## Code Administrator Consultation

# CMP395: Cap BSUoS costs and Defer payment to 2023/24 to protect GB customers

**Overview**: Seeks to cap BSUoS (proposed to be set at £15/MWh) per Settlement Period from 1 October 2022 to 31 March 2023, recoup the money in charging year 2023/2024; and cap the liability to be carried by the ESO at £250m.

### Modification process & timetable

1. **Proposal Form** — 11 August 2022
2. **Workgroup Consultation** — 26 August 2022 to 1 September 2022
3. **Workgroup Report** — 12 September 2022
4. **Code Administrator Consultation** — 13 September 2022 to 16 September 2022
5. **Draft Final Modification Report** — 20 September 2022
6. **Final Modification Report** — 21 September 2022
7. **Implementation** — 30 September 2022

**Have 5 minutes?** Read our Executive summary

**Have 20 minutes?** Read the full Code Administrator Consultation

**Have 30 minutes?** Read the full Code Administrator Consultation and Annexes.

**Status summary:** The Workgroup have finalised the proposer's solution and 5 Workgroup Alternative CUSC Modifications (WACM). We are now consulting on this proposed change.

**This modification is expected to have a: High impact** on Customers, Suppliers, Generators and the ESO; and a **Medium impact** on Traders

| | | |
|---|---|---|
| **Governance route** | Urgent modification to proceed under a timetable agreed by the Authority (with an Authority decision) | |
| **Who can I talk to about the change?** | **Proposer:** Scott Keen, Saltend Cogeneration Company Ltd.<br>scott.keen@tritonpower.co.uk<br>Phone: 07522 214676 | **Code Administrator Chair**: Paul Mullen<br>Paul.j.mullen@nationalgrideso.com<br>Phone: 07794537028 |

# Contents

**Contents** ..... **2**
**Executive summary** ..... **3**
**What is the issue?** ..... **6**
Why change? ..... 6
**What is the solution?** ..... **7**
Proposer's solution ..... 7
**Workgroup considerations** ..... **7**
**Workgroup Consultation summary** ..... **20**
**Workgroup Alternatives** ..... **21**
**Legal Text** ..... **23**
**What is the impact of this change?** ..... **23**
Proposer's assessment against Code Objectives ..... 23
Proposer's assessment against CUSC Charging Objectives ..... 23
**Workgroup assessment of Impacts** ..... **24**
**Workgroup vote** ..... **29**
**When will this change take place?** ..... **31**
Implementation date ..... 31
Date decision required by ..... 31
Implementation approach ..... 31
**Interactions** ..... **31**
**How to respond** ..... **31**
Code Administrator consultation questions ..... 31
**Acronyms, key terms and reference material** ..... **32**
Reference material ..... 32
**Annexes** ..... **32**

## Executive summary

Seeks to cap BSUoS (proposed to be set at £15/MWh) per Settlement Period from 1 October 2022 to 31 March 2023, recoup the money in charging year 2023/2024; and cap the liability to be carried by the ESO at £250m.

### What is the issue?

Over the past few months a number of market factors (e.g. Increased GB interconnection exports, high prices and tighter margins across Europe due to gas security issues and French nuclear plant outages, network constraints in south of England and high temperatures causing droughts) have driven balancing costs and volatility to even higher levels than seen during Covid.

The Proposer argues that to protect customers this winter these charges need to be capped which will lower volatility, thereby the risk premia, and ultimately lower balancing costs overall. The deferred balancing costs (from above the cap) would be recouped during the 2023/2024 Charging Year.

### What is the solution and when will it come into effect?

**Proposer's solution:**

- **Set a £15/MWh cap on BSUoS from 1 October 2022 until 31 March 2023**
- **Defer the BSUoS costs incurred above the cap to the 2023/2024 charging year**
- **Recover the additional BSUoS costs above the cap from 1 April 2023 and by no later than 31 March 2024 from Suppliers and 31 December 2023 from Generators (based on forecast if actuals are not available)**
- **For Suppliers, recover an identical amount per day that is allocated to Settlement Periods on a chargeable volume weighted basis or in line with CMP361/CMP362 if implemented by 1 April 2023.**
- **Limit the liability on the ESO to £250m. There will be daily reporting of the percentage utilisation of the deferred amount.**
- **CMP395 BSUoS Support Scheme will fall away on the earlier of 31 March 2023 or when the £250m limit has been reached.**

**Implementation date:** From the first Settlement Period (00:00 – 00:30) on 1 October 2022 if approved on 28 September 2022 (or such later date as the Authority may specify)

**Summary of potential alternative solution(s) and implementation date(s):**

The table below sets out the other solutions developed by the Workgroup. These build on the CMP395 Original by:

- Varying the BSUoS price cap; and/or
- Limiting the BSUoS price cap to Suppliers only; and/or
- Introducing a reassessment of the BSUoS price cap

For completeness, we have shown how these other solutions compare with CMP395 Original:

| Other Solutions | BSUoS Price Cap | Reassessment of BSUoS Price Cap? | Applies to Generators and Suppliers or Suppliers only? |
|---|---|---|---|
| ***CMP395 Original*** | *£15/MWh* | *No* | *Generators and Suppliers* |
| ***CMP395 WACM1*** | *£25/MWh* | *No* | *Generators and Suppliers* |
| ***CMP395 WACM2*** | *£30/MWh* | *No* | *Generators and Suppliers* |
| ***CMP395 WACM3*** | *£40/MWh* | *No* | *Generators and Suppliers* |
| ***CMP395 WACM4*** | *£25/MWh* | *Yes – by ESO* | *Generators and Suppliers* |
| ***CMP395 WACM5*** | *£15/MWh* | *Yes – by Ofgem* | *Generators and Suppliers* |

**Workgroup conclusions:** The Workgroup unanimously concluded that WACM4 better facilitated the Applicable CUSC Objectives than the Baseline and by majority concluded that the Original, WACM1, WACM2, WACM3 and WACM5 better facilitated the Applicable CUSC Objectives than the Baseline.

## What is the impact if this change is made?

- The Proposer and some Workgroup Members argue that the re-introduction of a BSUoS Cap will allow Generators to better manage the BSUoS risk premia they currently include in prices and thereby reduce the overall level of BSUoS costs for the benefit of consumers. The risk premia is linked to the increased volatility of BSUoS, and feeds directly into higher BSUOS costs (and wholesale energy costs).

- Suppliers argued they could be exposed to significant losses without this mitigation. In the current retail market this could drive more Suppliers to leave the market, thereby reducing competition and therefore competitive forces which keep prices as low as possible for customers.

- Implementing CMP395 could reduce BSUoS charges by an average of £1/MWh over the winter period in which the BSUoS Cap is effective. This on the face of it appears minimal (£250m vs total forecast BSUoS of £3.7 billion over the winter period[1]). However, the BSUoS Cap could provide additional support via the argument that a BSUoS cap will reduce the overall level of BSUoS costs for the benefit of consumers, through the amount of the hedging product.

[1] bsuos-forecast-report_winter_contingency.pdf (nationalgrideso.com)

## Interactions

This a short-term solution to address the current exceptional market conditions and does not specifically impact, nor overlap with, the other BSUoS modifications (CMP308 and CMP361 and CMP362) which seek to deliver an enduring framework for BSUoS from 1 April 2023.

- There could arguably be interactions with CMP308 for solutions where there is proposed to be BSUoS cost recovery from Generators from 1 April 2023 as CMP308 removes Generator liability to pay BSUoS from 1 April 2023. However, the costs being recovered from Generators under CMP395 would be costs incurred pre 1 April 2023.

- The Workgroup noted that CMP361 and CMP362 has not yet been approved by Ofgem; however CMP395 solution(s) assume that CMP361 and CMP362 will be implemented by 1 April 2023.

This modification has no interactions with EBR[2] Article 18 Terms and Conditions.

[2] If your modification amends any of the clauses mapped out in Exhibit Y to the CUSC, it will change the Terms & Conditions relating to Balancing Service Providers. The modification will need to follow the process set out in Article 18 of the European Electricity Balancing Guideline (EBR – EU Regulation 2017/2195) – the main aspect of this is that the modification will need to be consulted on for 1 month in the Code Administrator Consultation phase. N.B. This will also satisfy the requirements of the NCER process.

## What is the issue?

Over the past few months a number of market factors (e.g. Increased GB interconnection exports, high prices and tighter margins across Europe due to gas security issues and French nuclear plant outages, network constraints in south of England and high temperatures causing droughts) have driven balancing costs and volatility to even higher levels than seen during Covid.

