Modification proposal:	**Connection and Use of System Code (CUSC) CMP250: Stabilising BSUoS with at least a twelve month notification period**		
Decision:	The Authority[1] has decided to reject[2] this modification		
Target audience:	National Grid Electricity Transmission PLC (NGET), Parties to the CUSC, the CUSC Panel and other interested parties		
Date of publication:	25 October 2018	Implementation Date:	N/A

Background

Balancing Service Use of System ('BSUoS') charges are the means by which National Grid Electricity Transmission ('NGET') as the System Operator ('SO') recovers the costs associated with balancing the electricity transmission system. BSUoS charges are recovered from demand customers and larger generators based on the amount of energy imported or exported onto the network (£/MWh) within a given half-hourly period. The current approach to calculating BSUoS (hereafter referred to as the 'Baseline') is that the value varies in each half hourly settlement period reflecting the different costs incurred by the SO in each period. The charge is currently levied on an ex post basis (after the event).

CMP250, and the Workgroup Alternative CUSC Modifications ('WACMs'), seek to fix the value of BSUoS for a period of time, with a notice period in advance of this. Any under or over recovery of BSUoS costs would be reconciled in a future charging period.

The modification proposal

Drax Power Limited ('the proposer') raised CMP250 and submitted it to the CUSC Modification Panel (the 'Panel') for its consideration on 28 August 2015.

The alleged defect identified by the proposer is that BSUoS is becoming significantly more volatile and unpredictable because of the dramatically changing generation mix. The proposer believes that there is an increasing risk for market participants in forecasting the cost of BSUoS incorrectly and this could result in loss making and/or uncompetitive market activity. Furthermore, the proposer believes unpredictability and volatility of BSUoS results in the application of risk premia in the market which will tend to inflate the costs borne by the end consumer. The proposer argues CMP250 will reduce the BSUoS risk premium (applied by generators and suppliers) and deliver better value for money compared to the current charging arrangements.

The original proposal seeks to fix the BSUoS price for 12 months with a 12-month notice period (the 'Original'). The Workgroup agreed to support four alternative modification proposals (WACMs) which all proposed a fixed BSUoS price but with varying fixed and notice periods. These are:

[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.
[2] This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

- WACM 1 – 12 months' notice, 6 month fixed period
- WACM 2 – 15 months' notice, 6 month fixed period
- WACM 3 – 15 months' notice, 12 month fixed period
- WACM 4 – 9 months' notice, 12 month fixed period

The proposer considers the Original and all WACMs will allow parties to know what their BSUoS charge will be ahead of time, and to reallocate this risk from those parties that are poorly placed to manage the risk, in particular smaller market participants, to a party that is more financially capable of dealing with it. Consequently, the proposer believes this will increase competition and better facilitate Applicable CUSC Charging Objective (a).

The Workgroup assessed the Original, four WACMs and existing arrangements (the 'Baseline'), against the Applicable CUSC Charging Objectives.

- Three Workgroup members concluded that the Original Proposal is the best option.
- Two Workgroup members believed that WACM 3 is best.
- WACM 1 and the Baseline received one vote each.

The workgroup's detailed discussions are described in the Final Modification Report (FMR).[3]

CUSC Panel[4] recommendation

At the Panel meeting on 26 January 2018, a majority of the Panel considered that CMP250 and all four WACMs would better facilitate the Applicable CUSC Charging Objectives and could be implemented.

WACM 3 received the most support as being the best option, with four votes (although this received the joint least support for achieving the Applicable CUSC Charging Objectives compared to the Baseline). Two Panel Members did not support any of the proposals and considered the Baseline the best option.

Our decision

We have considered the issues raised by the modification proposal and the FMR dated 2 February 2018. We have considered and taken into account the responses to the Code Administrator consultation on the modification proposal which are attached to the FMR.[5] We have concluded that implementation of the modification proposal will not facilitate better the achievement of the applicable charging objectives of the CUSC.[6]

[3] CUSC modification proposals, modification reports and representations can be viewed on the NGET website at: http://www2.nationalgrid.com/UK/Industry-information/Electricity-codes/CUSC/Modifications/Current/
[4] The CUSC Panel is established and constituted from time to time pursuant to and in accordance with section 8 of the CUSC.
[5] CUSC modification proposals, modification reports and representations can be viewed on NGET's website at http://www.nationalgrid.com/uk/Electricity/Codes/systemcode/amendments/
[6] 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

Reasons for our decision

Many market participants will be aware that there are questions about the role of BSUoS, and the way in which it is calculated. These discussions are ongoing. In this context, we consider that the Original and four WACMs do not facilitate Applicable CUSC Charging Objectives (c) and (e) better than the Baseline. We do not consider that the evidence provided in the FMR is sufficient to allow us to determine whether the Original or four WACMs have a positive or negative impact on Applicable CUSC Charging Objectives (a) and (b).

