National Grid ESO
Faraday House, Gallows Hill
Warwick, CV34 6DA

To all industry parties who pay
or are affected by TNUoS tariffs

Rebecca Yang
Revenue Manger
Faraday House
Warwick Technology Park
Gallows Hill Road
Warwick
CV34 6DA

rebecca.yang@nationalgrideso.com
Direct tel +44 (0) 7917174420
www.nationalgrideso.com

21 December 2020

TNUoS Locational Onshore Security Factor for RIIO2 Period

Dear Industry Colleagues,

This letter concerns the value of the Locational Onshore Security Factor (referred to as security factor in this letter), to be applied to the TNUoS tariffs over the RIIO2 period (2021/22 – 2025/26).

On 16th November 2020, we published a consultation seeking industry feedback on the value of the security factor[1]. Thank you to all those who took the time to respond, your thoughts and suggestions are much appreciated.

Taking into account the feedback received, and the ongoing changes affecting the 2021/22 TNUoS tariffs, after assessing the options against a set of criteria, we have decided that the best course of action is to: –

- Maintain the value of security factor at 1.8 for year 2021/22 tariffs, and
- Raise a CUSC modification proposal in early 2021 to clarify two decimal places for security factor, and if approved, apply the value of 1.76 to the TNUoS tariffs for the rest of RIIO2 period (2022/23 – 2025/26).

Further information on the comments received, and the rationale for our decision is detailed in this letter.

Background

The security factor reflects level of redundancy built in the wider transmission network and is used in the wider locational tariffs calculation which affects all TNUoS users. Currently the security factor is 1.8 which was set for the RIIO1 price control period. In accordance with the CUSC, we have re-calculated the value to be applied to the TNUoS tariffs for the RIIO-2 period, and presented and discussed the calculation and the new value in the last three Transmission Charging Methodology Forum (TCMF) meetings.

In light of different opinions expressed at the TCMF and the suggestion of inviting wider industry's comments, we issued a consultation in November on the number of decimal places should be used on the new security factor value. We provided three options in the consultation letter – (1) keeping 1 decimal place at 1.8 (2) applying 2 decimal places at 1.76 (3) applying 8 decimal places at 1.75547656.

[1] https://www.nationalgrideso.com/document/180741/download

The Consultation Responses
We received 13 responses from the industry indicting their preferred options. Many provided commentaries as well regarding the criteria they used when assessing the three options.

The majority of responses favour increasing the number of decimal places from 1d.p. to 8d.p as the most cost reflective option, while a number of respondents highlighted the risk of significant and unforeseen changes to 2021/22 tariffs if moving away from current practice of 1d.p a month before the final tariffs are published.

A number of respondents noticed that the impact by changing from 2d.p. to 8d.p. is small, compared to changing from 1d.p. to 2d.p. One respondent added that practicality was the main reason for them to choose option 2d.p., while retaining reasonable accuracy. Another respondent said that there was no good administrative reason for the use of 2d.p. rather than 8d.p.

Our Assessment Approach
We carefully considered the responses, and came up with four options to take forward for assessment:

- **Option 1**- maintaining 1d.p. and applying 1.8 for the 2021/22 – 2025/26 tariffs.
- **Option 2a** – applying 2 d.p and use 1.76 for the 2021/22 – 2025/26 tariffs.
- **Option 2b** - maintaining 1.8 for the 2021/22 tariffs and raising a CUSC modification proposal to clarify 2 d.p. for security factor and applying 1.76 for the 2022/23 - 2025/26 tariffs.
- **Option 3** – applying 8 d.p. and use 1.75547656 for the 2021/22 – 2025/26 tariffs.

The table below shows the assessment against the criteria based on the industry feedback.

Option	Cost Reflectivity	Tariff Predictability	Tariff Stability
Option 1 – maintaining 1.8	Negative	Positive	Positive
Option 2a – applying 1.76	Positive	Negative	Negative
Option 2b – applying 1.8 for 21/22 then 1.76 for 22/23 – 25/26	Positive	Positive	Neutral
Option 3 – applying 1.75547656	Positive	Negative	Negative

Cost reflectivity
Some respondents think that in order to achieve cost reflectivity, rounding and tolerance should be avoided if possible. In reality, this security factor is likely to require rounding, as it is derived from thousands of data by using least-square fitting methodology[2].

We noticed that some respondents recognised that the difference between 1.d.p. and 2d.p. can be significant to some TNUoS users, therefore we considered option 2a and 3 to be positive against cost reflectivity. We consider that overall option 2b is also positive in terms of cost reflectivity, as the value of 1.8 is used on a one-off basis for 2021/22 tariffs, while the accuracy will be increased to 2d.p. for future years via a CUSC modification proposal, to ensure accurate long-term investment signals. In addition, 2d.p. is also consistent with other onshore factors in the CUSC.

[2] https://www.nationalgrideso.com/document/183406/download

Tariff predictability
Some respondents said that changing the number of decimal places away from 1d.p. will create significant and unforeseen changes to 2021/22 tariffs, and that it will create winners and losers. They further added that when forecasting TNUoS liabilities, it was reasonable to assume parties will adopt the established rounding methodology for 2021/22 tariffs, as the ESO's own forecasts have done.

We recognised that tariff predictability is important to customers, and that there has been significant levels of uncertainty in the 2021/22 tariffs under RIIO-2 and TCR. We consider option 2a and 3 as negative on tariff predictability, as moving away from the established practice of 1d.p. for security factor may not be expected by some customers. We consider that options 1 and 2b are positive, as future tariffs with 1.8 security factor are more predictable for customers. Whilst option 2b highlights some potential changes to future years' tariffs, and the lead time seems adequate for the magnitude of change.

Tariff stability
One respondent pointed out that parties will have already entered into fixed price contracts with customers for the 2021/2022 period. A number of respondents highlighted the risk of significant and unforeseen changes to 2021/22 locational tariffs if moving away from current practice of 1d.p, just a month before the final tariffs are published. We consider option 1 as positive, option 2a and 3 as negative as they introduce changes to the locational tariffs which will cause changes between the draft and final tariffs. We consider option 2b as neutral, as it is a compromise between short-term stability for 2021/22 and long-term changes.

Our Assessment Outcome
Based on our assessment against cost reflectivity, tariff predictability and tariff stability, on balance, we consider option 2b as optimal, and will take this forward.

Next Steps
We plan to implement option 2b in the following steps:

- Apply 1.8 as the value of security factor for 2021/22 final tariffs, to be published by 31st January.
- In early 2021, raise a CUSC modification proposal to clarify that 2 decimal places are to be used for TNUoS locational onshore security factor and onshore expansion factors.
- If the CUSC modification proposal is approved, we will apply 1.76 as the security factor for charging years 2022/23 – 2025/26.

Although we propose to change the number of decimal places for the security factor from 1d.p. to 2d.p., evidence supporting other options are also welcome through the course of the CUSC proposal process.

If you have any queries, please contact us on TNUoS.Queries@nationalgrideso.com. Thank you for your support and patience on this piece of work.

Yours faithfully

Rebecca Yang
Revenue Manager