Company Secretary
National Grid Electricity System
Operator plc

By email

Direct Dial: 020 7901 7000
Email: TCR@ofgem.gov.uk

Date: 31 March 2020

Dear Company Secretary,

Consent to withdraw Connection and Use of System Code (CUSC) Modification Proposal CMP332 'Transmission Demand Residual bandings and allocation (TCR)' and Direction to raise a new modification proposal to enable new Transmission Demand Residual charges to be effective as of 1 April 2022

On 25 March 2020 we received a request from National Grid Electricity System Operator Limited (NGESO) seeking consent to withdraw CMP332 and for it to then be progressed in accordance with any further Directions issued by the Authority.

We have considered NGESO's request. For the reasons set out in this letter, we have decided to consent to the withdrawal and direct NGESO to raise a new proposal, to enable reforms to Transmission Demand Residual charges to be effective as of 1 April 2022. The Consent and Direction are attached in the Annex to this letter.

Background: The TCR decision and implementation timeline

The TCR decision[1], published on 21 November 2019, is comprised of the following main elements:

- Removing the Transmission Generation Residual (TGR) Embedded Benefit by setting TGR to zero, from April 2021.

[1] https://www.ofgem.gov.uk/publications-and-updates/targeted-charging-review-decision-and-impact-assessment

- Removing an Embedded Benefit associated with Balancing Services Use of System (BSUoS) charges, by charging suppliers BSUoS on a gross basis at the Grid Supply Point (GSP), from April 2021.
- Addressing a third Embedded Benefit (also associated with BSUoS charges) through the launch of the second Balancing Services Charges Task Force.
- Introducing new Transmission Demand Residual (TDR) charges in April 2021.
- Introducing new Distribution Demand Residual charges in April 2022.

Our Consent to NGESO's withdrawal request, and the attached new Direction, impact the new TDR charges only, changing only their implementation date from April 2021 to April 2022. The other elements of the TCR will progress as set out in our original TCR Directions[2]. The two Embedded Benefits reforms of setting TGR to zero and charging suppliers BSUoS on a gross basis at the GSP, will continue to progress for implementation in April 2021. We agree with NGESO that market participants are well-prepared for these changes, and believe that reforms to these elements of charging will deliver significant consumer benefits from April 2021.

In coming to our November 2019 decision regarding TDR reform, we considered the potential benefits and risks of different implementation timelines. We anticipated approximately £50 million in benefits to consumers, from implementing TDR reforms in 2021 versus 2022. We also anticipated that there may be some limitation to the realisation of these benefits, due to the time needed for suppliers to pass these benefits on to consumers (as some suppliers agree prices with consumers in advance).

In making our November 2019 decision, our view was that the consumer benefits from 2021 implementation of new TDR charges would likely outweigh the incremental costs associated with that timeline, compared to implementation in 2022.

Information we have received since the TCR decision

The industry process to deliver the TCR reforms formally began in December 2019. Since then, several suppliers and large energy consumers have provided us with detailed information regarding the difficulties arising from the lack of certainty in 2021 TDR charges on the non-domestic supply market. This information was supported by several other suppliers and consumers in their responses to the CMP332 industry consultation.

The lack of certainty around TDR network charges from April 2021 is being driven by two factors. First, accurate charges for April 2021 will not be available until late 2020, due to the new data requirements of the new charging structure and the code modification timeline.

Second, there is an increasing view in industry that the timeline for implementing the TDR reforms contains significant risks, and there is a growing concern that accurate charges may not be delivered on time. Our view is that the NGESO and the TCR Steering Committee (led by the Energy Networks Association) have developed an integrated plan to

[2] https://www.ofgem.gov.uk/system/files/docs/2019/11/cusc_direction_1.pdf and https://www.ofgem.gov.uk/system/files/docs/2019/11/dcusa_direction_1.pdf

deliver the reforms, as outlined in their Project Initiation Document[3]. However, we acknowledge that the plan is subject to several risks and that some of these risks are very difficult for industry to control.

In particular, there is a relatively short period allowed for the implementation of the new IT systems and charging processes, with very little time available to address and resolve issues that may arise during testing. As evidenced in the Project Initiation Document, it should be noted that these risks do not apply to the timeline for the Embedded Benefits modifications, which do not require new data flows and new charging structures on a similar scale.

How this is affecting suppliers and non-domestic consumers

As a result of both of the factors described above, there is concern that the uncertainty around TDR charges from 2021 will continue until late 2020, or perhaps longer. Most suppliers fix their electricity prices for many of their non-domestic customers in advance, through contracts. The current uncertainty means that energy suppliers are not able to accurately estimate the charges they will incur in 2021 for these customers.

We understand there is a significant variation in how suppliers are dealing with this, in setting prices for their 2021 contracts. Some suppliers have signed, or are continuing to sign, a significant number of non-domestic contracts for 2021 that do not take account of the expected changes to TDR charges. On average, TDR charges will increase for non-domestic consumers and decrease for domestic consumers. Hence, suppliers continuing to contract with non-domestic consumers without taking account of the TDR reforms will lead to: 1) these suppliers incurring losses, or 2) these suppliers triggering re-opener clauses with non-domestic customers to increase these charges.

