

Modification proposal:	<b>Connection and Use of System Code (CUSC) Modification Proposal (CMP) 361 - BSUoS Reform: Introduction of an ex ante fixed BSUoS tariff</b>		
Decision:	The Authority <sup>1</sup> directs that Workgroup Alternative CUSC Modification Proposal (WACM) 3 be made <sup>2</sup>		
Target audience:	National Grid Electricity System Operator (NGESO), Parties to the CUSC, the CUSC Panel and other interested parties		
Date of publication:	15 December 2022	Implementation date:	1 April 2023

## Introduction

This Decision carries the following structure:

- Background
- The modification proposal
- CUSC Panel recommendation
- Ofgem consultations
- CMP406 and CMP407
- Our decision
- Reasons for our decision
- Next steps

## Background

BSUoS (Balancing Services Use of System) charges are the means by which National Grid Electricity System Operator (NGESO) recovers the costs associated with balancing the electricity transmission system. BSUoS charges are currently recovered from Suppliers

<sup>1</sup> References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

<sup>2</sup> This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

and Large Generators<sup>3</sup> based on the amount of energy imported or exported onto the network (£/MWh) within each half-hour period.

Earlier this year, we approved CMP308 (Removal of BSUoS Charges from Generation) which means that from 1 April 2023 BSUoS charges will be recovered solely from Final Demand.<sup>4</sup>

The magnitude of the current volumetric charge can vary significantly from period to period, and can fall below £0/MWh or reach prices of over £100/MWh. Due to the range, and the fact that BSUoS costs are not known at the time of electricity delivery, risk premia are also present in contracts where BSUoS costs are included.

The second Task Force recommended<sup>5</sup> that BSUoS be paid solely by Final Demand, and also that it should be levied in the form of a flat volumetric £/MWh charge that was known to users in advance and was of a fixed level for a set period.

The key reasons for their conclusions that BSUoS should be levied in the form of an ex ante flat volumetric £/MWh charge were that:

- BSUoS costs reflect that this service has significant energy cost drivers, unlike asset related costs such as Transmission Network Use of System or Distribution Use of System charges, and as such are more suited to fixed or capacity charges;
- Volumetric charges, being broadly similar to the existing method, avoid significant distributional impacts or charge redistribution;
- Charging BSUoS on volumes is simple and relatively transparent, aiding understanding and implementation; and
- While fixed charges are less avoidable than volumetric charges, volumetric charges do not include the “cliff edges” that come with banded charges which can lead to strong incentives at the margins of bands.

In December 2020, we published an open letter that supported the second Task Force’s recommendations in principle, whilst recognising that quantitative analysis as to the overall impacts of the reforms would be required to inform a final decision.

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<sup>3</sup> Large Generators are those generators that are directly connected to the transmission network and generators that are connected to the distribution network with capacities greater than 100MW. Interconnectors and distribution connected generation smaller than 100MW do not face BSUoS charges

<sup>4</sup> [Decision on CMP308: Removal of BSUoS charges from Generation](#)

<sup>5</sup> <https://www.chargingfutures.com/media/1477/second-balancing-services-charges-task-force-final-report.pdf>

## The modification proposal

In February 2021, NGENSO raised CMP361 and CMP362 to give practical effect to the Task Force's ex ante BSUoS recommendation.

CMP361 proposes to amend Section 14 of the CUSC to deliver a BSUoS tariff which:

- i) is set prior to the charging period to which it relates;
- ii) is fixed for a period within a charging year, or is fixed for the entire charging year; and
- iii) is set by reference to a specific level of certainty (the 'P Level').

The scope of CMP361 further extends to the funding arrangements required for NGENSO to set a BSUoS tariff without undermining its financial stability.

CMP362 proposes changes to Section 11 of the CUSC to introduce or amend definitions of terms included within Section 14 and is therefore contingent on CMP361. This decision relates solely to CMP361. A separate decision to approve CMP362 has been published today.

CMP361 resulted in seven Workgroup Alternative CUSC Modifications (WACMs) alongside the Original Proposal, collectively referred to in this decision as 'the options'. Each option under CMP361 is differentiated by its approach to the various components of the calculations underpinning the fixed BSUoS tariff. These options and their respective approaches to these components are displayed below.

