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**Connection and Use of System Code (CUSC): Amending the Fixed Price Period from 6 to 12 Months (CMP415)**

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| Decision | The Authority[1] has determined that Workgroup Alternative CUSC Modification Proposal (WACM) 1 should be made[2] |
| Target audience | National Energy System Operator (NESO), Parties to the CUSC, the CUSC Panel and other interested parties |
| Date of publication: | 30 October 2024 |
| Implementation date: | 01 April 2025 |

## Background

Balancing Services Use of System (BSUoS) charges are the means by which the National Energy System Operator (NESO) recovers the costs associated with balancing the electricity transmission system in Great Britain (GB). These charges are levied on Final Demand consumers in GB[3] based on the amount of energy imported from the transmission network.[4]

On 15 December 2022, we approved CUSC modification CMP361 '*BSUoS Reform: Introduction of an ex ante fixed BSUoS tariff*', Workgroup Alternative CUSC Modification (WACM) 3.[5] This modification implemented the recommendations of the second Balancing Services Task Force to set BSUoS charges as a flat volumetric rate on an ex-ante basis instead of within each half-hour period[6]. As a result, since 1 April 2023, BSUoS charges have been set at a £/MWh rate, nine months in advance, fixed for a six-month period, with the intent to provide predictability and stability for both suppliers and consumers, which in turn would likely reduce the level of risk premia built into contracts where BSUoS costs are included.

Alongside CMP361, we also approved CMP362 '*BSUoS Reform: Consequential Definition Updates*' to make the necessary definitional updates to Section 11 of the CUSC to support the implementation of CMP361.

[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.

As explained in our decision, CMP361 resulted in eight proposed solutions each differentiated by its approach to the various components of the calculations underpinning the fixed BSUoS tariff (e.g., the notice and fixed periods). Some proposals also extended to introducing funding arrangements for NESO to enable it to set a fixed BSUoS tariff in advance without undermining its financial stability in the event of under-recovery, and minimising the risk of mid-period tariff resets.[7] These funding arrangement proposals were intended to supplement the NESO's Working Capital Facility (WCF), £300m of which had been ring-fenced by NESO to cover fixed BSUoS tariffs.[8]

Each proposal under CMP361 had a corresponding 'P level' being a representation of the proposal's likelihood to provide tariffs that, under normal circumstances once set, would not change, based on the number of years out of 100 that tariffs would be expected to remain certain (i.e., 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 also determined the extent of funding arrangements for NESO required to ensure that level of stability.

As outlined in our minded to decision[9], we initially favoured a three-month notice with a 12-month fixed period. However, the options which adopted this structure under CMP361 also included provision for a BSUoS Fund, effectively a sum derived from surplus collection of BSUoS to create a ringfenced reserve to be utilised in the event of under-recovery through the fixed tariff and where the ESO's WCF had been exhausted. Our analysis indicated that a high level of tariff stability (P-99) under a three-month notice, 12-month fixed solution would have been translated into a BSUoS Fund of approximately £2 billion at the time, which would represent and an additional annual cost to consumers of £0.4 billion (if recovered over five years) or £1 billion (if recovered over two years).[10] We concluded that this level of cost was unacceptable on the basis that it would increase consumer costs significantly, and therefore considered that approval of such options (i.e. those with three months' notice and 12-month fixed period) would be inconsistent with our Principal Objective to protect the interests of consumers.

As a result, we approved WACM3, which provided for a nine-month notice period and 6-month fixed period, without a BSUoS Fund, which represented a P-77. Our decision concluded that this option would balance the need for improved predictability and stability of tariffs over longer durations, compared to previous half-hour settlements, without the financial burden on consumers. This tariff structure also aligns with the Balancing Services Task Force's recommendation that the total notice and fixed period length should be around 14 to 15 months, allowing suppliers to benefit from the predictability and stability to plan their pricing strategic more efficiently.

However, the tariff structure we approved in CMP361 & CMP362 requires NESO to forecast volatile costs 9 months ahead of the tariff implementation, instead of the 3 months we initially intended to approve. In our CMP361 decision letter, we noted that a longer notice period likely impacts NESO's ability to produce more accurate forecasts, which may increase their cash flow risks. We also noted: "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".