This contracting activity could lead to significant disruption for some non-domestic consumers. If a significant number of contracts do not account for these increases, suppliers may need to re-open a significant number of their non-domestic contracts to recover the additional charges, when the new TDR charges become available in late 2020.

This could lead to a significant level of disputes, re-contracting and switching in the non-domestic supply market, which is typically based on longer-term contracts than other parts of the market. This could put some suppliers under financial strain, particularly those whose portfolios lack diversity or those who are reliant on a small number of large contracts for a significant portion of their revenue.

Potential consumer impacts and our decision to delay implementation of TDR charges

There is a risk that the impacts outlined above could lead to significant costs for some non-domestic consumers. As explained above, this risk is difficult for industry to manage comprehensively. Balancing this risk against the expected benefits of the introduction of

[3] As outlined in the Energy Networks Association Targeted Charging Review Project Initiation Document http://www.chargingfutures.com/media/1390/tcr-joint-eso-dno-pid-v10.pdf

new TDR charges in 2021 compared to 2022, we now believe that a delay of one year is in the best interests of consumers.

In the current circumstances, this delay will have the additional benefit of reducing pressures on industry and consumers in the coming months, and will hence further facilitate the implementation of the more straightforward changes to the two Embedded Benefits in 2021.

If you have any queries or comments in relation to the issues raised in this letter, please contact us by email at TCR@ofgem.gov.uk in the first instance.

Yours sincerely,

Frances Warburton
Director, Energy System Transition
For and on behalf of the Authority

cc: Kayte O'Neill, Electricity System Operator

Annex

Consent granted in accordance with Section 8.17A.4 of the Connection and Use of System Code (CUSC) and paragraph 4 of the Annex to the Direction issued by the Gas and Electricity Markets Authority (the Authority) to National Grid Electricity System Operator Limited (NGESO) on 21 November 2019 in relation to the Significant Code Review under the Targeted Charging Review

1. On the 21 November 2019 the Authority issued a Direction (the '2019 Direction') to NGESO in accordance with paragraph 6C(a) of standard licence condition C10 of the electricity transmission licence and Section 8.17.6(a) of the CUSC.

2. The 2019 Direction directed NGESO to raise one or more CUSC code modification proposals in the terms and for the reasons set out in that direction; and in sufficient time to enable the modifications proposals to be effective as of 1 April 2021.

3. On 12 December NGESO raised CUSC Modification Proposal CMP332 'Transmission Demand Residual bandings and allocation (TCR)' (the Proposal) in response to the 2019 Direction.

4. On 25 March 2020 we received a request from NGESO seeking consent to withdraw the Proposal and for it to then be progressed in accordance with any further Directions issued by the Authority.

5. We have considered NGESO's request, and for the reasons set out in the letter to which this Consent is attached, we have decided to grant consent to withdraw the Proposal, with immediate effect.

Hereby:

In accordance with Section 8.17A.4 of the CUSC and paragraph 4 of the 2019 Direction, the Authority hereby grants consent to the withdrawal of the Proposal, with immediate effect.

This Consent and the letter to which it is attached constitutes notice pursuant to section 49A of the Electricity Act 1989.

Frances Warburton, Director, Energy System Transition

For and on behalf of the Authority

31 March 2020

Direction issued in accordance with Section 18.17A.2(a) of the of the Connection and Use of System Code (CUSC) in relation to the raising of a CUSC modification proposal relating to Transmission Demand Residual bandings and allocation

1. On the 21 November 2019 the Authority issued a Direction (the '2019 Direction') to NGESO in accordance with paragraph 6C(a) of standard licence condition C10 of the electricity transmission licence and Section 8.17.6(a) of the CUSC.

2. The 2019 Direction directed NGESO to raise one or more CUSC code modification proposals in the terms and for the reasons set out in that direction; and in sufficient time to enable the modifications proposals to be effective as of 1 April 2021.

3. On 12 December NGESO raised CUSC Modification Proposal CMP332 'Transmission Demand Residual bandings and allocation (TCR)' (the 'Proposal') in response to the 2019 Direction.

4. On 25 March 2020 we received a request from NGESO seeking consent to withdraw the Proposal and for it to then be progressed in accordance with any further directions issued by the Authority.

5. We considered NGESO's request and decided to grant consent to NGESO to withdraw the Proposal with immediate effect.

6. We have also decided to direct NGESO, for the reasons set out in the Letter to which this Direction is attached, to raise a new modification proposal, to replace the Proposal withdrawn and which must meet the requirements set out in paragraph 7 below.

7. The new modification proposal must:
    a. enable transmission demand residual bandings and allocation and the resulting charging arrangements to be effective as of 1 April 2022; and
    b. comply with the relevant terms of the 2019 Direction in relation to transmission residual charging in all other respects.

Hereby:

In accordance with Section 18.17A.2(a) of the CUSC, the Authority hereby directs NGESO to raise a new transmission demand residual bandings and allocation modification proposal (which complies with paragraph 7 above) and which enables the new modification proposal to be effective by 1 April 2022.

This Direction and the letter to which it is attached constitutes notice pursuant to section 49A of the Electricity Act 1989.

Frances Warburton, Director, Energy System Transition

For and on behalf of the Authority

31 March 2020