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Modification proposal:	**Connection and Use of System Code (CUSC) CMP286: 'Improving TNUoS Predictability through Increased Notice of the Target Revenue used in the TNUoS Tariff Setting Process' (CMP286)**
Decision:	The Authority[1] has decided to reject[2] this modification proposal
Target audience:	National Grid Electricity System Operator (NGESO), Parties to the CUSC, the CUSC Panel and other interested parties
Date of publication:	3 May 2024
Implementation date:	N/A

Background

Transmission Network Use of System (TNUoS) charges recover the annual cost of the provision, maintenance, and upgrade/expansion of the transmission system (c.£4.19bn in charging year 2024-25). TNUoS charges are levied on generators (c.£1.06bn) and demand users (c.£3.13bn). National Grid Electricity System Operator (NGESO) publish a draft forecast of TNUoS tariffs in November each year, for the forthcoming charging year (April to March). Final TNUoS tariffs are then published by NGESO, as required within the Connection and Use of System Code[3] (CUSC), by the 31 January ahead of the forthcoming charging year commencing on 1 April, providing two months' notice to CUSC parties of the charges they will face.

TNUoS charges are set by the NGESO by populating several inputs into the charging methodology model. One such input is the forecast 'Target Revenue'. The Target Revenue is derived from various components. These include relevant costs expected 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] This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.
[3] CUSC Section 14.14.13.

be borne by NGESO and sums included in submissions made by the Transmission Owners (TOs) as to the total amount of their Allowed Revenue to be collected in the given charging year. The TOs are required to make this submission to the NGESO by 25 January in each year in order that NGESO can calculate and then set final TNUoS tariffs by the 31 January deadline.

Under and over recovery of revenues occurs when actual costs outturn higher or lower than the revenue collected through TNUoS charges. When this happens NGESO reconcile this variance by including any under or over recovery values within future TNUoS tariffs.

The modification proposal

E.ON Energy[4] (the 'Proposer') raised two CUSC Modification Proposals, CMP286 (the 'Proposal') and CMP287[5] on 10 October 2017. CMP286 seeks to increase the notice period of the Target Revenue component of the TNUoS tariff setting process from two months to 15 months, in turn requiring earlier forecasts by NGESO and the TOs of the components which make up this input to the methodology. Similarly, CMP287 seeks to increase the notice period for demand volume inputs by the same duration. CMP286 and CMP287 were not formally amalgamated.

The Proposer considered that the modifications would provide more certainty for market participants on the inputs to the TNUoS charging methodology which they cannot currently predict. They considered this would lead to reductions in the risk premia to be included by suppliers within fixed contracts for consumers therefore reducing end consumer costs. The Proposer argued that both CMP286 and CMP287 would carry a positive impact on Applicable CUSC Objective (ACO) (a), as providing more certainty to charges would result in fewer 'price distortions' facilitating effective competition amongst suppliers, while considering the change to be neutral against the other ACOs.

The Workgroup raised a Workgroup Alternative CUSC Modification (WACM1). WACM1 operates as per the Original Proposal but with certain relevant costs borne by NGESO[6] which are defined within the Transmission Licence not locked down 15 months ahead of tariffs coming into effect.

[4] CMP286 and CMP287 were originally raised by Npower who then became part of the E.ON Group in 2019.
[5] CMP287 Improving TNUoS Predictability Through Increased Notice of Inputs Used in the TNUoS Tariff Setting Process | ESO (nationalgrideso.com)
[6] Relevant costs detailed within 'Diagram 6' of the FMR.

The majority of the Workgroup concluded that overall, the Original and WACM1 better facilitate the ACOs than the Baseline.

The first Workgroup Consultation, which focused on the Original Proposal, was issued on 4 April 2019 and resulted in four non-confidential responses from industry, three of which supported the change and implementation approach, with the remaining respondent providing no comment.

The CUSC Panel (the 'Panel') met on 25 November 2022. The Code Administrator explained that, in its view, while not formally amalgamated, it would be impractical to separate out the CMP286/CMP287 solutions. The Panel noted this and voted on CMP286 and CMP287 together as if they were a single proposal. The majority considered that the Original Proposals of each modification and CMP286 WACM1 would better facilitate the ACOs and therefore recommended their approval.[7]

Send Back and Subsequent Workgroups

On 7 December 2022, the Panel submitted a single Final Modification Report (FMR) in respect of CMP286 and CMP287. On 30 June 2023, we decided to send back[8] the FMR on the basis that we were unable to properly form an opinion due to:

a) Procedural issues: single set of Panel voting, and a single proposed legal text had been proposed in respect of both modifications despite each proposal being distinct and capable of separate implementation; and
b) A lack of analysis of the impact of CMP287 alone.

We directed that the FMR was revised and resubmitted, either with formal amalgamation of CMP286 and CMP287 or as two separate FMRs with separate legal text. The CUSC Panel subsequently decided that the Workgroup should undertake assessment of CMP286 and CMP287 separately.

