

# Second Balancing Services Charges Task Force

Meeting 3

25 February 2020



# Welcome and Introductions

Colm Murphy, National Grid ESO



# Apologies

Josh Logan, Drax

Alternate – No  
Alternate

Dial In – Lisa Waters,  
Waters Wye Assoc.

Topics to be discussed	Lead
1. Welcome and Introductions 10:00-11:00 <ul style="list-style-type: none"> <li>- Introductions – 5 mins (CM)</li> <li>- Action Log – 10 Mins (CM)</li> <li>- Playback from second meeting – 30 Minutes (EH)</li> </ul>	Colm Murphy
2. Finance 10:45-12:30 <ul style="list-style-type: none"> <li>- Ofgem Finance – ESO risk and Financing – 45 Mins (Ofgem)</li> <li>- ESO Finance – 45 Mins (National Grid ESO)</li> </ul>	Various
3. Lunch Break 12:15-13:00	-
4. Feedback <ul style="list-style-type: none"> <li>- Suppliers and Interconnectors (JH) 13:00-13:15</li> <li>- Engagement Plan – 15 Minutes (JW) 13:15-13:30</li> <li>- NOA – What it can and cannot do 13:30-13:45</li> </ul>	Various
5. Options for who should pay (deliverable 1) and how the charge should be recovered (deliverable 2) 13:45-15:45	Various
6. AOB and next steps 15:45-16:00	Colm Murphy

# Actions Log

Number	Action	Status
1	Action: Task Force members to organise attendance at Industry events to update on the work of the Task Force	Ongoing
2	Action: All members to complete analysis ahead of next Task Force meeting by February 7	Open
3	Action: Task Force members to volunteer for upcoming engagement opportunities and events by contacting Joseph Henry.	Open
4	Action: Grace March to attend TCMF and provide updates on Task Force progress.	Open
5	Action: Secretariat to review Terms of Reference in regards to implementation approaches	Open
6	Action: Ofgem to consider publication around implementation timescales.	Open
7	Action: ESO to provide BSUoS forecast information	Open
8	Action: Kayt Button to distribute EU Commission Infringement Letter (2009)	Open
9	Action: Ofgem to write to Industry to request Contractual Positions Data	Open
10	Jon Wisdom and Kayt Button to word questions for request of Contractual Positions Data	Open
11	Josh Logan to update CMP250 Analysis	Open
12	ESO to refine Interconnector Flow Analysis	Open
13	Task Force Members to complete Table detailing their thoughts on potential solutions ahead before 21 February 2020	Open