Ref	Notice Period	Fixed Period	P level	BSUoS Fund	BSUoS Fund recovery period
Original	3 months	12 months	P99	Yes	2 years
WACM1	12 months	3 months	P99	Yes	2 years
WACM2	9 months	6 months	P99	Yes	2 years
WACM3	9 months	6 months	P77	No	N/A
WACM4	12 months	3 months	P77	No	N/A
WACM5	3 months	12 months	P99	Yes	5 years
WACM6	9 months	6 months	P90	Yes	Capped at £25m per year
WACM7	12 months	3 months	P90	Yes	Capped at £25m per year

These different components can be described in the following ways:

- The Notice Period is how far in advance of 1 April in any given charging year the fixed BSUoS tariff is set and shared with industry;
- The Fixed Period is the duration of that fixed BSUoS tariff;
- The P level is a representation of a given proposal's likelihood to provide tariffs that, under normal circumstances once set, will not change, based on the number of years out of 100 that tariffs would be expected to remain certain (ie. a higher P Level is *in principle* less likely to lead to a tariff reset during the Fixed Period than a lower P Level). The P level determines the total combined money required to cover BSUoS under the specified risk level for the Fixed Period;
- The BSUoS Fund is included in some WACMs. It is driven by surplus collection of BSUoS associated with higher P Levels, leading to the build up of a ringfenced reserve "fund" of money to allow it to better manage the cash flow impacts of setting a fixed charge for unpredictable balancing services costs (ie. periods of underrecovery of BSUoS), after NGENSO have utilised their Working Capital Facility. It therefore provides the means by which higher P Levels result in additional certainty that the risk of a tariff reset during the Fixed Period is reduced;
- The BSUoS Fund Recovery Period is the period of time over which any BSUoS Fund should be accrued.

### **CUSC Panel<sup>6</sup> recommendation**

The CUSC Panel met and voted on CMP361 on 25 February 2022. All CMP361 options received majority support as better facilitating the Applicable CUSC Objectives (ACOs) than the Baseline (i.e. the existing provisions of the CUSC). The CUSC Panel further considered that the Original proposal and WACM2 were the best options available.

### **Ofgem consultations**

We have published two consultations with respect to CMP361 and CMP362.

Our first consultation<sup>7</sup> dated 21 September 2022 set out that our minded-to decision was to approve WACM5 of CMP361 (and its counterpart WACM under CMP362), and contained our draft Impact Assessment and quantitative analysis. We considered that this option better facilitated the ACOs than the Baseline and would be consistent with our principal

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<sup>6</sup> The CUSC Panel is established and constituted from time to time pursuant to and in accordance with section 8 of the CUSC.

<sup>7</sup>[CMP361/362 - Minded-to decision and draft impact assessment | Ofgem](#)

objective and other statutory duties. The full rationale for that minded-to position can be found within the published material.

Following our first consultation, on 15 November 2022, we published an additional consultation<sup>8</sup> with respect to the BSUoS Fund element of the proposals. Our draft impact assessment, which we published alongside our minded-to consultation, is informed by the findings of the Workgroup and analytical work carried out by consultants Frontier Economics and LCP. The Frontier/LCP report analysed the system and consumer impacts of the proposed change to the BSUoS regime. Given the information available at the time when the analysis was done, the report did not consider the impact of one of the elements which was later added to some of the CMP361 options, the BSUoS Fund. Our second consultation sought to provide some additional information in respect of the potential costs of the BSUoS Fund.

Owing to the significant incremental costs that implementation of WACM5 would introduce to consumers, resulting from the estimated size of the BSUoS Fund required (>£2bn) to support financing of the current levels of BSUoS, we stated in our second consultation that we supported the concept in principle of a BSUoS Fund but expected NGENSO to bring forward other modification proposals. We highlighted that we were particularly supportive of options with a 3-month Notice Period and a 12-month Fixed Period, but that we thought any new modification proposal(s) should consider the appropriate P Level and therefore<sup>9</sup> BSUoS Fund to reduce the impact to consumer bills.

### **CMP406 and CMP407**

On 22 November 2022, NGENSO brought forward CMP406 and CMP407. These proposals were drafted to serve as alternatives to CMP361.