We consider the proposals are neutral/have no impact in respect of Applicable CUSC Charging Objective (d).

(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

Five Panel members considered that the Original and all four WACMs better facilitated Applicable CUSC Charging Objective (a). Two Panel members supported at least one of the proposals when assessed against Applicable CUSC Charging Objective (a). Two Panel members considered that all proposals were negative against Applicable CUSC Charging Objective (a).

Those Panel members in favour of proposals agreed with the proposer's comments that BSUoS is becoming increasingly volatile and implementation of one of the proposals would reduce risk premia, ultimately leading to lower costs to consumers. Where Panel members supported at least one of the proposals, but not others, this was due to the trade-off between certainty and the risk associated with longer notice periods.

One Panel member who did not support any of the proposals considered that the proposals might increase prices because the cost to the SO of managing the risk would be passed through. A further concern was that future customers might be charged for actions in previous years. Finally, another Panel member voted against all of the proposals believing fixing BSUoS did not recognise the transition to a more dynamic system and the price signal that BSUoS will provide for smarter, more flexible markets. They considered it would be more suitable to develop a BSUoS product ahead of the next SO price control which fixes those elements of BSUoS that form a residual cost and leaves variable those elements that provide a market signal.

Our position

A key argument in favour of CMP250 put forward by the proposer and Panel members is that the proposal will reduce the risk premia currently applied by market participants. This cost is ultimately borne by the consumer so it is argued that implementation will deliver better value than the status quo.

The FMR recognises that one of the key pieces of evidence for the success of the modification proposal is establishing whether the costs associated with the existing regime are higher or lower than the proposed arrangement, and whether GB consumers would benefit overall. We agree with the views in the FMR that there is unlikely to be a homogenous approach to managing the risk amongst generators and suppliers and exposure to any risk premia currently reflected in the BSUoS price within a given

settlement period. However, we are not satisfied that a case has been made that the proposed changes facilitate more effective competition leading to lower costs to consumers.

The workgroup attempted to carry out high-level analysis using publicly available data. This is unfortunately limited, partially due to the fact that parties' approach to BSUoS risk is commercially sensitive. The workgroup suggested overcoming this with the possibility of a separate Ofgem consultation to gather such data. We considered the pros and cons of doing this but do not believe it is appropriate to pursue at this stage.

Firstly, we consider this would have been of limited value given different appetites to risk and difficulty in obtaining comparable data. Secondly, we encouraged industry participants within the Code Administrator Consultation to respond directly if they had information on how they forecast and apply risk premia within their business to help better inform our decision. Thirteen respondents replied to the Code Administrator Consultation but we received a significantly lower response to our request. We therefore have no evidence to suggest that a further data gathering exercise would provide us with any better information than had already been discussed within the workgroup.

On balance, we do not consider that the FMR sufficiently demonstrates that implementation of CMP250 would better facilitate Applicable CUSC Charging Objective (a). We believe further work is required, potentially breaking BSUoS into its components, and evaluating the impact each has on the risk premia and ultimate cost to consumers.

(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[7]) incurred by transmission licensees in their transmission businesses and which are compatible with standard condition C26 (Requirements of a connect and manage connection);

Six Panel members considered that CMP250 was neutral in terms of applicable CUSC Charging Objective (b). Three Panel members considered the proposal was negative when assessed against applicable CUSC Charging Objective (b).

One Panel member who considered it neutral against applicable Charging Objective (b) commented that BSUoS was a residual charge and therefore a cost recovery mechanism and did not reflect the incremental costs that market participants have on the system. Consequently, fixing this cost ahead of time would not reduce the cost reflectivity of the charge and is neutral against this objective.

Another Panel member considered that cost reflectivity would be reduced by definition, but also felt cost reflectivity had little value in this context as they believed it cannot provide an effective market signal. A further Panel member said that cost reflectivity would be reduced as the costs incurred by the SO in particular settlement periods would not be passed through to those causing them.