The Proposer withdrew their support for CMP287 on 23 February 2024. The Proposer's request to withdraw CMP287 was presented to the March 2024 CUSC Panel who agreed to the withdrawal of CMP287.

[7] https://www.nationalgrideso.com/document/272931/download
[8] Authority decision to send back CUSC modification proposals 286 & 287: https://www.nationalgrideso.com/document/282616/download

The Second Code Administrator Consultation for CMP286 closed on 5 January 2024 and received seven responses. Five out of seven respondents agreed that the Original Proposal and WACM1 better facilitate the ACOs. The majority of respondents supported the Original Proposal, noting it would be simpler to implement. One respondent noted that the Original Proposal places additional risk on NGESO cash flow and was therefore supportive of WACM1. Another respondent noted that the Proposal would introduce additional material risks for the Onshore TOs Price Control arrangements. Two respondents considered that further work was required, which could be addressed separately under CMP413 'Rolling 10-year wider TNUoS generation tariffs[9], TNUoS Task Force[10] and the Strategic Transmission Charging reform programme[11]. The majority of respondents supported the proposed implementation approach of 31 December 2024, effective from 1 April 2026, with one respondent noting that they would be supportive of an earlier implementation date.

CUSC Panel[12] recommendation

On 26 January 2024, the Panel voted on CMP286 against the ACOs. The Panel voted by majority that the Original Proposal and WACM1 better facilitated the ACOs than the existing provisions within the CUSC (the 'Baseline'). Of the nine Panel members, five voted for the Original Proposal, two voted for WACM1, and two voted for the Baseline as being the best option. All Panel members that voted in favour of either the Original Proposal or WACM1 stated that ACO (a) was better met than by the Baseline, with one Panel member stating that ACO (c) and ACO (e) were also better facilitated by the Original Proposal. Further details on the views of the Panel members are set out in the Second Final Modification Report (FMR)[13].

Our decision

We have considered the issues raised by the Proposal, the first FMR dated 7 December 2022 and the second FMR dated 8 February 2024. We have also considered and taken into account the responses to the industry consultations on the Proposal which are attached to the FMRs. We have concluded that:

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[9] https://www.nationalgrideso.com/industry-information/codes/cusc/modifications/cmp413-rolling-10-year-wider-tnuos-generation-tariffs
[10] https://www.nationalgrideso.com/industry-information/charging/charging-futures/task-forces
[11] https://www.ofgem.gov.uk/publications/open-letter-strategic-transmission-charging-reform
[12] The CUSC Panel is established and constituted from time to time pursuant to and in accordance with section 8 of the CUSC.
[13] CMP286 Second Final Modification Report – see: https://www.nationalgrideso.com/document/302141/download

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- Implementation of the Proposal would not better facilitate the achievement of the ACOs
- Directing that the modification be made would not be consistent with our principal objective and statutory duties.[14]

Reasons for our decision

We believe that the Proposal would not better facilitate ACOs (a), (b) and (e), and would have a neutral impact on the other ACOs. We first address the Workgroup's perception of the interaction between this CMP286 and a previous CUSC Modification Proposal, CMP244.

On 15 July 2016 we rejected CMP244[15], a code modification proposal which sought to increase the length of the notice period for TNUoS tariffs from two months to a suggested period of 200 calendar days (approximately 6½ months before the relevant 1 April). Given the similarities, the CMP286 Workgroup considered it appropriate to address the reasons for CMP244 rejection and specifically demonstrate how moving the allocation of risk from suppliers to TOs would improve outcomes for consumers.

CMP244, like DCP178 [16], sought to change the timescales under which network tariffs are set. CMP286 seeks only to change the timescales under which one input into the calculation of network tariffs is set. Whilst we accept that there is some similarity in subject matter (i.e. notice periods for tariff-related information), we do not consider that a direct comparison between these proposals is suitable owing to the fundamentally different purposes of the proposals. We have decided to reject CMP286 for the reasons set out below.

(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;

The Proposer believes that CMP286 will reduce price distortions in the competitive market and the need for suppliers to resource extensive forecasting, thus allowing smaller

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[14] 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.
[15] See https://www.nationalgrideso.com/document/7916/download
[16] https://dcusa-cdn-1.s3.eu-west-2.amazonaws.com/wp-content/uploads/2019/08/20110439/DCP-178-CP-Form.zip

suppliers to enter the market and facilitate more effective competition in retail energy supply. The Workgroup and Panel considered that the Original Proposal and WACM1 would create more stable arrangements for those costs which suppliers cannot control, thus promoting competition by reducing requirements for risk premia.

Our view

We acknowledge that in principle the Original Proposal and WACM1 may to a degree reduce near term volatility between draft and final TNUoS tariffs and as such could reduce the need for suppliers to take account of this near-term volatility when forecasting. Consequently, this could reduce the level of risk premia specifically included in the first year of fixed price contracts, which is considered by some within industry to negatively influence prices within the competitive market . However, the effectiveness of this proposal in terms of enhancing competition has not been adequately evidenced and is inherently reliant on supplier pricing behaviour, risk appetite, and the application of risk premia, which will significantly vary by supplier. To the extent that the Workgroup considers existing arrangements to be a barrier to entry, we do not believe that sufficient evidence has been provided to validate assertions that the Proposal would enable new entrants into the market.

