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Email: eleanor.wood@ofgem.gov.uk
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Dear Trisha,

Authority[1] decision to send back Connection and Use of System Code (CUSC) Modification Proposal CMP344 'Clarification of Transmission Licensee revenue recovery and the treatment of revenue adjustments in the Charging Methodology'

Purpose of this document

The purpose of this document is to explain our reasons for sending back CMP344 ('the Proposal') second Final Modification Report ('FMR')[2] and to direct the CUSC Panel to revise and resubmit the FMR. We have decided that we cannot properly form an opinion on the Proposal based on the submitted FMR and we are therefore sending it back for further work.

Context

RWE ('the Proposer') raised the Proposal on 21 May 2020. The Proposal is intended to codify existing charging arrangements in respect of the recovery by Transmission Licensees of revenue associated with Income Adjusting Events (IAEs). However, it is clear that the Proposal goes well beyond providing greater clarity in relation to existing arrangements and intends a change to remove offshore generator liability associated with IAEs, providing that such sums are instead recovered solely through the Transmission Demand Residual charge.

The first FMR[3] for CMP344 came to us for decision on 12 January 2021. On 5 May 2021, the Authority issued a direction to the CUSC Panel (under 8.23.12 of the CUSC) and sent the FMR back directing that the Panel resubmit the FMR on the basis that we were unable to

[1] 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.
[2] download (nationalgrideso.com)
[3] download (nationalgrideso.com)

properly form an opinion on the Proposal at that time.[4] Specifically, we considered that the first FMR was not clear as to which Offshore Transmission Owner (OFTO) Pass-through Items the Proposal was intended to apply to, nor the potential impacts of the proposed change, given the FMR did not contain any quantitative information regarding how the change would impact different network users.

Following this, the Workgroup agreed that the scope of CMP344 would be limited to the treatment of costs related to IAEs only, and not other Pass-through Items. The Proposer also commissioned Cornwall Insight to carry out analysis[5] modelling the implications that CMP344 (if implemented) could have on a) Contract for Difference[6] ("CfD") bids made by generators; and b) demand consumer Transmission Network Use of System (TNUoS) charges if an IAE was approved in the future.

We have actively considered the second FMR. Although the second FMR clarifies the scope of the Proposal and, to a certain extent, provides the requested quantitative analysis (see below), we have concluded that the information contained in the second FMR still lacks clarity; specifically in relation to the treatment of IAEs in the current charging arrangements and the extent to which the arrangements onshore and offshore currently differ and would be better aligned by this Proposal. As a result, we have concluded that we cannot properly form an opinion on the Proposal and have decided to send it back for further work. We further outline our detailed reasons for this send back in the section below, followed by detail on the changes required to the FMR.

Reason for send back

The second FMR appears to proceed on the basis that the Proposal would align the methodology for the recovery of sums related to IAE costs through Offshore Local Charges with the equivalent onshore charging regime. However, the second FMR has the following deficiencies, which means that we are unable to properly form an opinion on the Proposal:

a) The FMR is not clear as to the arrangements which the Proposer/Workgroup consider to be the onshore equivalent to cost recovery of IAEs. Based on the information available, we would consider the equivalent regime to be the charging treatment of unforeseen costs in relation to additional expenditure to address deficiencies with Onshore Local Assets. However, reference within the second FMR to IAE costs being associated with the 'total system' makes it unclear whether a comparison is being made between IAE cost recovery via Offshore Local Charges, and Onshore Local Charges or Onshore Wider Charges. We believe that the comparison should be against Onshore Local Charges.
b) The FMR does not sufficiently explain, nor evidence, the charging methodology the Electricity System Operator (ESO) currently follows in its operational practice for cost recovery of sums associated with: (i) IAE events in relation to Offshore Local Assets; nor (ii) the comparative onshore regime.
c) Without this information, there is insufficient evidence that there is inconsistent treatment under the status quo, and it is unclear which parts of the onshore

[4] Authority decision to send back CUSC modification proposal CMP344 'Changes to the way offshore transmission charges are shared between Users of the transmission system/generators and suppliers' (ofgem.gov.uk)
[5] See Annex 10 and Annex 11 of the 2nd FMR.
[6] A Contract for Difference, or CfD is a contract between a renewable generator and the 'Low Carbon Contracts Company' guaranteeing that the generator will receive a specific price for every unit of electricity they export. These contracts are awarded through a government auction into which generators bid, taking into account their projected revenues and liabilities including TNUoS.