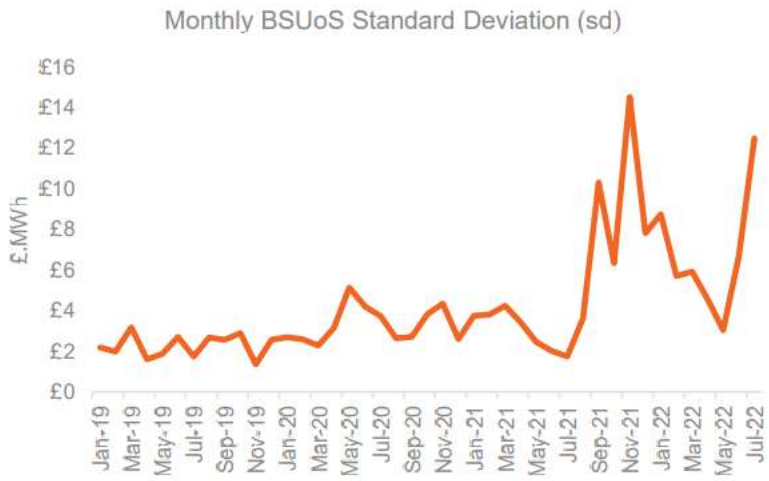
The Proposer argues that some of these costs were unforecastable and the only way for all parties to manage them is to add in a BSUoS risk premia, where they can. Due to the way BSUoS is settled, within day volatility[3] and individual periods seeing BSUoS of c£170/MWh, this risk premia is increasing.

The Proposer argues that to protect customers this winter these charges need to be capped and recouped from 2023/2024 Charging Year after the current energy cost crisis has passed.

## Why change?

The Proposer argues that as a result of exceptional market conditions, BSUoS costs are significantly higher than expected, due to factors largely out of the ESO's control. They consider these cost drivers were not forecastable by industry parties. The Proposer also notes that BSUoS price volatility has been high, citing a broad range of BSUoS prices. This is illustrated by Table 1, which shows the standard deviation for monthly BSUoS. This uncertainty the Proposer suggests, have led parties to increase the BSUoS risk premia into their trades and commercial activities.

**Table 1**




[3] Within day volatility has seen prices swing between Settlement Periods from ~-£0.50/MWh to ~£170/MWh within just one day (20 July 2022).

To reduce the need for such risk premia, the Proposer suggests a BSUoS cap be implemented this winter, with any charges incurred above the cap deferred to the 2023/2024 charging year.

## What is the solution?

### Proposer's solution

- **Set a £15/MWh cap on BSUoS from 1 October 2022 until 31 March 2023**
- **Defer the BSUoS costs incurred above the cap to the 2023/2024 charging year**
- **Recover the additional BSUoS costs above the cap from 1 April 2023 and by no later than 31 March 2024 from Suppliers and 31 December 2023 from Generators (based on forecast if actuals are not available)**
- **For Suppliers, recover an identical amount per day that is allocated to Settlement Periods on a chargeable volume weighted basis or in line with CMP361/CMP362 if implemented by 1 April 2023.**
- **Limit the liability on the ESO to £250m. There will be daily reporting of the percentage utilisation of the deferred amount.**
- **CMP395 BSUoS Support Scheme will fall away on the earlier of 31 March 2023 or when the £250m limit has been reached.**

## Workgroup considerations

The Workgroup convened 4 times to discuss the perceived issue, detail the scope of the proposed defect, devise potential solutions and assess the proposal in terms of the Applicable Code Objectives.

### Consideration of the proposer's solution

#### What are the drivers for CMP395 and how does this compare with previous BSUoS Cap Modifications?

The driver for the previous BSUoS Cap Modifications (CMP345, CMP350 and CMP381) was Covid and demand decrease had driven higher and exceptional BSUoS costs. The expectation was that these would stabilise to pre-Covid levels.

CMP395 has been raised due to global factors, that have caused more unpredictable exceptionally high balancing costs and is therefore seeking protection for all industry participants against exceptional BSUoS prices or higher frequency of exceptional levels of BSUoS prices. However, the drivers for some of the solutions goes beyond simply protection against these exceptional prices but seeks to reduce the risk premia being applied (due to exceptional and volatile BSUoS prices) and therefore total costs of BSUoS and also maximise the support available to market participants.

BSUoS costs >£15/MWh themselves are not an exceptional cost. However there are more BSUoS costs >£15/MWh and the distribution of BSUoS charges has increased in volatility and unpredictability. The cost of ESO system actions are also very dependent on power market conditions in Europe. In the opinion of a Workgroup Member, this demonstrated why the current BSUoS costs are exceptional given the cumulative instances of BSUoS costs >£15/MWh.

**Set a £15/MWh cap on BSUoS from 1 October 2022 until 31 March 2023.**

Some Workgroup Members, including the Proposer, argued that the primary reason for the BSUoS cap is to remove BSUoS risk premia (in wholesale power prices) from the market and thereby reducing the overall cost to consumers. A Workgroup Member argued illustratively that a £1/MWh reduction in BSUoS risk premia added by Generators could be equivalent to ~£4.3 million benefit to consumers across 1GWh of Winter 2022 hedging[4].

The Proposer believes that £15/MWh is a reasonable cap and is ~ the median of the ESO's most recent (September 2022) BSUoS price forecast for winter. Each Settlement Period between 1 October 2022 and 31 March 2023 will be capped at £15/MWh. Anything above this, will be deferred until the following charging year up to a limit of £250m. No Workgroup Member considered any extension beyond 31 March 2023.

Some Workgroup Members argued that if the BSUoS price cap is too low, then (depending on your view of future BSUoS prices[5]) the CMP395 BSUoS Support Scheme is potentially all used up early and arguably the support would only reach a limited number of market participants and future consumer burdens would be greater. Additionally, if the support is all used up it wouldn't necessarily be available for a similar future mechanism (if a need should arise).

To help support what an appropriate cap may be, the ESO Workgroup Member presented analysis of how much could be deferred in winter 2022 under different price caps. This is shown in Table 2, with the full analysis in Annex 4:

**Table 2**

| Charges by Month | Amounts that would be deferred under different cap values based on latest forecast data including winter contingency (£/MWh) | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Sept Forecast Values | £15 Cap | £20 Cap | £25 Cap | £30 Cap | £35 Cap | £40 Cap | £45 Cap | £50 Cap |
| £ 546,705,495.00 | £ 116,395,464.22 | £ 70,773,984.00 | £ 43,094,187.91 | £ 26,247,051.81 | £ 14,191,499.67 | £ 6,965,372.00 | £ 2,761,257.54 | £ 881,273.21 |
| £ 740,247,253.00 | £ 282,660,070.61 | £ 221,392,972.02 | £179,680,655.40 | £ 151,615,573.76 | £ 130,107,583.81 | £ 113,394,665.61 | £ 100,568,734.29 | £ 89,131,203.90 |
| £ 726,005,495.00 | £ 225,451,357.00 | £ 160,650,717.64 | £115,791,839.70 | £ 85,480,569.77 | £ 67,420,505.43 | £ 57,529,052.11 | £ 51,747,089.83 | £ 46,427,373.57 |
| £ 631,005,495.00 | £ 161,424,537.73 | £ 114,839,605.02 | £ 86,624,614.95 | £ 72,095,900.63 | £ 63,434,921.56 | £ 56,006,218.31 | £ 49,587,131.07 | £ 44,183,577.06 |
| £ 587,130,769.00 | £ 129,984,863.83 | £ 87,898,299.85 | £ 31,656,102.92 | £ 11,652,050.82 | £ 3,010,004.12 | £ 254,505.08 | £ - | £ - |
| £ 532,805,495.00 | £ 127,237,604.38 | £ 78,201,337.66 | £ 46,797,795.23 | £ 27,701,809.41 | £ 16,132,775.66 | £ 8,836,818.27 | £ 4,461,247.78 | £ 2,241,972.28 |
| | | | | | | | | |
| | | | | | | | | |
| | | | | | | | | |
| £3,763,900,002 | £1,043,153,898 | £713,756,916 | £503,645,196 | £374,792,956 | £294,297,290 | £242,986,631 | £209,125,461 | £182,865,400 |

The costs in the ESO's most recent (September 2022) BSUoS price forecast for winter including the winter contingency costs were used as the best idea of what the costs will be for the October 2022 to March 2023 period.

The forecast only gives Monthly data and the cap calculator needs Half Hourly data to be able to calculate what the potential deferred values will be, so ESO have used the Half Hourly data from October 2021 to March 2022 as the base and then increased the Half Hourly values by a percentage for each month to equal the latest forecast values for each month.

ESO applied the cap calculator (that has been used for CMP345, CMP350 and CMP381) to the values derived from the above and this showed how much would likely to be deferred during each Settlement Period. The ESO Workgroup Member confirmed that the cap calculator is accurate when we have compared to fully calculated historical deferrals

[4] Assumes 0.5GW average demand * 181 days * 24 hours (spread between Generators and Suppliers)
[5] ESO's September 2022 forecast suggests that a cap of £15/MWh is likely to result in a deferral of £1.04 billion for the 6-month period the scheme is aiming to cover.

carried out under previous BSUoS caps. However, how much would be deferred under each cap level is very closely tied to how volatile each day is and how high the Half Hourly Settlement Period peaks are. It is possible to have similar total monthly costs but different deferral amounts if the daily volatility is different. This is particularly the case as you get to the higher price cap levels as there are fewer Settlement Periods with high prices above the cap. By definition, with a higher cap, the higher the range of volatility and risk that remains in each Settlement Period – thereby reducing the opportunity to reduce balancing costs overall.