5

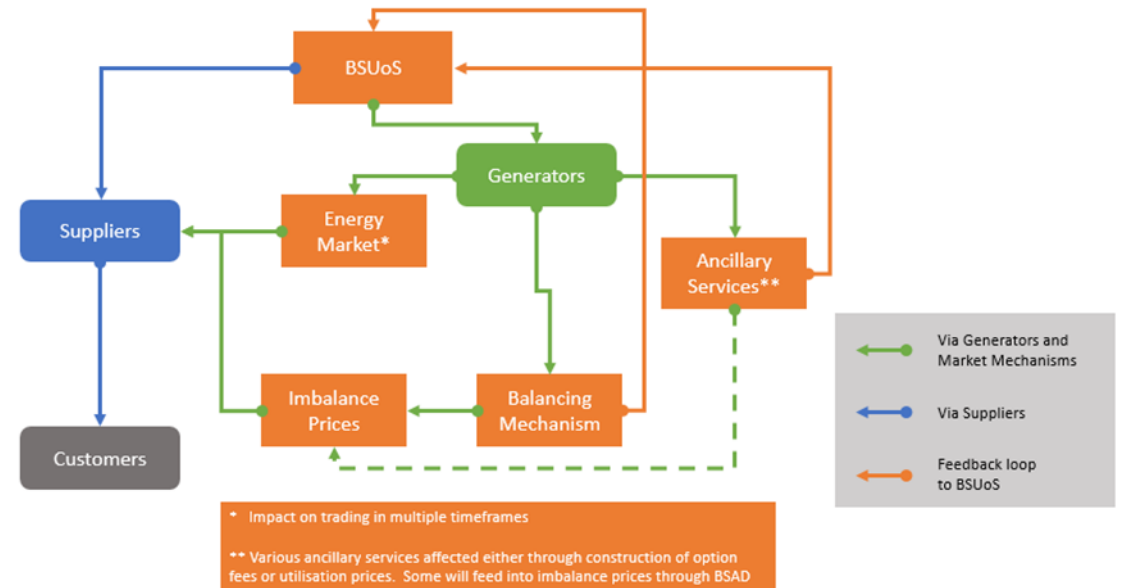
# Meeting 2 – Play Back

Eleanor Horn



# Playback from Meeting 2 – “The one with the Analysis”

- Market Distortions: Qualitative Analysis →
- Quantitative analysis: The ESOs forecast is frequently wrong (and usually underestimates the BSUoS price), the conclusions are sensitive to the WACC assumptions for generators vs suppliers and the forecast horizon.
- European Comparisons -> GB generators pay far more in Balancing Services charges than their European counterparts.
- CMP250 -> this is a useful piece of work and should be expanded on.
- Decarbonisation -> There would likely be a neutral impact on decarbonisation were Suppliers to pay the whole cost
- Interconnector Investment Efficiency -> to be reviewed once modelling team back from holiday
- Ofgem confirmed that under current legislative frameworks it is not possible to charge interconnectors for BSUoS.



# Finance Update

David Beaumont and  
Andrew Ryan, Ofgem





# BSUOS Taskforce Meeting



**Andrew Ryan**  
**Regulatory Finance**  
25/02/2020

- Who pays?
  - Historically under the Pool, Uplift was 100% recovered from demand
  - At NETA (2001), Uplift was replaced by BSUOS (and RCRC), split between generation and demand
  - To what degree is BSUOS a cost-reflective-signal?
  - BSUOS charges as paid by generation is recovered via wholesale prices, but it is noted that credit arrangements may differ across markets
- When are charges set?
  - Though external balancing costs are recovered “live/dynamically”, ESO’s revenue to cover Internal Costs are “fixed” at the beginning of the calendar year
    - Revenue is currently set in a similar way to networks Allowed Revenue i.e. initial view of revenue set at Final Proposals, with an Annual Review process (AIP) to reset it, typically a 2 year lag to adjustments
  - For RIIO-T2 and RIIO-GD2, we are reviewing several aspects of the AIP process, including the element of forecast Totex for the forthcoming year
  - In addition, for the ESO, TIM is being replaced by a “pass-through” arrangement, with the possibility of cost-disallowance continuing
  - One option includes allowing the revenue of the ESO to be set “within-year/dynamically”

