue to reflect costs incurred by the transmission licensee as a result of incentive payments/penalties determined by the Authority. CMP299 therefore results in charges that more accurately reflect transmission licensee costs than the baseline methodology.

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[3] The CUSC Panel is established and constituted from time to time pursuant to and in accordance with section 8 of the CUSC.
[4] CUSC modification proposals, modification reports and representations can be viewed on NGET's website at: http://www2.nationalgrid.com/UK/Industry-information/Electricity-codes/CUSC/Modifications/
[5] As set out in Standard Condition C5(5) of NGET's Transmission Licence, see: https://epr.ofgem.gov.uk//Content/Documents/Electricity%20transmission%20full%20set%20of%20consolidated%20standard%20licence%20conditions%20-%20Current%20Version.pdf
[6] 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.

(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 that the modification better facilitates this objective as it reflects changes to how the ESO business will operate following the introduction of the new ESO incentive scheme. The Panel and consultation respondents agreed with this view, with some noting that the proposals help ensure consistency with changes already implemented in NGET's licence. We agree that this modification better facilitates charging objective (c) for the reasons put forward.

(e) Promoting efficiency in the implementation and administration of the CUSC arrangements.

The Proposer considers that the modification better facilitates this objective because it removes complexity from section 14 of the CUSC which is no longer required under the new incentive arrangements. The majority of the Panel and a consultation respondent shared this view. We agree that CMP299 better facilitates this objective as it removes examples and text that are no longer relevant, helping to avoid confusion in parties' understanding of the CUSC.

Clarifications on the new incentives approach and incentive recovery

We would also like to take this opportunity to make some clarifications about the new incentives approach to help avoid potential confusion from stakeholders. These clarifications are in response to a number of passages contained in the FMR, including the National Grid BSUoS Charging Circular (attached as Annex 1 to the FMR), as well as the follow-up BSUoS Charging Circular on 25th May.[7]

Under the new ESO incentives framework, the level of incentive payment/penalty will be determined after an end of year evaluation of the ESO's performance, based on five different criteria. The scope of this assessment is not solely the contents of the ESO's Forward Plan but any evidence on the ESO's performance that is relevant to its seven ESO Principles.[8] Ultimately, incentive payments will only be made to the ESO if there is clear evidence that it has delivered consumer benefits that go above and beyond our baseline expectations.

Our Formal Opinion[9] on the ESO's Forward Plan is intended to provide an upfront steer on the level of ambition in the ESO's proposed deliverables and performance metrics. This includes our view on the extent to which the Forward Plan provides evidence of additional consumer benefits. The Formal Opinion did not specify an expected upfront financial value for delivering the Forward Plan. We therefore welcome the ESO's recent clarification[10] that the incentive forecast it published on 25th May was based on a subjective assessment by the ESO and that this value was not discussed or agreed with Ofgem or stakeholders. More generally, we encourage the ESO to ensure it is familiar with the messages contained in the Formal Opinion and the comments ourselves and stakeholders made as the plan was developed.

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[7] https://www.nationalgrid.com/sites/default/files/documents/BSUoS%20Charging%20Circular%20-%202018-19%20ESO%20Incentive%20Recovery.pdf
[8] For more information on the new incentive framework please see: https://www.ofgem.gov.uk/publications-and-updates/policy-decision-electricity-system-operator-regulatory-and-incentives-framework-april-2018
[9] For more information please see: https://www.ofgem.gov.uk/publications-and-updates/ofgem-s-formal-opinion-electricity-system-operator-s-forward-plan-2018-19
[10] https://www.ofgem.gov.uk/publications-and-updates/eso-incentives-notice-proposed-modifications-special-conditions-electricity-transmission-licence-held-nget

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We note that a more evaluative incentive framework means there may be increased scope for differences between the ESO's incentive forecasts and the actual incentive value determined for the relevant year. We welcomed the ESO's updated thinking in response to our statutory licence changes consultation on 23 February that it could be beneficial to introduce further licence changes to reduce BSUoS volatility.[11] We did not progress a licence change at the time as this would not have been appropriate during that late stage of the licence change process. Instead, we encouraged the ESO to work with its customers and stakeholders to further review options for incentive cost recovery under the new arrangements. To clarify, we do not consider that this precludes changes to the incentive payment/penalty reconciliation process for year 2018/19. We look forward to seeing the ESO and stakeholders' latest thinking in this area.

Decision notice

In accordance with Standard Condition C10 of NGET's Transmission Licence, the Authority hereby directs that modification proposal CMP299: Consequential changes to the CUSC to facilitate the 2018-2021 ESO Incentive Scheme be made.

Grendon Thompson

Head of SO Regulation, Systems & Networks
Signed on behalf of the Authority and authorised for that purpose

[11] Please see: https://www.ofgem.gov.uk/publications-and-updates/eso-incentives-notice-proposed-modifications-special-conditions-electricity-transmission-licence-held-nget