In summary, ESO's analysis showed that a cap of £40/MWh could ensure that the £250m limit is not reached too quickly and therefore seeks to provide protection for the whole period to the 31 March 2023.This should allow the benefits to reach a wider range of participants and customers, not just those with volumes weighted more to earlier months. However, some Workgroup Members noted that a BSUoS price cap of £40/MWh would not decrease the uncertainty sufficiently to markedly reduce BSUoS, nor would it be effective at lowering balancing costs through reducing volatility and also noted that limits available for previous BSUoS caps, were not fully utilised.

A Workgroup Member utilised ESO's data and provided an additional perspective of ESO's analysis by taking outturn BSUoS costs from a number of years (2018, 2019, 2020 and 2021) and uplifted each individual Half Hourly Settlement period by a fixed %. Broadly the numbers were in line with the ESO's above analysis and identified potential BSUoS cap ranges of £26/MWh to £39/MWh.

| | | Required PRICE CAP (£/MWh) | Deferred £m |
|---|---|---|---|
| PRICE CAP based on fund limit (£250m): | 2018/19 BSUoS Profile | £34.26 | £250 |
| | 2019/20 BSUoS Profile | £26.04 | £250 |
| | 2020/21 BSUoS Profile | £36.19 | £250 |
| | 2021/22 BSUoS Profile | £39.14 | £250 |

The same Workgroup Member then took the same period and uplifted each individual Half Hourly Settlement period by a fixed £/MWh rather than a fixed % uplift. This altered the calculation and produced potential BSUoS cap ranges of £14/MWh to £24/MWh.

| | | Required PRICE CAP (£/MWh) | Deferred £m |
|---|---|---|---|
| PRICE CAP based on fund limit (£250m): | 2018/19 BSUoS Profile | £14.63 | £250 |
| | 2019/20 BSUoS Profile | £14.92 | £250 |
| | 2020/21 BSUoS Profile | £16.69 | £250 |
| | 2021/22 BSUoS Profile | £24.09 | £250 |

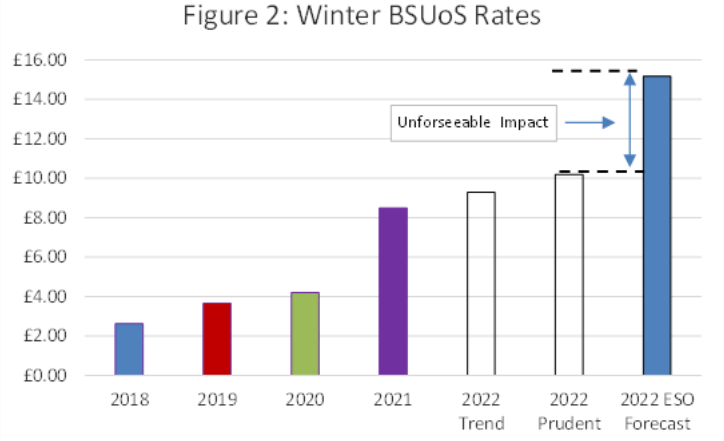
The full analysis is set out in Annex 5 and, based on this analysis, there is arguably a range of possible BSUoS Caps from £14/MWh to £39/MWh assuming a £250m BSUoS deferral limit. Workgroup Members, including the Proposer, added that if there is a BSUoS cap, then Generators would not price in BSUoS bids higher than the cap and therefore BSUoS costs would actually be lower than the numbers quoted above. In their opinion, this is

justification for a lower BSUoS cap. However there is no analysis to support what reduction there could be and given the commercial nature of this, industry were asked to consider submitting any specific analysis on this directly to Ofgem.

A Workgroup Member provided analysis (see Annex 5) to support a BSUoS cap. The analysis is a refresh of that undertaken for CMP381 and attempts to objectively derive an average BSUoS rate which a prudent market participant could have reasonably foreseen for Winter 2022 (October-March). A trend of observed BSUoS rates over previous winter seasons is first used to project what a market participant could have anticipated for the winter 2022 BSUoS rate. This provides an estimated 'central view' BSUoS rate of £9.29/MWh.

The analysis then builds in an error margin to reflect the likely actions a prudent market participant would take. For this, the BSUoS variability analysis conducted by the ESO and published as Table 4 in the CMP361/CMP362 Code Administrator Consultation[1] is used. That analysis estimates a quarterly P80 level of BSUoS cost variability of £122m. Doubling this to £244m for the two quarters under consideration for CMP395 equates to £0.91/MWh for Winter 2022. Adding this P80 variability risk to the central view above gives a prudent BSUoS estimate of £10.20/MWh which can be compared to the latest ESO BSUoS forecast of £15.16/MWh (Figure 2 below).

Figure 2: Winter BSUoS Rates




Based on BSUoS profiles over the last few years, a tariff cap of between £12/MWh and £15/MWh would be required to deliver a capped average BSUoS rate of £10.20 MWh. However it is estimated that this would require around £1bn of current forecast costs to be deferred, if the risk premia impact is not factored in, which the Proposer argues could be significant.

Following assessment of the responses to the Workgroup Consultation, alternative BSUoS caps were discussed namely:

| BSUoS Price Cap | Applies to Generators and Suppliers or Suppliers only? |
|---|---|
| ***£25/MWh*** | *Generators and Suppliers* |
| ***£30/MWh*** | *Generators and Suppliers* |
| ***£40/MWh*** | *Generators and Suppliers* |

[1] https://www.nationalgrideso.com/document/224286/download – Table 4 is on page 16

| | |
|---|---|
| ***£15/MWh*** | *Suppliers only* |
| ***£25/MWh*** | *Suppliers only* |

The Workgroup discussed the rationale for each of these and the discussion on alternative BSUoS Caps that apply to both Suppliers and Generators is summarised in the table below:

| BSUoS Price Cap | Applies to Generators and Suppliers or Suppliers only? | Justification as to why this BSUoS Price Cap may better facilitate the CUSC Objectives than the CMP395 Original |
|---|---|---|
| ***£25/MWh*** | *Generators and Suppliers* | Seeks to address the potential for a higher frequency of exceptional levels of Half Hourly BSUoS prices over the course of the winter which is arguably likely to add inefficient risk premia to the market, and also seeks to provide some mitigation for Parties for the exceptional level of 'average' BSUoS prices expected this winter which is arguably beyond what could have been reasonably foreseen by a prudent market participant. The cap of £25/MWh is chosen to balance these objectives, whilst also taking account of the deferral limit of £250m highlighted by the ESO.<br><br>A £25/MWh BSUoS cap arguably reasonably represents an exceptional Half Hourly BSUoS price – it is broadly equivalent to the mean plus two standard deviations of Half Hourly BSUoS prices over the most recent 12 month period (Aug-21 – Jul-22: mean £8.10 plus two standard deviations (2 x £8.17) = £24.44). It is therefore consistent with the approach used to derive the £20/MWh cap in CMP381 (which used 2021 calendar year data). |
| ***£30/MWh*** | *Generators and Suppliers* | Argues that 25/MWh to £30/MWh BSUoS price cap better reflects the inflection point whereby BSUoS costs can rapidly increase (meaning ESO will need to take action in the Balancing Mechanism).<br><br>The party proposing this believes that a BSUoS price cap of £30/MWh is optimum as will remove inefficient risk premia being factored in by Generators and Suppliers in wholesale markets and the Balancing Mechanism and encourage increased liquidity in the wholesale markets by reducing risk around forward hedges. It is their view that the size of the deferral fund will still need to be revisited outside of the CMP395 process. |

| | | |
|---|---|---|
| | | Analysis to support this conclusion has been shared directly with Ofgem but the forward looking analysis focuses on a range of credible gas price scenarios. |
| ***£40/MWh*** | *Generators and Suppliers* | Seeks to minimise the impact of the spiky peaks/exceptional events of BSUoS costs over the whole 6-month period and make the best use of the available fund the ESO can finance and ensures this fund can be utilised as long as possible over the 6-month period giving some protection from those potential high BSUoS prices. The ESO Workgroup Member believes that in accordance with the September 2022 BSUoS Forecast that the fund the ESO can finance would likely run out in the first or second week of December if a £15/MWh cap were implemented and so, in their view, not provide the duration of support needed by industry or indeed reduce risk to provide the opportunity to trigger different pricing strategies. |

Some Workgroup Members argued that if the BSUoS price cap is too low, then (depending on how your view of future BSUoS prices) the CMP395 BSUoS Support Scheme is potentially all used up early and arguably the support would only reach a limited number of market participants and future consumer burdens would be greater. However, some Workgroup Members noted that the higher BSUoS price caps would not offer sufficient support to market participants.