The CUSC Panel met on 23 November 2022 and exercised their discretion to disallow the two proposals being formally raised into the code governance process on the basis that the Panel considered the proposals to have a substantially similar effect as CMP361. Those modification proposals are therefore not live options and will not proceed meaning

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<sup>8</sup>[CMP361 - Update to our minded-to and draft impact assessment | Ofgem](#)

<sup>9</sup> Where the P Level used to derive the tariff is higher, i.e. closer to 100, the greater the requisite BSUoS Fund. A high P Level indicates that tariffs are less likely to be amended than a lower P Level. To support the reduced likelihood of a tariff amendment, the BSUoS Fund for those options at P99 is significantly higher than the BSUoS Fund for options at lower P Levels.

that (at this stage) the options we have available to approve are those included within CMP361.

Recognising the strong desire within industry for certainty as to the implementation of fixed ex ante BSUoS, as an alternative approach, the CUSC Panel were supportive of industry working with NGENSO outside of the formal code governance process to examine appropriate options for the P Level and any BSUoS Fund. NGENSO has, at the time of publication, held several industry workshops to discuss these various options. We understand that these workshops are expected to conclude with a further CUSC Modification Proposal being raised, which we will consider upon receipt.

### **Our decision**

We have considered the issues raised by CMP361 and the Final Modification Report (FMR) dated 8 March 2022. We have considered and taken into account the responses to the Workgroup Consultation and the Code Administrator Consultation on the Modification Proposal which were attached to the FMR<sup>10</sup>. These have been summarised in our Minded-to Consultation. We have also considered the votes of the Workgroup and the CUSC Panel, as well as the responses to our two previous consultations. We have concluded that:

- CMP361 WACM3 would best facilitate the achievement of the ACOs;<sup>11</sup> and
- directing that CMP361 WACM3 be made is consistent with our principal objective and statutory duties.<sup>12</sup>

### **Reasons for our decision**

Consistent with the view expressed in our minded-to decision, we consider that the implementation of any CMP361 option would be an improvement when assessed against the Baseline (i.e with no fixed ex ante BSUoS charging). Whilst our view is that longer term Fixed Periods eg of 12 months would be optimal (and WACM3 does not provide for such a longer-term Fixed Period), we do consider it to be better than the Baseline as it

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<sup>10</sup> CUSC modification proposals, modification reports and representations can be viewed on [NGESO's website](#)

<sup>11</sup> As set out in Standard Condition C5(5) of the [Electricity Transmission Licence](#)

<sup>12</sup> The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Electricity Act 1989 as amended.

will provide some degree of industry certainty around BSUoS arrangements from April 2023, (noting the interaction with the Default Tariff Cap<sup>13</sup> and CMP308).

Based on our updated analysis (and consultation responses) we believe that those options currently available to us under CMP361 which do not require a BSUoS Fund are likely better than those options that do.

The original proposal, and WACM5 (which we indicated previously we were minded to approve), would both introduce a BSUoS Fund of ~£2bn, recovered over two, or five years (respectively). In practice this would lead to an additional cost to consumers of ~£0.4-£1bn per year, in order to deliver the total fund value NGESO considers is required to fix BSUoS charges at a P99 Level for 12 months. We find this level of cost to be unacceptable, particularly at this time when meeting energy costs is a challenge for many GB consumers. We consider any option which utilises a P99 option and therefore the creation of the associated size of BSUoS Fund would increase consumer costs significantly, and that approval of such options would be inconsistent with our Principal Objective to protect the interests of consumers.

We believe that the consumer benefit of an ex ante BSUoS tariff is derived from a likely reduction in supplier risk premia, used within supply contracts to mitigate the financial exposure faced by Suppliers where there is a difference between the BSUoS value they have forecast and outturn BSUoS. It follows, therefore that the extent of the consumer benefit is likely linked to the duration of the Fixed Period – where NGESO publishes a BSUoS tariff which is likely to be in place for 12 months, Suppliers have a greater degree of certainty than where a tariff might be in place for 3, or 6 months and we would expect to see commensurate reductions in risk premia. We note the strong interaction between the certainty afforded by a longer Fixed Period and the duration of any Notice Period. We believe it is likely that where charges are set significantly in advance of the point in time in which they will be incurred, they will be less accurate (affording less certainty of forecasting) than charges set closer to ‘real time’.