# Interactions between RII0-2 and BSUoS

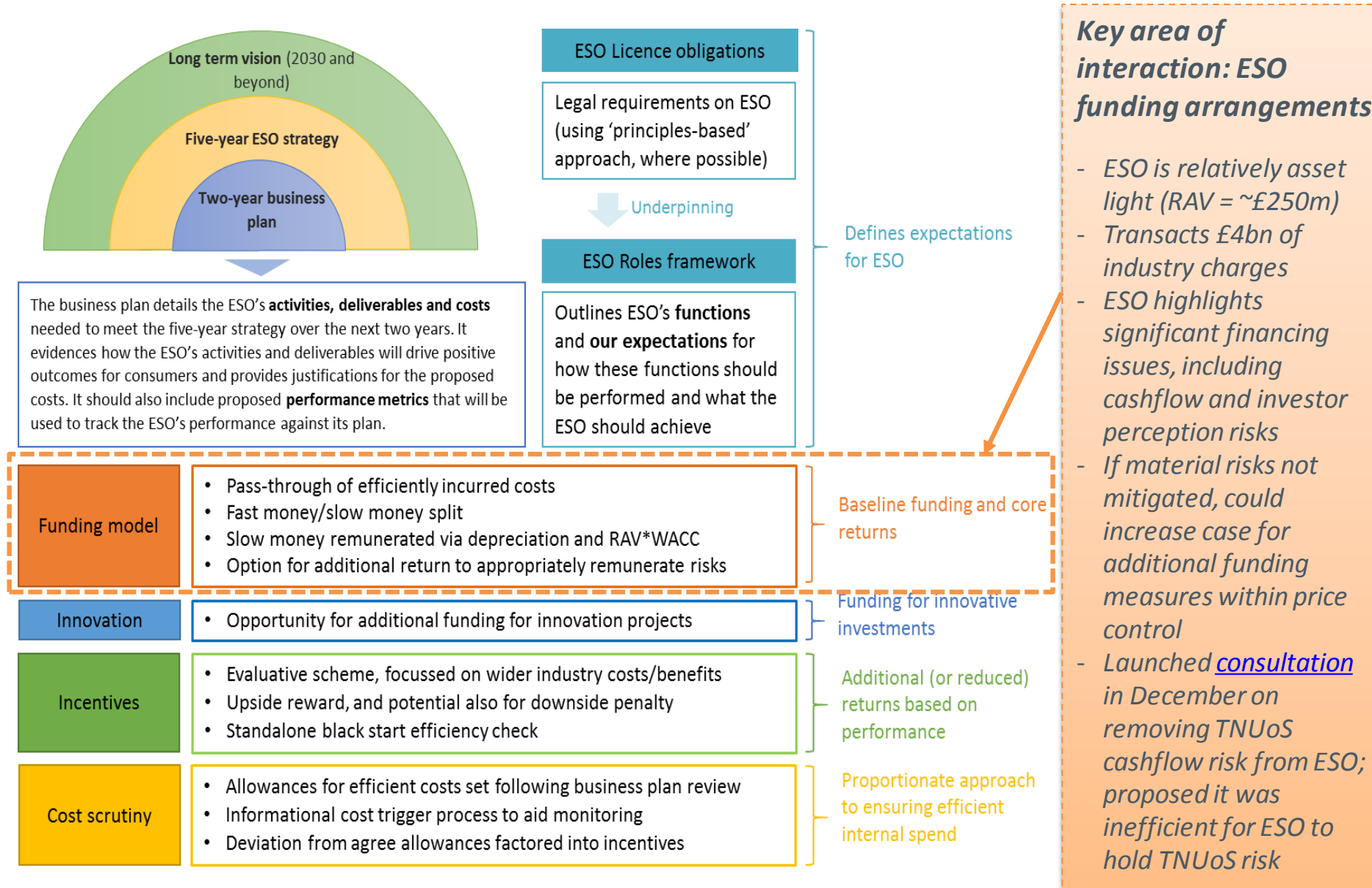
## BSUoS Task Force – Meeting 3



25/02/2020

## Aim of today:

1. Discuss interactions between BSUoS task force work and the ESO's RIIO-2 price control
2. Help ensure these interactions are part of the task force's consideration
3. Answer any questions



"The **revenue management role introduces significant cash flow and profit volatility risk** at a scale that is completely different to the rest of the risks faced by the ESO, in addition to credit and wider business risks. This affects our ability to secure an investment grade credit rating as required by our licence; our ability to provide assurances over the financeability of the notional company; and our proposition for attracting investors and providing adequate returns to them." **NGESO**

"SONI undertakes a similar industry revenue management role to us, but on a smaller scale: SONI transacts revenues around five times the size of its controllable revenues, compared to revenues around 20 times our size in our transactions. The CMA recognised these risks in reaching its conclusions for SONI, which are equally, if not more, relevant to us due to the much larger scale of industry revenues we manage. **The CMA decided that a risk premium would be appropriate for SONI, and that this should be in the form of a margin on revenues, "as the level of risk is related to the size of the revenues handled"** **NGESO**

"SONI was awarded a 0.5 per cent margin on external costs. While SONI is our closest comparator, it is not perfect, so we cross checked this with private sector benchmarks. These indicated a range, where we have proposed a reduced position of 0.35 per cent." **NGESO**

"...a **funding gap compared to the RAV\*WACC funding model of £32-36 million.**" **NGESO**

"The outcome of the methodology grid is A1 on a forward-looking basis [following the legal separation of NG ESO from NGET]. The assigned rating is **three notches lower, reflecting NG ESO's unusually high cash flow volatility and associated liquidity risks, offset by its ownership by National Grid plc**" **Moody's**

- Stakeholders have told us they want the ESO to be forward-looking, ambitious and focussed on delivering wider system outcomes.
- Our key tools to achieve this are the incentives scheme and the ESO's obligations. We want these to be the predominant driver of ESO behaviour during RIIO-2.
  - Placing disproportionate risk on an asset light ESO, could impact financeability and/or require additional financing measures – there is a risk that these measures potentially detract focus from the incentive scheme
  - Risk that additional financing measures may have unintended consequences that could counter our aims for the price control
- We also want the ESO to be flexible and reactive to changing system priorities. This drove our decision to remove the Totex Incentive Mechanism (TIM) for the ESO and move to pass-through funding approach.
  - Successful implementation of pass-through funding *may* mean allowing the ESO within-year flexibility around its recovery of internal costs through BSUoS