The Workgroup also discussed the idea of a Supplier only BSUoS price caps and the ESO Workgroup Member argued that a Supplier only BSUoS price cap provides targeted protection of the impacts of exceptional BSUoS events to Suppliers and End Consumers and will enable Suppliers to remain competitive over winter and therefore ensuring competition is maintained in the retail landscape. The ESO Workgroup Member also argued that Generators can participate in a wider range of markets and products and can flex their pricing within the shorter-term priced product; however, this is dependent on individual Generators' trading strategies and some Workgroup Members argued that this underestimates the complexity[6] of how power is sold in the first place and underestimates the volatility in the market. A respondent to the Workgroup Consultation also noted that, in their view, a Supplier only BSUoS price cap would reduce the BSUoS related risk premia for fixed price customers taking new contracts or renewing contracts over winter. Furthermore, a Supplier only BSUoS price could simply cost recovery as generators would not be required to repay in the 2023/2024 charging year and arguably ensures there is no Generator to Consumer cost transfer in 1 April 2023.

The ESO Workgroup Member also argued that a Supplier only BSUoS price cap should be set at £25/MWh to ensure the fund can be utilised as long as possible over the proposed period. However, another Workgroup Member believed that £25/MWh was too conservative for a Supplier only BSUoS price cap and therefore proposed that £15/MWh

[6] e.g. there is Supplier and generation shaping and operational risk closer to real-time when refined BSUoS premia could be added when optimising positions.

would be more appropriate. To support this argument, the same Workgroup Member, although supportive of a £15MWh BSUoS Cap that supports Suppliers and Generators, argued that it could be lower than £15MWh and noted that average BSUoS out-turned at 9MWh in Winter 2021 and also that forecast average BSUoS was showing as 8MWh in ESO's July 2022 forecast.

However, the majority of Workgroup Members highlighted that a Supplier only BSUoS cap would not address the overall BSUoS costs volatility issue and would not decrease the BSUoS risk premia. This could limit the effectiveness and potential benefit to consumers of CMP395. Some Workgroup Members added that this could create distortions in the market throughout the winter (as all BSUoS paying parties benefit from the risk reduction) and preferred that the BSUoS cap applies to both Suppliers and Generators and any cost recovery is dealt with separately.

There was limited support for a Supplier only BSUoS cap within the Workgroup and the responses to the Workgroup Consultation (only 1 advocate and 7 respondents against this) with the distortive impact and the argument that this would not reduce risk premia being applied by generators and therefore result in continued high wholesale and Balancing Mechanism costs outweighing the simpler implementation and the increased likelihood of the support being in place for the duration of the support period.

However, requests for Workgroup Alternatives were proposed for a Supplier only BSUoS price cap of £25/MWh and, in response to this, a Supplier only BSUoS price cap of £15/MWh. Neither of these were taken forward as Workgroup Alternative CUSC Modifications and more details on this can be found in the "Workgroup Alternative" section of this document.

**Review the BSUoS cap at defined points during the CMP395 BSUoS Support Scheme and potentially alter this BSUoS cap upwards or downwards**

The Workgroup (and some respondents to the Workgroup Consultation) noted that the maximum limit of the additional BSUoS costs that would be deferred had not been fully utilised as part of previous BSUoS caps (see Figure 1 below).

**Figure 1**

Previous mods – caps and usage

| | CMP345 - £15/MWh | CMP350 - £10/MWh | CMP381 - £20/MWh |
|---|---|---|---|
| Length of scheme | 4 months | 1 month | 3 months |
| No of SPs within scheme | 2400 | 3506 | 3550** |
| No of SPs above the cap | 121 | 204 | 167 |
| Cumulative BSUoS charges | £8.1m | £13.2m | £43m |
| Total cap | £100m* | £100m | £200m |

*There wasn't a hard cap, as there was with CMP350/381.
"Nonetheless, we recognise that there is a limit to the amount of liquidity that can be provided by NGESO, under current arrangements. With this in mind, we think it would be efficient and appropriate, should the level of BSUoS costs being deferred approach £100m, to consider further how to mitigate the NGESO's exposure."
** clock change

Therefore, the Workgroup discussed a mechanism where at defined windows, a review would be undertaken on utilisation of the of the CMP395 BSUoS Support Scheme. This wouldn't replace the reporting[7] that the ESO propose to carry out.

Although the aim to ensure maximum utilisation of the CMP395 BSUoS Support Scheme was broadly welcomed and could avoid any potential cliff edge where all available deferral is utilised before the end of winter, there was some concern that if the BSUoS cap can be increased, this could create market uncertainty over longer dated hedging products bought by Suppliers and Generators may need to add risk premia, which could increase overall BSUoS costs. This is further exacerbated if the BSUoS cap can be increased or decreased or if there are frequent review points.

The other primary concern was complexity and some Workgroup Members noted the complexity of defining clear criteria to re-assess the BSUoS cap against and the process for explaining and notifying industry of any movements.

Only 3 out of 12 respondents to the Workgroup Consultation supported this in period reassessment with the prevailing view being that complexity and lack of market certainty as to what the BSUoS Cap is outweighs maximising the support in place. However, a request for Workgroup Alternative was proposed to include an ESO review of the level of BSUoS Cap when utilisation has reached 60% of the £m deferred limit, or is reasonably expected by the ESO to reach that level once Settlement data for past Settlement Days becomes available. This request for Workgroup Alternative became WACM4 - more details on this can be found in the "Workgroup Alternative" section of this document.

At this point, the ESO, using a mechanistic process, will review the level of the cap and if necessary, increase (not decrease) the cap to apply in respect of the remaining Settlement Days in the scheme to a level which seeks to ensure a cap will remain in place for the duration of the scheme (to 31 March 2023). The process that the ESO would apply, if this WACM is approved by Ofgem, is set out below:

| | |
|---|---|
| Step 1 | Calculate the percentage of costs that would have been deferred from 1 October 2022 to the date when utilisation exceeded 60% of the £m deferred limit under different levels of price cap, increasing in £5 increments. |
| Step 2 | Based on the latest available ESO forecast of BSUoS costs at that point in time, estimate the percentage of costs that would need to be deferred for the remainder of the scheme period (to 31 March 2023) to remain within the £m deferral limit |
| Step 3 | Find the lowest £5 increment from Step 1 that would extend the life of the BSUoS cap to 31 March 2023 (i.e. based on the required percentage derived in Step 2). |
| Step 4 | If the chosen £5 increment is higher than the approved BSUoS cap, publish the higher level of cap with a 5 Working Days' notice of implementation. The ESO Workgroup Member explained that this would be relatively simple to implement in the system as it would be a small adjustment to the price cap level; however |

[7] *There will be a weekly report of the percentage utilisation of the deferred amount, moving to daily reporting when 60% of total support has been used.*

| | |
|---|---|
| | there would a time lag (7 – 10 days) between the actual Settlement Day and the II data runs themselves so prudent that review could happen when utilisation has reached 60% of the £m deferred limit or is reasonably expected by the ESO to reach that level once Settlement data for past Settlement Days becomes available. |

Some Workgroup Members agreed that this proposed process could provide further mitigation against the £250m not lasting for the whole winter and argued that this in itself provides a degree of certainty for the market and allows e.g. Generators in the day ahead market to lower the BSUoS prices they provide in their Offers in the Balancing Mechanism. However, some Workgroup Members maintained their view that this may affect parties ability to reduce risk premia later if the BSUoS cap level is uncertain and would not give consumers and industry parties certainty of how high BSUoS could be.

A Workgroup Member suggested that you could have a review each month and adjust the BSUoS Cap if a certain % of the £m deferred limit had been reached. The majority of the Workgroup believed this added too much complexity and market uncertainty not least because there are more intervention points and a risk that ESO increase the BSUoS Cap too early if there was an exceptionally high BSUoS cost day in e.g. the 1st month of the CMP395 BSUoS Support Scheme period.

In the area of an in period reassessment, a further Workgroup Alternative was proposed, which allows Ofgem/GEMA to propose, taking into account its wider statutory duties, a higher BSUoS cap amount if new funds are made available and negate the need for a further industry modification. There were concerns that this was not implementable as such intervention would be the responsibility of Government and argue this is not within Ofgem's statutory duties and a subsequent industry Modification would be the preferred approach.

**Defer the additional BSUoS costs above the cap to the 2023/24 charging year**

**Recover the additional BSUoS costs above the cap from 1 April 2023 and by no later than 31 March 2024 from Suppliers and 31 December 2023 from Generators (based on forecast if actuals are not available)**

The following table shows when ESO would invoice for the Settlement Day itself:

| Settlement Day | When will ESO invoice for this Settlement Day? |
|---|---|
| 1 October 2022 | 25 October 2022* |

*Note that this is subject to scheduling changes.

The BSUoS costs to be deferred will be limited to £250m. However, if this cap is not reached the end date of the CMP395 BSUoS Support Scheme will be 31 March 2023 (whichever is earliest).