It is unclear to us, in addition, that approval of the Proposal would result in any substantial change to a supplier's resource requirements in respect of forecasting TNUoS charges: typically, fixed price contracts span longer than a year, therefore a supplier would still need to take a view on the potential Target Revenue for future years as is the case under the Baseline. In respect of supplier processes, insufficient evidence has been provided to illustrate that today's arrangements are limiting competition or that the Proposal would ameliorate that position.

We also consider the CMP286 Proposals to have potentially negative impacts on competition. In the context of the significant volumes of transmission infrastructure being built to facilitate network reinforcement, it is likely that the coming years will see significantly increased Target Revenues. Setting these values over a year prior to their expected expenditure, as proposed under both the Original Proposal and WACM1, would likely result in under/over recovery in charges requiring reconciliation of large sums of money between charging years. Whilst we accept that each Transmission Licensee would be 'made whole' per the price control framework, we consider that this additional carryover into future years is likely detrimental to competition as it would likely increase the absolute value of year-on-year variances in TNUoS, making it less predictable for suppliers seeking to price their consumer contracts and therefore jeopardising effective competition.

(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 in accordance with the STC) incurred by transmission licensees in their transmission businesses and which are compatible with standard condition C26 (Requirements of a connect and manage connection);

The Proposer states that CMP286 will have a neutral impact on ACO (b). However, several Panel members stated that both the Original and WACM1 will have a negative impact on this ACO, highlighting that the additional lags introduced between costs incurred by TOs and their reflection within TNUoS charges will reduce overall cost reflectivity. One comment specifically refers to the significant delay between reconciling forecast and recovered revenue, potentially taking years to be resolved through TNUoS tariffs.

Our view

We agree with the Panel that implementation of CMP286 and the additional lags introduced as mentioned above, would reduce the level of cost reflectivity within TNUoS charges. Specifically, the proposed solutions would require the use of long-term forecast revenue positions and Target Revenues provided by the TOs and NGESO as part of the tariff setting process, which inherently will be less reflective than short-term forecasts provided closer to tariff setting. We further consider that either the Original Proposal or WACM1 would lead to a greater likelihood of instances and increased magnitude (absolute value) of under- or over-recovery in a charging year. These potentially larger recovery values from prior years would feed through to latter years as per the "Kt factor" in NGESO's licence[17], which would then affect the level of cost-reflectivity of future years' TNUoS charges. As such, we conclude that both the Original and WACM1 would result in a negative outcome for ACO (b).

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

[17] National Grid Electricity Transmission Consolidated Special Conditions - Current.pdf (ofgem.gov.uk)

The Proposer states that CMP286 will have a neutral impact on ACO (e). However, some Panel members believed the Original and WACM1 would be negative in relation to ACO (e) as additional complexity would be introduced beyond existing arrangements.

Our view

We consider that both the Original and WACM1 will reduce the efficiency of the implementation and administration of the charging methodology as it would likely see a greater degree of variance between forecast Target Revenues and the TOs' actual revenue requirements, leading to otherwise avoidable increases in year-on-year TNUoS revenues as sums are carried between financial years. We consider this to be less efficient than the Baseline.

Consistency with the Authority's principal objective and statutory duties

We believe directing that CMP286 be made would not be consistent with the Authority's principal objective to protect the interests of existing and future consumers. This is because the perceived benefit of this modification in terms of lower risk premia will only be relevant for fixed-contract consumers (a small proportion of demand sites in the current market conditions), while the potential increased costs (which the FMR suggests might outweigh any benefits of reduced risk premia) and increased volatility associated with revenue true-ups for Transmission Owners will be borne by those demand consumers not protected by a fixed price contract. This could create a situation whereby a large proportion of demand consumers are paying to reduce the bills of a small subset of consumers on fixed term contracts.

In addition, the FMR does not provide adequate evidence of a clear case as to how any benefits would be delivered and passed through to end consumers. The analysis provided by the TOs suggests that this change would lead to additional costs being passed through to consumers due to increased TO cash flow risk and the additional financing required. We consider that the requirement for TOs to provide forecast Allowed Revenues 15 months in advance will effectively result in larger variances in terms of under and over recovery. This will ultimately increase TNUoS volatility in the longer term, and given that fixed price contracts typically span longer than a year, would still require risk premia to be applied and passed through to end consumers, potentially offsetting the initial benefits quoted.

Decision notice

In accordance with Standard Condition C10 of the Transmission Licence, the Authority has decided that modification proposal CUSC CMP286: '*Improving TNUoS Predictability through Increased Notice of the Target Revenue & Inputs used in the TNUoS Tariff Setting Process'* is not made.

James Stone

Principal Policy Expert - Transmission Charging

Signed on behalf of the Authority and authorised for that purpose