## Views? Questions?

### Next steps:

- Decision on TNUoS cashflow risk allocation
- Draft determinations on RIIO-2 in summer
  - Timing considerations with June TF
- Final determinations on RIIO-2 by end of year



# Finance Update

Jane West, James  
Thompson

National Grid Finance



# What are the financial characteristics of a legally separate ESO?

## **NGESO is a legally separate company within the National Grid Group**

- Separated from NGET 1<sup>st</sup> April 2019
- NGESO must have its own financing arrangements
- Licence obligation to maintain an investment grade credit rating
- NGESO will have its own new funding framework in RII02

## **NGESO funded through equity and debt**

- Current working capital facility £550m to manage significant and volatile cash flows

## **NGESO is an asset-light, for profit organisation**

- Transacts £4bn of revenue annually
- Current RAV is ~£200m (compared to NGET RAV ~£12bn)

# Who should bear the risks of any changes to the BSUoS billing framework?

**As with the TNUoS risk transfer, its important to consider the lowest cost for consumers**

- Currently a risk premium in supplier charges to consumers
- Transfer of risk to another party should aim to reduce overall cost

**There would be an impact of transferring further risk to NGENSO**

- Working capital facility not currently sized to fund this risk
- Likely increase in profit volatility and investor risk
- Further risk could impact ability to maintain investment grade credit rating
- There would be costs associated with systems and process changes

**There should be no assumption that NG Group could financially support NGENSO given the system operation review**

Lunch



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# Feedback



# Feedback Received - Supplier

**In the interim period between meeting 2 and 3, the Task Force received the following feedback from a supplier:**

- Need for thorough analysis to ensure that no industry party is unfairly burdened by the changes or receives an unfair windfall.
- A cost reflective split between industry participants is key to market integrity. This should be calculated in a transparent and reflective manner
- It is not in consumer interest for unexpected and unfair industry costs to be imposed. This can materially impact customers profitability and could lead to an increase in customer insolvencies.
- Any proposed change to cost apportionment would need a considerable lead time, at least 3 years to account for contract durations in the non-domestic market.
- BSUoS cost impacts cannot be considered in isolation of other TCR changes.

**Have we taken these concerns into consideration thus far?**

**Is there anything we need to do as a Task Force to thoroughly address this feedback?**

# Feedback Received - Interconnector

**In the interim period between meeting 2 and 3, the Task Force received the following feedback from an interconnector:**

- “We note that the ToR for the group was generators, embedded generators and suppliers and that current EU and UK law excludes the application of charges to interconnectors. Therefore we had not previously pressed for representation at the group. Our observation now though is that the group appears to be considering the application (or otherwise) of charges to interconnectors”.

*“It would be great to hear your views on this and whether an interconnector representative is required to ensure a balanced debate”*

**Have we taken these concerns into consideration thus far?**

**Is there anything we need to do as a Task Force to thoroughly address this feedback?**

NOA



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# Network Organisation Assessment

The NOA can...

- recommend the most economic reinforcements, whether build or alternative options, for investment over the coming years, to meet bulk power transfer requirements as outlined by the ETYS
- recommend when investments should be made under the different scenarios set out in the FES to deliver an efficient, coordinated and economic future transmission system
- recommend whether the TOs should start, continue, delay, hold or stop reinforcement projects to make sure they are completed at a time that will deliver the most benefit to consumers
- indicate the optimum level of interconnections to other European electricity grids – as well as any necessary reinforcements
- indicate whether the TOs should begin developing the Needs Case for potential SWW options
- indicate to Ofgem and other relevant stakeholders which reinforcement options and works for future generator and demand connection projects are eligible for onshore competition.

# Network Organisation Assessment

The NOA cannot...