As the ESO may not have all finalised data before recovery commences, they proposed the following:

- Recovery commences on 1 April 2023;
- On 8 April 2023, ESO will publish the total cost for the CMP395 scheme. This will be made up of SF and II data; and
- On 28 April 2023, ESO will publish an updated figure to recover following all SF data being available.

The ESO Workgroup Member stressed the importance of recovery of any deferred costs by 31 March 2024 as this ensures that the ESO will have the right level of credit facilities available to adequately manage its regulatory cash timing risks and is not reliant on support from the National Grid Group to cover any of these risks. This is particularly important because of the planned complete separation of ESO from National Grid Group by 2024, through the creation of the Future System Operator organisation. Recovery of costs beyond the 2023/2024 charging year would also limit ESO's ability to provide a meaningful level of support to BSUoS fixed tariffs which ESO expect will be implemented from 1 April 2023.

**Generators to pay an equal proportion of the deferred BSUoS costs in Charging Year 2023/2024**

The Workgroup noted CMP308, which comes into effect on 1 April 2023 removes the payment of BSUoS cost incurred from that date from Generators. Without an appropriate mechanism in place the deferral of BSUoS costs to 1 April 2023 could represent a cost transfer from Generators to Consumers (£125m if £250m limit). The majority of Workgroup Members agreed that Generation would need to pay their share of the deferred BSUoS charges and the Proposer re-iterated it was not the intention for Generators to avoid these costs but to limit volatility, increase market liquidity and reduce the BSUoS risk premia. There was an observation that if these costs were levied on Generators from 1 April 2023, ultimately consumers would still pay these as Generators would seek to recoup the deferred costs through wholesale power prices.

The Workgroup explored options as to how Generators could pay their share of the deferred costs from 1 April 2023 noting that Generators will not pay BSUoS incurred from 1 April 2023 due to the introduction of CMP308.

| Option Number | Option Detail | Workgroup Comments |
|---|---|---|
| **1** | Update the STAR system to include generators | In line with recovery principle under CMP345, CMP350 and CMP381; however Generators don't pay BSUoS from 1 April 2023 due to CMP308 and therefore ESO would need to update the new Billing system (STAR) to include generator pay back.<br><br>The ESO Workgroup Member outlined that this is not feasible as the system is already in development and does not include generator volumes. Amending the system now would be costly, and risk the implementation of CMP308 and CMP361/362 |

| | | |
|---|---|---|
| **2** | Use the existing CAB system | In line with recovery principle under CMP345, CMP350 and CMP381; however Generators don't pay BSUoS from 1 April 2023 due to CMP308 and therefore ESO would need to update the current Billing system (CAB) to include generator pay back. There would be a cost to update the system and this is not a feasible option.<br><br>The ESO Workgroup Member outlined that this option would entail fairly substantial updates to run alongside STAR from April 2023 with generator only tariff for this recovery. The Fixed tariff for suppliers in STAR, and a variable tariff for generators in CAB creates complexity for system updates and billing. It was noted that previous caps have been done offline and not through CAB. CAB has not been previously updated with the cap during the cap period. The deferral amount has been added to the cost element during recovery. |
| **3a** | Manual billing of generators – track BSUoS charges over the cap, defer these to April 2023 and manually bill a monthly amount to each generator that has been deferred. Each generator to pay back the same amount in 2023/2024 that they had originally deferred from 2022/2023. | Manual billing process was followed for CMP345, CMP350 and CMP381 – would need ESO resource to administer.<br><br>Some Workgroup Members believe that targeting the costs will undermine the benefit of CMP395 as the BSUoS deferred, in any given Settlement Period, would still need to be included into generator's short-run marginal cost during the implementation period of the BSUoS cap. The BSUoS risk premia would therefore also continue to be included in order to mitigate the risk of not having recovered sufficient costs from the wholesale market. A Supplier highlighted that individual generators seeking to recover costs from the wholesale market from April 2023 would result in significant market distortion. |
| **3b** | Manual billing of Generators - charge the deferred BSUoS amounts from 2022/2023 for the charging year 2023/2024 based on the new volumes for 2023/2024. This would be recovered via an identical amount per day that is allocated to Settlement Periods on a | Liabilities from 2022/2023 will potentially be paid for by other Generator users but is in line with recovery principle under CMP345, CMP350 and CMP381.<br><br>Some Workgroup Members believe that BSUoS risk premia, above the cap, that would have been included in Short Run Marginal Cost they offer into the market will not remain with this option. Therefore, arguably overall BSUoS costs would be reduced. |

| | | |
|---|---|---|
| | chargeable volume weighted basis (as was done for CMP381). | |

The Proposer, the majority of Workgroup Members and 10 out of 12 respondents to the Workgroup Consultation, prefer Option 3b and suggested that recovery of the generator cost should be carried out over 9 months (1 April 2023 to 31 December 2023) to avoid the need for further reconciliation in 2024/2025.

Option 3b and recovery of the generator cost over 9 months (1 April 2023 to 31 December 2023) is a feature of all the solutions except the solutions that propose a Supplier only BSUoS Cap (none of which were taken forward as Workgroup Alternative CUSC Modifications).

**For Suppliers, recover an identical amount per day that is allocated to Settlement Periods on a chargeable volume weighted basis or in line with CMP361/CMP362 if implemented by 1 April 2023**

The Workgroup supported:

- Recovering an identical amount per day that is allocated to Settlement Periods on a chargeable volume weighted basis.
    - The costs recovered in each settlement day are the same and the costs are volume weighted across the day through each settlement period i.e. when volume is highest in the day, the largest proportion of costs are recovered
    - This is how the majority of BSUoS charges work in Business As Usual and is how CMP381 is being recovered. Note that CMP381 recovery finishes on 31 March 2023.

- Recovery would start from 1 April 2023 which would be based on a forecast if the actual deferred costs are not known at this date.

The main reasons are:

- This in line with the approach used on CMP381;
- Appears to be fairer as this is the process as set out in the charging methodology in CUSC today for costs which are not incurred in a specific settlement period;
- Provides more certainty for BSUoS payers as to what they will be charged; and
- Minimises any distortion by spreading them across as many Settlement Periods as possible as Balancing Services feed into Imbalance costs. By not weighting costs for low volume Settlement Periods, the distortion will be bigger. The ESO Workgroup Member did note that there is a distributional impact of this approach in so far that if a party generates more in 2022/2023 then in 2023/2024, they will pay back less than they had incurred (and vice versa) as is the case for CMP381.

**Limit the liability on the ESO to £250m**

The Workgroup noted there is a limit to the amount of deferral cost that could be financed by the ESO and that Ofgem have a statutory duty to ensure that the ESO are financeable and can fulfil their licence requirements. The ESO's position is that the total costs which can be deferred are to be limited to £250m and therefore the Proposer has included this limit in their CMP395 Original Proposal. Offering £250m support would still allow the ESO to support BSUoS fixed tariffs in 2023/2024 as long as the recovery of the deferred costs starts from 1 April 2023. The ESO Workgroup Member also noted that recovery of these deferred costs must be completed by 31 March 2024 to position the ESO to fully manage its regulatory cash flow risks and help enable the transition to Future System Operator.

The scheme will end if the £250m limit has been reached. This is consistent with the proven approach adopted for CMP381. The £250m cap includes the ESO's financing and administration costs.

The ESO Workgroup Member also noted that they are open to providing support to industry; however currently the ESO has other financial commitments, which makes this level of support, at short notice, very challenging for a legally separate asset light company. These include:

- Being exposed to significant cashflow risk this winter because of high Grid Trade Master Agreement (GTMA) costs which are cash negative in the short term and winter contingency contracts for which the majority of cost is incurred prior to recovery from 1 October 2022. A Workgroup member noted that the cash flow implications of the GTMA, such as the high interconnection costs, which was one of the key factors that could feed into their ability to offer more than £250m. The Workgroup Member added that this in turn may not be sufficient to increase confidence in BSUoS costs over the implementation period; and
- To fund £250m the ESO is reliant on National Grid Group to fund any regulatory timing risks ESO would normally be able to accommodate within its working capital facility. The assumption for this limit is that the recovery occurs in 2023/2024. If recovery goes beyond this timeframe, the ESO would need to recalculate the amount available.

The ESO concluded that the maximum support they can provide is £250m and they believe this provides a significant level of support to industry whilst ensuring that the ESO can also maintain its existing commitments especially as National Grid Group will be funding the ESO's regulatory timing risks, which wasn't the case under CMP381. The ESO must also continue to fulfil its licence obligations around sufficiency of resources and maintaining an investment grade credit rating.

There was a general recognition within the Workgroup that the £250m limit is in line with what ESO can reasonably provide at this time. However, some Workgroup Members (and some respondents to the Workgroup Consultation) saw £250m limit as a good starting point but would like to see the ESO and Ofgem seek more innovative funding arrangements such as from HM Treasury, to increase the limit significantly above £250m (albeit not within this Modification as given the timing of the proposed support, it was agreed that this was not a viable option to progress for this particular modification).