Our position

The FMR argues that BSUoS is a volatile charge which cannot be predicted with any degree of accuracy. We consider that this is an overly simplistic view of BSUoS and does

[7] System Operator Transmission Code (STC).

not take into account the individual components of the charge. While the FMR does set out the different components that make up the BSUoS price, there is no further analysis on their volatility or the factors behind the volatility.

No clear argument has been made on the best approach to BSUoS, as some of its components are best suited to cost recovery while others may be more suited to a cost reflectivity approach. CMP250 does not seek to address this, or the drivers of volatility for each component, but instead seeks to flatten charges over a longer period.

The FMR notes that using a fixed ex ante price will mean that it is unlikely that the SO will be able to recover the exact cost of balancing the electricity transmission system within the relevant charging period, resulting in an over- or under-recovery that will need to be addressed in subsequent periods.

We also note that in the option recommended by the majority of the Panel (WACM3), any over- or under-recovery would be reconciled in the second subsequent year due to the requirement to provide 15 months' notice of the new BSUoS price, further exacerbating the difference between when costs are incurred and eventually recovered.

On balance, we do not consider that the FMR sufficiently demonstrates that implementation of CMP250 would better facilitate Applicable CUSC Charging Objective (b). We consider that any future assessment of BSUoS would benefit from investigating the components that make up BSUoS in order to determine which are best suited to cost recovery and which are more suited to a cost reflectivity approach.

(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;

Eight Panel members considered the Original and the WACMs either did not better facilitate this objective or were neutral against it. One Panel member considered the Original and WACMs were negative against Applicable CUSC Charging Objective (c). They considered that fixing costs would not reflect developments in balancing services and products. Furthermore, the costs of these would not be accurately reflected in the immediate BSUoS price.

Our position

We agree with the Panel member's comment to an extent. Fixing BSUoS for a period will mean that the costs associated with new products and services developed during the fixed period are not reflected until future periods. There is therefore a delay in taking account of developments in transmission licensees' transmission businesses. We also consider that the negative effect varies depending on the length of time BSUoS is fixed for, and the notice period required.

On balance, we consider that the Original and WACMs tend not to better facilitate Applicable CUSC Charging Objective (c) due to the potential for delay in reflecting changes within the transmission licensees' transmission businesses.

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

Two Panel members considered the Original and WACMs were positive against Applicable CUSC Charging Objective (e), while others felt it was neutral or did not better facilitate it. No clear reason was provided to explain why the Original or WACMs would better facilitate Applicable CUSC Charging Objective (e).

Our position

When we have assessed the proposal against this Applicable CUSC Charging Objective, we have been aware of other work currently going ahead that may affect BSUoS. This is the Targeted Charging Review (TCR) Significant Code Review (SCR) and Electricity Network Access project.[8]

Within our recent consultation on whether to launch a SCR on electricity network access and forward-looking charges (our "Electricity network access project"), we have said that there would be benefits from further analysis of whether the elements of BSUoS which have a cost-reflective element could be enhanced and hence provide stronger forward-looking signals. We think this would help establish the long-term direction for BSUoS. With regards to some components of BSUoS, and following the comments under objective (b) above, CMP250 could reduce any existing cost reflectivity in advance of proper consideration of these issues.

Notwithstanding this, the FMR notes that the CUSC modification process itself is not sufficient to implement the proposals set out in CMP250 and further changes to the transmission licence would be required (to allow for any over- and under-recovery by the SO).

We do not therefore consider that implementation of CMP250, which would require further changes to the regulatory framework for BSUoS at a time when we are considering wider reform, would be an efficient way forward. Consequently, we do not consider that CMP250 better facilitates Applicable CUSC Charging Objective (e) than the current arrangements.

Decision notice

In accordance with Standard Condition C10 of NGET's Transmission Licence, the Authority has decided that CUSC modification proposal CMP250: '*Stabilising BSUoS with at least a twelve month notification period'* should not be made.

Andy Burgess
Deputy Director, Systems and Networks
Signed on behalf of the Authority and authorised for that purpose

[8] Targeted Charging Review: Significant Code Review (https://www.ofgem.gov.uk/electricity/transmission-networks/charging/targeted-charging-review-significant-code-review); Reform of network access and forward-looking charges (https://www.ofgem.gov.uk/electricity/transmission-networks/charging/reform-network-access-and-forward-looking-charges)