- provide recommendations for customer connection. The NOA only recommends the most economic reinforcement to resolve wider network issues.
- insist that reinforcement options are pursued. We can only recommend options based on our analysis. The TOs or other relevant parties are ultimately responsible for what, where and when they invest
- comment on the details of any specific option, such as how it could be planned or delivered. The TOs or other relevant parties decide how they implement their options
- evaluate the specific designs of any option, such as the choice of equipment, route or environmental impacts. These types of decisions can only be made by the TOs or other relevant parties when the options are at a more advanced stage
- assess network asset replacement projects which don't increase network capability or individual customer connections
- list all the options that the TOs develop. Some are discarded early. The TOs develop options and consult with stakeholders on variations
- forecast or recommend future interconnection levels. It indicates the optimum level of interconnection.

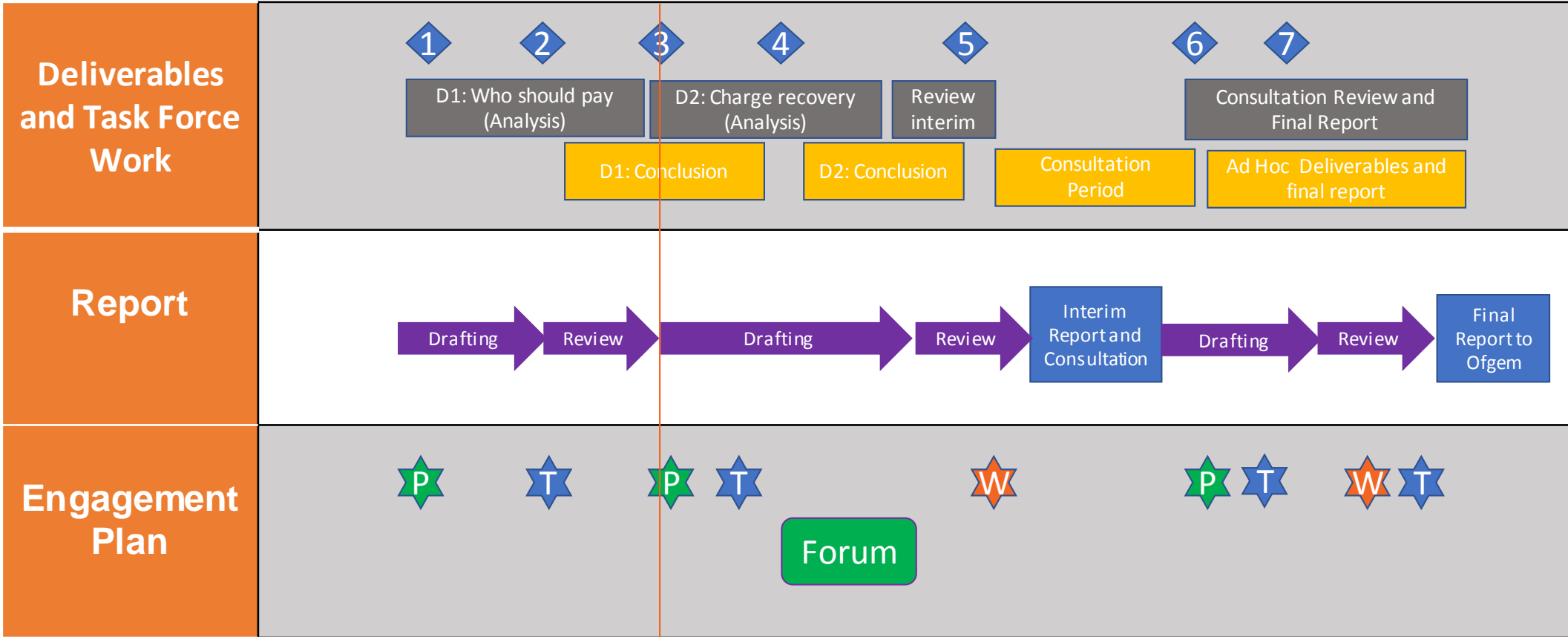
<https://www.nationalgrideso.com/document/162356/download> explains the process

# Engagement Plan

Jon Wisdom, National  
Grid ESO



# Overview of Deliverables and Engagement Plan



Key	
P	Podcast
W	Webinar
Forum	Charging Futures Forum
T	TCMF

- The ESO have agreed with Citizens Advice that they will observe TF 3
- Podcast planned at today's meeting
- Awaiting volunteer for Charging Futures Forum

# Deliverable 1 and 2 – Options

All



# AOB and Next Steps

Colm Murphy, National Grid ESO