None of the proposed options specifically seek a deferred limit > £250m; however, some Workgroup Members stressed that it is important that discussions continue between ESO and Ofgem on options to increase support available for the industry and WACM5, if approved by Ofgem, could in practice provide for an increase to the deferred limit of £250m at short notice without the need for a subsequent Modification.

**There will be daily reporting of the percentage utilisation of the deferred amount**

**CMP395 BSUoS Support Scheme will fall away on the earlier of 31 March 2023 or when the £250m limit has been reached.**

The Workgroup supported daily reporting, in line with that introduced for CMP381, to show how close to the £m limit, the additional BSUoS costs were.

The ESO will, under reasonable endeavours, provide notification that the total support limit is likely to be reached within 2 working days, however, this may mean that the CMP395 BSUoS Support Scheme ends sooner, or later, depending on when the limit is reached. To ensure that this scheme isn't ended early due to forecasting a cluster of high cost periods which may not materialise, the ESO Workgroup Member clarified that the CMP395 BSUoS Support Scheme will be ended in the Settlement Period immediately prior to the one in which the £m limit was exceeded.

This reporting is a feature of all the proposed solutions.

## Workgroup Consultation summary

The Workgroup held their Workgroup Consultation between 26 August 2022 and 1 September 2022 and received 13 responses (12 non-confidential and 1 confidential response). A summary of the 12 non-confidential responses and the full non-confidential responses can be found in Annexes 6 and 7 respectively. In summary:

- 11 out of 12 respondents were supportive of a BSUoS cap although 1 of these prefers a Supplier only Cap as they argue that Generators can participate in a wider range of markets and products and can flex their pricing within the shorter-term priced products. The other respondent does not support the need for a BSUoS cap and argues there is insufficient evidence that this is in consumers interests overall and without this change generators and suppliers would going out of business. This latter point is echoed by 1 other respondent.

- The level of BSUoS cap proposed ranged from £15/MWh to £40/MWh and sought to strike the right balance between seeking to ensure the cap is not set too high and seeking to ensure that the £250m (or higher limit as suggested by 4 respondents) lasts for the duration of the winter period. The numbers proposed by respondents depend on their view on how much reduced risk premia would lead to reduced overall BSUoS costs and whether or not the ESO's BSUoS forecast is too conservative (given previous utilisation).

- General recognition that the £250m limit is in line with what ESO can reasonably provide but 4 out of 12 respondents see this as a good starting point and would like to see the limit increased (albeit not necessarily within this Modification).

- Clear consensus (11 out of 12 respondents) to recover deferred costs from 1 April 2023 to 31 March 2024 and to utilise the same reporting against the deferred limit as per CMP381.

- Limited support (3 out of 12 respondents) for an in period reassessment of the BSUoS Cap as process complexity and potentially undermining the risk reducing element of CMP395 outweighs the desire to ensure the support is maximised.

- Limited support for a Supplier only BSUoS cap (only 1 advocate and 7 respondents against this) with the distortive impact and the argument that this would not reduce risk premia being applied by generators and therefore result in continued high wholesale and Balancing Mechanism costs outweighing the simpler implementation and the increased likelihood of the support being in place for the duration of the support period.

- Majority of respondents (10 out of 12) believed that a BSUoS cap will allow some generators and suppliers to reduce the risk premia included within their prices and that any reduction should reduce the overall BSUoS costs by passing through to consumers bills. However, 2 of these respondents also noted that the benefit depends on generators' and suppliers' pricing strategies.

## Workgroup Alternatives

Following review of the Workgroup Consultation responses, the Workgroup assessed the CMP395 Original and any potential solutions brought forward by the Workgroup which built on the CMP395 Original by:

- Varying the BSUoS price cap; and/or
- Limiting the BSUoS price cap to Suppliers only; and/or
- Introducing a reassessment of the BSUoS price cap

For completeness, we have shown how these other solutions compare with CMP395 Original and where their key components are discussed in this document:

| Other Solutions | BSUoS Price Cap | Reassessment of BSUoS Price Cap? | Applies to Generators and Suppliers or Suppliers only? |
|---|---|---|---|
| ***CMP395 Original*** | *£15/MWh* | *No* | *Generators and Suppliers* |
| ***CMP395 Request for Alternative 1*** | *£25/MWh* | *No* | *Generators and Suppliers* |
| ***CMP395 Request for Alternative 2*** | *£30/MWh* | *No* | *Generators and Suppliers* |
| ***CMP395 Request for Alternative 3*** | *£40/MWh* | *No* | *Generators and Suppliers* |
| ***CMP395 Request for Alternative 4*** | *£25/MWh* | *Yes – by ESO* | *Generators and Suppliers* |
| ***CMP395 Request for Alternative 5*** | *£15/MWh* | *No* | *Suppliers only* |

| | | | |
|---|---|---|---|
| ***CMP395 Request for Alternative 6*** | *£25/MWh* | *No* | *Suppliers only* |
| ***CMP395 Request for Alternative 7*** | *£15/MWh* | *Yes – by Ofgem* | *Generators and Suppliers* |

The Workgroup reviewed all of these proposed solutions and following, this review, all seven of these were voted on and five were taken forward by the Workgroup. The Request for Alternative 3 did not receive majority support from the Workgroup. However, the Chair noted that a £40/MWh BSUoS price cap could ensure that the £m deferred limit is not reached too quickly and therefore could provide protection for the whole period to the 31 March 2023. Therefore, it is possible that the Request for Alternative 3 may better facilitate the overall objectives than the Original for some market participants and it would be prudent to present this option to Ofgem. The Chair therefore decided that this should be progressed as WACM3.

The Requests for Alternative 5 and 6 also did not receive majority support from the Workgroup and in this case the Chair did not save these as, in his view, this could create market distortions and it seems more appropriate to offer the same support to both parties that pay BSUoS and noted that under all other options Generators would pay back the deferred costs (albeit the recovery process is more complex than a Supplier only recovery process).

The following table summarises which requests for Alternatives became Workgroup Alternative CUSC Modifications:

| Other Solutions | BSUoS Price Cap | Reassessment of BSUoS Price Cap? | Applies to Generators and Suppliers or Suppliers only? | WACM? |
|---|---|---|---|---|
| ***CMP395 Original*** | *£15/MWh* | *No* | *Generators and Suppliers* | *N/A as Original* |
| ***CMP395 Request for Alternative 1*** | *£25/MWh* | *No* | *Generators and Suppliers* | *Yes – WACM1* |
| ***CMP395 Request for Alternative 2*** | *£30/MWh* | *No* | *Generators and Suppliers* | *Yes – WACM2* |
| ***CMP395 Request for Alternative 3*** | *£40/MWh* | *No* | *Generators and Suppliers* | *Yes – WACM3* |
| ***CMP395 Request for Alternative 4*** | *£25/MWh* | *Yes – by ESO* | *Generators and Suppliers* | *Yes – WACM4* |
| ***CMP395 Request for Alternative 5*** | *£15/MWh* | *No* | *Suppliers only* | *No* |
| ***CMP395 Request for Alternative 6*** | *£25/MWh* | *No* | *Suppliers only* | *No* |
| ***CMP395 Request for Alternative 7*** | *£15/MWh* | *Yes – by Ofgem* | *Generators and Suppliers* | *Yes – WACM5* |

## Legal Text

The Legal text can be found in Annex 10.

Note that, as per the Legal Text, the ESO will confirm from April 2023 (once the actual BSUoS costs incurred between 1 October 2022 and 31 March 2023 are known), what percentage of the deferred BSUoS costs will be recovered from Generators and Suppliers. The current expectation is that this will be 55% to Suppliers and 45% to Generators – the reason this is not 50/50 is because Interconnectors and Distribution Network Operators do not pay BSUoS. Although the percentage split is unlikely to change materially, the Workgroup agreed on balance that it is better for ESO to confirm the percentage split (once the actual BSUoS costs incurred between 1 October 2022 and 31 March 2023 are known) rather than hard-code the percentage split now or base it on Winter 2022 costs, which arguably are not directly comparable.