We note however, that although there are 8 options available to us under this CMP361, none of them utilise a 12-month Fixed Period without relying on a significant BSUoS Fund value. We have therefore considered whether any other options, with shorter Fixed Periods might serve as a better solution, either as a new Baseline against which any

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<sup>13</sup> We have set out our view that we are minded to reflect CMP361 or equivalent modifications in the ‘Price Cap’ methodology: [Price cap: Consultation on reflecting potential changes to BSUoS charges in the price cap | Ofgem](#)

further CUSC Modification Proposals might be raised, or as an enduring solution. We have concluded that WACM3 is the best solution overall.

WACM3 provides a Fixed Period of 6 months, which we consider to be both reasonable, and an improvement on the Baseline. We expect this will likely lead to a substantial reduction in risk premia values, but will not increase the overall BSUoS charge faced by consumers through reliance on a BSUoS Fund.

We note that WACM3 utilises a 9-month Notice Period, i.e. charges which apply from month M are set and published in month M-9. We recognise that in practice, for this first year, should charges be fixed from 1 April 2023, any option available to us would result in a 2-month Notice Period owing to the date of this decision. We consider that implementation of WACM3 would therefore deliver a 2-month Notice Period for the first 6 months of charges, with a 8-month Notice Period for the next set (i.e. before February 2023, NGENSO publishes the BSUoS charges which it expects to apply from 1 April 2023 – 30 September 2023, and also publishes, with 8 months' notice, the BSUoS charges it expects to apply from 1 October 2023 – 31 March 2024). We recognise that the legal text for WACM3 states industry would be provided with 'at least' 6 months' notice of the charges to apply in this first charging year, and that in practice NGENSO will only be able to provide (and industry receive) 2 months' notice<sup>14</sup>. In the circumstances we believe that Suppliers will accept a fixed BSUoS tariff with a shorter Notice Period rather than not see a fixed BSUoS tariff in April 2023. Should further CUSC Modification Proposals be brought forward, we would encourage industry to consider the appropriate Notice Period. As per our minded-to decision, we continue to believe that a 3-month Notice Period strikes the appropriate balance between providing Suppliers with sufficient advance notice of charges, and mitigating the risk of inaccuracy in a forecast set in advance of the timeframe to which it relates.

We see the merit in the current circumstances of very volatile BSUoS charges, in a BSUoS Fund. We would encourage NGENSO and industry, to the extent it wishes to bring forward alternative CUSC Modification Proposals which might build upon CMP361 WACM3, to consider all available options, including in particular the trade-off between P Level and consumer cost. We do not, therefore, expect any further proposals to rely on or create a BSUoS Fund which would significantly increase BSUoS costs overall.

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<sup>14</sup> NGENSO or another industry party is able to bring forward a clarification modification to make clear that 2 months notice will be provided for the first fixed period and 8 months notice for the second.



## **Our assessment against the Applicable Charging Objectives**

For the reasons set out below, we believe that CMP361 WACM3 better facilitates ACO (a) and has neutral impact on ACO (b) and (e). We do not consider ACOs (c) or (d) to be impacted by CMP361 as we do not consider there to have been any 'relevant developments' in NGESO's business which might relate to this modification proposal, nor do we consider there to be an interaction with the Electricity Regulation or any other binding decision.

***(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;***

We set out in our minded-to decision that we considered CMP361 would better facilitate ACO (a). We remain of the view that all options under CMP361 would be better than the Baseline in this respect, but specifically in relation to CMP361 WACM3, as we:

- expect to see a reduction in risk premia commensurate to the increased certainty Suppliers are given by its implementation;
- do not consider it to be efficient for Suppliers to compete on their ability to forecast cost-recovery charges; and
- recognise that for consumers who use behind-the-meter generation (BTMG), volatile BSUoS charges can lead to inefficient dispatch decisions (i.e. consumers with BTMG will switch to their on-site generation to avoid importing during times they consider might carry high BSUoS charges).