charging methodology within Section 14 of the CUSC the Proposal is seeking to align the offshore charging methodology to. To the extent we have been able given the deficiencies in the FMR and the uncodified nature of parts of the methodology as recognised below, our preliminary analysis has not identified such inconsistent treatment.

d) Finally, the FMR appears to place reliance on a previous event (the Sloy determination) as an example of a precedent supporting this change. The Sloy determination concerned the adjustment of revenue allowances for onshore transmission licensees in relation to the delayed connection of renewable generation under a specific mechanism (Transmission Investment for Renewable Generation or TIRG).[7] Based on the information available, we are unclear as to the relevance of this example in the current context of the treatment of costs relating to IAEs in relation to Offshore Local Assets as it proceeded on a materially different factual basis.

As a result of the above, we are unclear on the nature of the apparent inconsistent treatment upon which the Proposal is premised. We are seeking further information to ensure that our assessment of the Proposal against the Applicable CUSC Objectives, in particular ACO (a), and our principal objective and other statutory duties is robust. If the equivalent charging treatment between the onshore and offshore regimes is currently consistent, we are concerned that respondents evaluating the Proposal may have based their assessment on a misunderstanding as to the status quo arrangements and this could have materially affected their views. If this were the case, it would potentially undermine the effectiveness of consultations to date and Ofgem's ability to properly take account of industry views in its decision-making.

Considering the amount of time between submission of the second FMR and this send back decision, we aim to prioritise the next FMR on receipt in order to issue a decision in good time, if the required information below is submitted.

Required changes

We direct that further work is undertaken to address the deficiencies above, specifically the FMR must be revised to:

1. Clearly set out the charging arrangements which are considered to be the onshore equivalent to cost recovery of IAEs and the justification for that position.
2. Sufficiently explain, and evidence by reference to the CUSC, the charging methodology which the ESO currently follows for the cost recovery of IAE events and the equivalent onshore comparator, e.g. unforeseeable events for additional expenditure to address deficiencies with Onshore Local Assets (i.e. how such sums are recovered via Onshore Local Charges, or otherwise). Our understanding is that the current arrangements in respect of (i) cost recovery of IAEs; and (ii) unforeseen costs for additional expenditure to address deficiencies with Onshore Local Assets are not explicitly codified in full and we therefore expect the ESO to provide the Workgroup with an explanation of the exact charging methodology which it currently follows in its operational practice in a form that can accurately be relied upon as forming the basis of the Proposal and the assessment thereof.

[7] Noted on page 7 of second FMR under heading 'Recovery via Transmission Demand Residual' - download (nationalgrideso.com)

3. Explain, with reference to relevant sections of licences, the CUSC and/or the ESO's explanation as to the current approach where applicable, the existing inconsistent treatment (such as it exists) and if considered appropriate, an explanation as to which aspects of onshore and offshore charging arrangements the Proposer considers should be aligned and how that will be achieved.

Other issues

Quantitative analysis provided in the second FMR

Notwithstanding that we have been unable to form a view of the Proposal, based on the information available, we have considered the quantitative analysis provided in the second FMR. Our initial view is that the analysis does not provide a well-rounded view of the impacts of CMP344, with respect to existing generators with CfD contracts. If it is the case that generators price risk premia into their CfD bids to financially mitigate against the risk of IAEs occurring, on that logic - the removal of the financial risk covered by that risk premium via the approval of CMP344 would result in a windfall gain for those generators that already have contracts in place. Therefore, by not quantifying the value of this windfall gain in the analysis, we consider it does not provide a balanced assessment. We would encourage the Workgroup to consider whether the analysis could be adapted or supplemented to provide a more holistic view of the potential impacts.

CUSC Section 14

When assessing the second FMR, we noted that there were missing formulae in CUSC Section 14 (see 14.15.81 and 14.15.91).[8] The ESO amended this error on 7 February 2024. We consider that this amendment will aid in further discussions for the Proposal in relation to the current charging arrangements for both onshore and offshore generation.

We would reiterate that it is the responsibility of the Code Administrator to ensure that the CUSC is clear of errors and ambiguity and that it is capable of operation.

Direction

In view of these deficiencies in the second FMR and associated annexes we cannot properly form an opinion on the Proposal. After addressing these issues and revising the FMR as required, the CUSC Panel should re-submit it to us for decision as soon as practicable.

Yours sincerely,

Eleanor Wood
Deputy Director, Energy Systems Management & Security

Duly authorised on behalf of the Authority

[8] CUSC Code Documents | ESO (nationalgrideso.com)