## What is the impact of this change?

### Proposer's assessment against Code Objectives

| Proposer's assessment against CUSC Charging Objectives | |
|---|---|
| **Relevant Objective** | **Identified impact** |
| (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; | **Positive**<br>At the current time there is a risk Consumers, Suppliers and Generators could go out of business as they try to manage these costs. |
| (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); | **Neutral** |
| (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; | **Positive**<br>Developments have made BSUoS charges a significant risk to energy companies and customers, this will help protect them and lower overall costs to consumers. |
| (d) Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency *; and | **Neutral** |

| | |
|---|---|
| (e) Promoting efficiency in the implementation and administration of the system charging methodology. | **Neutral** |
| *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. | |

## Workgroup assessment of Impacts

**Consumers**

The Workgroup identified different Consumer groups and summarised the impacts in the table below:

| Consumer Categories | With CMP395 | Without CMP395 |
|---|---|---|
| **Domestic – on Default Tariff Cap** | Recovery of exceptional costs from October 2022 – March 2023 spread over 2.5 years from April 2023. Could reduce price impact from April 2023 to March 2024; however, price impacts in subsequent cap periods would need to increase to compensate. | Recovery of exceptional costs from October 2022 – March 2023 spread over 18 months from April 2023. Could increase price impact from April 2023 to September 2024; however, there would be no price impact in subsequent cap periods. |
| **Domestic – not on Default Tariff Cap** | Not see any change until the end of their fixed tariff. Future fixed tariff may include deferred costs associated with CMP395 but may also include lower risk premia as a result exceptional costs addressed by CMP395 | Not see any change until the end of their fixed tariff. Future fixed tariff will not include costs associated with CMP395 but may include higher risk premia as a result of exceptional costs not addressed by CMP395 |
| **Non-Domestic – Not BSUoS cost pass through** | Not see any change until the end of their fixed tariff. Future tariff may include deferred costs associated with CMP395 but may also include lower risk premia as a result of exceptional costs addressed by CMP395 | Not see any change until the end of their fixed tariff. Future fixed tariff will not include costs associated with CMP395 but may include higher risk premia as a result of exceptional costs not addressed by CMP395 |
| **Non-Domestic – BSUoS cost pass through** | Exceptional Winter 2022 BSUoS costs deferred to be recovered in a predicable manner in 2023/2024 directly charged to the Consumer | Continued exceptional BSUoS prices for Winter 2022 but lower BSUoS costs in 2023/2024 directly charged to the Consumer. Allows for excess costs to be budgeted in 2023/2024. |

In summary, Consumers will be impacted differently but may in general end up paying higher costs in the short term (to the extent that improved cost pass-through is achieved and is not offset by the benefit of the removal of risk premia in balancing offers submitted by Generators) but with potential longer-term benefits through reduced risk premia, reflecting the reduced risk associated with the recovery of efficiently incurred costs.

The short-term consumer impact is arguably lower if less costs are deferred into 2023/2024; however, it is in the long-term interests of consumers that the market operates effectively and Suppliers and Generators are able to recover efficiently incurred costs.

A Workgroup Member did raise the impact of asking future consumers to pay for current consumption and whether this was reasonable. The ESO Workgroup Member also noted this is the 4th BSUoS cap Modification raised, and questioned how long and often exceptional costs are deferred for.

A respondent to the Workgroup Consultation was not supportive of any BSUoS Cap as insufficient evidence that this is in consumers interests overall and that this would lead to generators and suppliers going out of business. In their view, there is a clear benefit to generators, suppliers and those on BSUoS pass through terms but general consumer benefits are speculative. They further argued that Ofgem factored in the risk of supplier failure when deciding to the change the frequency of the price cap update to quarterly, and in the treatment of backwardation costs[8] in the price cap. However, some Workgroup Members noted that whilst the wholesale price element was addressed, the BSUoS element was not and added that the BSUoS allowance under the Supplier Variable Tariff cap for October 2022 to March 2023 is £7.66/MWh compared to the ESO September BSUoS forecast of an average of ~ £15/MWh.

**Suppliers**

As Suppliers have sold many fixed price products without these exceptional BSUoS prices taken into account, they could be exposed to significant losses without this mitigation. In the current retail market this could drive more Suppliers to leave the market, thereby reducing competition and therefore competitive forces which keep prices as low as possible for customers. Where customers are on the Default Tariff, the price cap will provide Suppliers with a BSUoS allowance of £7.66/MWh until March 2023. This compares to the ESO forecast for October 2022 to March 2023 of £15.16/MWh (September 2022 forecast). Suppliers with customers on the Default Tariff are therefore exposed to a significant shortfall attributable to the current high BSUoS forecast. Suppliers with a higher percentage of Customers on the Default Tariff Cap will experience more of an adverse impact and hence this will distort competition. Any deferral will need to be recovered in a subsequent period in which Suppliers may also have contracted with customers at prices which will not have included deferred costs. This could also distort competition, albeit volumes contracted in future periods will, in aggregate, be much lower than those for the near future.

Further Supplier failures would place unprecedented pressure on different parts of the industry and so could have unforeseen whole-system consequences. Information about

[8] *Backwardation costs are a result of the difference between the index used to set the cap level and the way suppliers are able to purchase energy for their cap customers*

the likelihood of BSUoS costs driving supplier failure is difficult to quantify as this is commercially sensitive information for individual organisations. This information could be shared with Ofgem directly, should parties wish to. CMP395 could arguably also lead to fewer Supplier failures that would have otherwise occurred and which would have led to greater costs for consumers, and further disruption of the market.

Deferring costs to a future period will allow Suppliers to reflect a portion of these costs into future tariff offerings. This portion will be paid by consumers and would represent a transfer of cost from suppliers to consumers. However, such protection would reduce the level of risk that will need to be factored into future tariffs and facilitate effective competition in the generation and supply of electricity and as a result, lower the long-term costs to consumers. A respondent to the Workgroup Consultation believes that Consumer benefits arising from the reduction in supplier risk premia is also currently limited (in comparison to previous modifications) as the majority of domestic customers are likely to now be under the retail price cap (and so not subject to supplier risk premia). A Workgroup Member responded that whilst it is the case that risk premia won't reduce in the short term for those customers on Supplier Variable Tariffs, CMP395 will help provide Suppliers' with some relief from these exceptional events and their expectation is that more customers will move to fixed tariffs when the current market conditions settle down.

Some Workgroup Members referenced the fact that on 5 September 2022, a Business to Business Supplier had taken the decision to reopen their Fixed Price Contracts, which they argued demonstrates the need for support as a Supplier, in a competitive environment, would not such decisions lightly.

**Suppliers – Impact on Default Tariff Cap**

Suppliers currently operate under a tariff cap regime for domestic customers. The Default Tariff Cap sets a maximum amount that can be charged for a typical domestic customer on a default tariff i.e. a standard variable tariff or a default fixed term or prepayment tariff.

The Supply Licence (Condition 28AD) and supporting annexes set out the methodology for calculating the level of the Default Tariff Cap. The tariff cap is currently scheduled to expire on 31 December 2023. At the beginning of every February and August, Ofgem publish the level of the cap for the forthcoming charge restriction period, which run from April to September (Summer) and October to March (Winter). The cap provides allowances for wholesale costs and network costs (including BSUoS), as well as for other costs, and is set at a level which reflects Ofgem's view of efficient costs. Note that whilst Ofgem have recently decided to update the cap on a quarterly basis, the allowance relating to BSUoS will continue to be updated only twice a year (in February and August).

The BSUoS element of the tariff cap methodology is currently set on a lagged pass-through basis. Specifically, the BSUoS allowance is derived using a volume weighted average of BSUoS charges in £/MWh in each settlement period across the preceding year ahead of publication of the tariff cap level. The summer (April-September) tariff cap(s) use BSUoS data from the previous calendar year and the winter tariff cap(s) (October-March) use BSUoS data from 1 July in the previous year to 30 June. This weighted average charge is then uplifted by forecast losses before being multiplied by annual domestic consumption to provide the BSUoS allowance in the tariff cap.

Should CMP395 be implemented, the amount of BSUoS costs deferred would be recovered between 1 April 2023 and 31 March 2024, and this would flow through to the Default Tariff Cap over two years starting from October 2023. If CMP395 is not implemented, the amount that would have been deferred would instead be recovered over 18 months starting from 1 April 2023.

Assuming that £250m would be deferred under CMP395, this is illustrated in the following example:

| | Oct-22 - Dec-22 | Jan-23 - Mar-23 | Apr-Jun 2023 | Jul-Sep 2023 | Oct-Dec 2023 | Jan-Mar |
|---|---|---|---|---|---|---|
| Amount Deferred (£m) | -£125 | -£125 | | | | |
| Amount Recovered (£m) | | | £63 | £63 | £63 | £63 |

| | Latest Price Cap Model |
|---|---|
| Industry BSUoS Volume (MWh) pre CMP308 | 500,365,147 |
| Industry Volume (MWh) post CMP308 | 276,200,000 |
| Domestic consumption (MWh) | 3.1 |
| BSUoS losses adjustment (%) | 110% |

| | | Amount included in cap | |
|---|---|---|---|
| Impact on Price Cap | Data used | Status Quo | CMP395 |
| 2023-24 Summer | Jan-22 to Dec-22 | £125 | £0 |
| 2023-24 Winter | Jul-22 to Jun-23 | £250 | £63 |
| 2024-25 Summer* | Jan-23 to Dec-23 | £125 | £188 |
| 2024-25 Winter* | Jul-23 to Jun-24 | £0 | £188 |
| 2025-26 Summer* | Jan-24 to Dec-24 | £0 | £63 |

*assuming price cap is extended beyond current scheduled end date

**Generators**

- Generators who are active in the Balancing Mechanism will have to price in BSUoS risks into their costs. The recent increase in BSUoS volatility has increased the risk premia that generators add to their offer prices in the forward market and the Balancing Mechanism. Therefore CMP395 could have a material impact on offer prices by removing uncertainty in expected BSUoS costs above a certain £/MWh threshold. This should reduce offer prices and provide benefits to all (reduced risk to Generators offering services and reduced BSUoS costs for generators, suppliers and consumers). However,
    - there is no available analysis to support what reduction there could be and given the commercial nature of this, industry were asked to consider submitting any specific analysis on this directly to Ofgem. A Workgroup Member argued illustratively that a £1/MWh reduction in BSUoS risk premia added by Generators could be equivalent to ~£4.3 million benefit to consumers across 1GWh of Winter 2022 hedging[9];
    - This depends on generators' and suppliers' pricing strategies and some may have already locked in BSUoS assumptions (e.g. may have already sold power for this winter with risk premia priced in) limiting their ability to respond. Some Workgroup Members argued that if the £m deferred limit only lasts for part of the support period, generators wouldn't change their bidding strategies.