We are of the view that implementation of WACM3 would better facilitate ACO (a) and would do so in a manner consistent with our Principal Objective by not relying on an expensive BSUoS Fund but still delivering a Fixed Period which should lead to consumer savings.

***(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);***

We consider that BSUoS is a cost-recovery charge. It is cost-reflective to the extent that it reflects the costs incurred by NGESO but it is not levied in such a way so as to allocate costs to users who drive, or are likely to drive them.

Notwithstanding the above, the move to fixed ex-ante charges may improve cost-reflectivity in the charging regime and electricity market overall. As explained above and in the minded to decision, the current regime of BSUoS charging can provide distortive signals. Dampening these distortive signals would contribute towards more effective dispatch decisions based on wider market signals.

However, as this benefit could sit outside of costs incurred by NGESO, and all options under CMP361 would result in charges which recover the actual costs incurred by NGESO, but levied in a way that does not reflect the way Users use the system, we consider CMP361 likely to have a neutral impact on ACO (b).

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

All options of fixed BSUoS will add complexity and administrative effort, as compared to the Baseline, required by NGESO to facilitate implementation and ongoing administration in the activities of forecasting and setting tariffs. However, setting BSUoS ex ante for a Fixed Period will reduce the frequency of tariff setting and therefore a level of ongoing administrative activity for NGESO.

Additionally, as we highlighted in our Minded-to Consultation, we consider that all options will lead to greatly simplified arrangements from a user perspective, in particular for Suppliers as it should be simpler to forecast and include within consumer prices.

Therefore, as there is a transfer of forecasting and volatility management from Suppliers to NGESO, but an improvement in efficiency through setting once for a Fixed Period, on balance we consider the transition to fixed BSUoS to be neutral against ACO (e).

**Impact Assessment**

Section 5A of the Utilities Act 2000 imposes a duty on the Authority (its "Section 5A duty") to undertake an impact assessment where it appears to the Authority that a proposal is important. A proposal is important if its implementation would be likely to, among other things, "have a significant impact on persons engaged in commercial

activities connected with the ... generation, transmission, distribution or supply of electricity.” Where this applies, the Authority is obliged to carry out an impact assessment.

We consider that our minded-to decision and draft Impact Assessment published 21 September 2022 satisfies the requirement under Section 5A, and is appropriate to utilise for this CMP361 decision, on the basis that we are not approving any option which relies on a BSUoS Fund, and it is that BSUoS Fund which was absent from our previous modelling for this CMP361.

### **Assessment against the Authority’s principal objective and statutory duties**

In making a decision on this modification proposal, we have considered whether our decision would be consistent with our principal objective and statutory duties. As explained above, given the significant additional burden that would be placed on consumers with the build up of high levels of BSUoS funds (as would be the case with WACM5 as per our minded to) we consider that CMP361 WACM3 takes the most proportionate and balanced approach to the recovery of exceptional BSUoS costs in a manner which is in the best interests of future and existing consumers.

We have a duty to have regard to the financeability of the regulated entities, and recognise that there is a limit to the amount of liquidity that can be provided by NGESO under current arrangements. We recognise that, in periods of exceptional volatility, options with low degrees of certainty place the requirement on NGESO to reset Tariffs with sufficient timeliness to retain sufficient capital available to continue to manage system balancing. We expect that if any further CUSC Modification Proposals are brought forward, they will consider the appropriate balance between consumer costs and pricing certainty.

### **Next steps**

Any requisite amendments to NGESO’s Special Conditions or Standard Conditions of its Transmission Licence will be dealt with by the Authority over the coming weeks.

Our consultation on reflecting CMP361 in the Default Tariff Cap closes on 23 December 2022.

We are open to the development of further options which might build upon this CMP361 WACM3 as a new Baseline. Any new options could in principle be developed over the coming months such that they would be capable of implementation prior to the expiration of the 6-month Fixed Period set by our approval of CMP361 WACM3 (if not earlier).

### **Decision notice**

In accordance with Standard Condition C10 of the Transmission Licence, the Authority, hereby directs that WACM3 of modification proposal CMP361 'BSUoS Reform: Introduction of an ex ante fixed BSUoS tariff' be made.

**Charlotte Friel**

**Deputy Director - Market Operations and Signals**

Signed on behalf of the Authority and authorised for that purpose