[9] Assumes 0.5GW average demand * 181 days * 24 hours (spread between Generators and Suppliers)

- Generators in Great Britain are faced with these sudden and substantial additional costs which they are unable to fully recover in the wholesale market given forward trading timescale and arguably could cease trading or operating which, could impact on the security of the electricity system. However, there is no current evidence that that generators would cease trading or operating. The Proposer argued that with costs coming in significantly higher than expected and not fed into power prices, this is a current risk.

- The effects on Generators will depend on their contractual positions.

    - Those who have contracted a significant amount of their power over the long term will benefit either by relieving losses resulting from under-forecasting BSUoS or providing additional gains in periods when BSUoS was anticipated correctly.
    - Those operating in shorter term markets such as day-ahead, intraday and the Balancing Mechanism would not have to factor in a potential BSUoS cost of currently up to £170/MWh[10] into their offer prices, thereby providing the opportunity to lower their offer prices. It has been established by the BSUoS Taskforces and the implementation of CMP308 that BSUoS charges are not cost reflective, so there are no efficiency losses by implementing a BSUoS cap.

**Traders**

- Any changes to BSUoS impact wholesale prices. Impact wholesale prices, by virtue of reduced risk premia; and

- Likewise, the carryover of £250m into 2023/2024 will impact forward prices.

**ESO**

- The £250m deferral, proposed in the CMP395 Original represents a significant cashflow risk for ESO and reported financial loss of up to £250m for FY23. This will be rectified in FY24 as a £250m profit. In general, under a lower BSUoS price cap, this cost will increase, increasing the exposure of the ESO. This could have an impact on future financeability.

- The ESO Workgroup Member stated that the maximum that the ESO is able to finance is £250m. Some Workgroup Members argued that the ESO was part of the wider National Grid group and believes there is opportunity to seek further finance up to the limit required by the CMP395 Original Proposal. However, to fund £250m the ESO is reliant on National Grid Group to fund any regulatory timing risks that ESO would normally be able to accommodate within its working capital facility.

- The re-introduction of a BSUoS cap to the total amount of deferred BSUoS costs will add an additional step to the ESO's process and will require additional monitoring by the ESO. This will increase the resource requirements in the revenue team for both daily reporting and increase HMRC reporting (due to increased

[10] £170/MWh prices were seen on 20 July 2022 (£169.736540 for Settlement Period 37; and £170.520190 for Settlement Period 38)

settlement periods where the cap is breached). However, this is not expected to be difficult to implement as was already implemented for CMP345, CMP350 and CMP381.

- Special Condition 4.2.2 of ESO's Licence talks about the inputs to the calculation of external costs of the Balancing Services Activity and has an end date of March 2022. It is possible that a licence change for collecting the costs will be required. ESO believe that deferring the costs doesn't require a licence change.

## Workgroup vote

The Workgroup met on 8 September 2022 to carry out their Workgroup Vote. 11 Workgroup Members voted, and the full Workgroup vote can be found in Annex 11. The tables below provide:

The tables below provide:

- a summary of how many Workgroup members believed the Original and each of the 5 WACMs were better than the Baseline; and
- a summary of the Workgroup members view on the best option to implement this change.

The Applicable CUSC (charging) Objectives are:

**CUSC charging objectives**

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) To promote 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.*

**Assessment of the Original and WACM1 to WACM5 inclusive vs Baseline**

The Workgroup unanimously concluded that WACM4 better facilitated the Applicable CUSC Objectives than the Baseline and by majority concluded that the Original, WACM1, WACM2, WACM3 and WACM5 better facilitated the Applicable CUSC Objectives than the Baseline.

| Option | Number of voters that voted this option as better than the Baseline |
|---|---|
| Original | 10 |
| WACM1 | 10 |
| WACM2 | 9 |
| WACM3 | 9 |
| WACM4 | 11 |
| WACM5 | 10 |

**Best Option**

| Workgroup Member | Company | BEST Option? | Which objective(s) does the change better facilitate? (if baseline not applicable) |
|---|---|---|---|
| Graz Macdonald | Waters Wye (on behalf of Saltend Cogeneration Company Ltd | Original | a, c |
| Karen Thompson - Lilley | National Grid ESO | WACM3 | a, b |
| Paul Youngman | Drax | WACM1 | a, c |
| Phil Broom | Engie | WACM1 | a |
| Simon Vicary | EDF Energy | Original | a, b, c |
| Sean Gauton | Uniper | Original | a |
| Ryan Ward | Scottish Power Renewables | WACM5 | a |
| George Moran | Centrica | WACM4 | a, c |
| Damian Clough | SSE Generation Ltd | WACM5 | a, c |
| Niall Coyle | E-ON | WACM1 | a |
| Iwan Hughes | VPI Immingham | WACM2 | a, c, e |

## When will this change take place?

**Implementation date**
From the first Settlement Period (00:00 – 00:30) on 1 October 2022 if approved on 28 September 2022 (or such later date as the Authority may specify).

**Date decision required by**
28 September 2022

**Implementation approach**
From the first Settlement Period (00:00 – 00:30) on 1 October 2022 if approved on 28 September 2022 (or such later date as the Authority may specify).

## Interactions

| | | | |
|---|---|---|---|
| ☐Grid Code | ☐BSC | ☐STC | ☐SQSS |
| ☐European Network Codes | ☐ EBR Article 18 T&Cs[11] | ☐Other modifications | ☐Other |

No interactions identified.

## How to respond

### Code Administrator consultation questions

- Do you believe that the Original Proposal and/or WACM1, WACM2, WACM3, WACM4 and WACM5 better facilitates the Applicable Objectives?
- Do you support the proposed implementation approach?
- Do you have any other comments?

Views are invited on the proposals outlined in this consultation, which should be received by **5pm** on **16 September 2022.**

Please send your response to cusc.team@nationalgrideso.com using the response pro-forma which can be found on the CMP395 modification page.

*If you wish to submit a confidential response, mark the relevant box on your consultation proforma. Confidential responses 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.*

[11] If the modification has an impact on Article 18 T&Cs, it will need to follow the process set out in Article 18 of the Electricity Balancing Regulation (EBR – EU Regulation 2017/2195) – the main aspect of this is that the modification will need to be consulted on for 1 month in the Code Administrator Consultation phase. N.B. This will also satisfy the requirements of the NCER process.

## Acronyms, key terms and reference material

| Acronym / key term | Meaning |
|---|---|
| BM | Balancing Mechanism |
| BSC | Balancing and Settlement Code |
| BSUoS | Balancing Services Use of System (charges), as set out in Section 14 of the CUSC. |
| CMP | CUSC Modification Proposal |
| CUSC | Connection and Use of System Code |
| EBR | Electricity Balancing Regulation |
| ESO | Electricity System Operator (often referred to as 'NGESO' or more formally in the CUSC as 'The Company') |
| FY | Financial Year |
| II | Interim Initial |
| SF | Settlement Final |
| STC | System Operator Transmission Owner Code |
| SQSS | Security and Quality of Supply Standards |
| SVT | Supplier Variable Tariff |
| T&Cs | Terms and Conditions |
| TCMF | Transmission Charging Methodologies Forum |
| TNUoS | Transmission Network Use of System Charges |
| WACM | Workgroup Alternative CUSC Modification |

### Reference material

- None provided

## Annexes

| Annex | Information |
|---|---|
| Annex 1 | Proposal form |
| Annex 2 | Terms of Reference |
| Annex 3 | Urgency letters |
| Annex 4 | CMP395 ESO Analysis |
| Annex 5 | CMP395 Workgroup Member Analysis |
| Annex 6 | Workgroup Consultation Responses |
| Annex 7 | Workgroup Consultation Responses Summary |
| Annex 8 | Workgroup assessment of potential Alternative solutions |
| Annex 9 | CMP395 Workgroup Alternative CUSC Modifications |
| Annex 10 | Legal Text |
| Annex 11 | Workgroup Vote |