On 17 January 2023, NESO raised CMP408 to address these concerns. It proposed to amend Section 14 of the CUSC to adjust the existing fixed BSUoS notice period by reducing it from nine months to three months. However, there was significant support for two possible alternatives to the CMP408 Original Proposal seeking to change the BSUoS fixed period alongside the notice period. However, Paragraph 8.16.2 of Section 8 (CUSC Modification) of the CUSC states that a proposal to modify the CUSC Charging Methodologies cannot modify any other section of the CUSC other than section 14 (Charging Methodologies). Both Workgroup Alternatives proposed to amend section 11 (Interpretation and Definitions), and as such, the alternatives could not progress to become WACMs to be considered alongside the Original Proposal and were therefore withdrawn.

On that basis, Workgroup Alternative 1 and Workgroup Alternative 2 from CMP408 were raised as two consequential modifications. Ultimately, these evolved into the Original Proposal and WACM1 of CMP415.[11] A separate decision to approve CMP408 has also been published today.

**The modification proposal**

CMP415 (the 'Proposal') was raised by NESO ('the Proposer') on 11 July 2023. The CMP415 Original Proposal (the 'Original Proposal') seeks to extend the fixed price period for BSUoS tariffs from 6 months to 12 months by changing the definition of 'Fixed Price Period' in CUSC Section 11. The primary objective of the Original Proposal is to enhance price certainty for suppliers, allowing them to manage their costs more effectively and reduce the risk premia embedded in their pricing structures. By extending the fixed period, the modification aims to create a more stable and predictable pricing environment for consumers, thereby enhancing overall market efficiency.

**CMP415 Workgroup Alternative CUSC Modification 1 ('WACM 1')**

WACM1 proposes to amend the fixed price period from 6 months to 12 months, divided into two seasonal tariffs. Specifically, a spring-summer tariff (April 1 to September 30) and an autumn-winter tariff (October 1 to March 31) are proposed. The Workgroup considers that this structure improves stability of BSUoS charges by ensuring that tariffs are more reflective of seasonal demand variations, allowing NESO to manage cash flow risks more effectively throughout the year.

**CUSC Panel[3] recommendation**

The CUSC Panel met on 29th September 2023 to vote on the Original Proposal and its alternative, WACM1. The Panel unanimously recommended that the Original Proposal does not better facilitate the CUSC Applicable Objectives compared to the current arrangements (the 'Baseline'). By a majority, the Panel also recommended that WACM1 does not better facilitate the Applicable CUSC Objectives (ACOs) compared to the Baseline.

However, a majority of Panel members commented that, if CMP408 was implemented alongside CMP415, CMP415 would better facilitate the ACOs, recognising the benefits of increased price certainty and reduced volatility in BSUoS charges. Some concerns were raised about the potential impacts on suppliers and consumers, highlighting the need for additional evidence to substantiate the benefits of the proposed change.

**Our decision**

We have considered the issues raised by CMP415 and the Final Modification Report (FMR) dated 13 October 2023. We have taken into account the responses to the Workgroup Consultation and the Code Administrator Consultation on the Proposal, which were attached to the FMR. We have also considered the votes of the Workgroup and the CUSC Panel. We have concluded that:

[3] The CUSC Panel is established and constituted from time to time pursuant to and in accordance with section 8 of the CUSC.

- implementation of the WACM1 will better facilitate the achievement of the ACOs;[4] and
- implementation of the WACM1 will be consistent with our principal objective and statutory duties.

**Reasons for our decision**

Our decision to approve WACM1 of CMP415 is based on several key considerations aimed at enhancing the price certainty and financial planning for suppliers and reducing costs for end consumers. We consider that a 12-month notice period with seasonal tariffs has potential to provide a longer-term stable pricing environment, reduce risk premia, and align the BSUoS charging methodology with industry practices.

The recommendations of the second Balancing Services Task Force emphasised the need for a structured approach to setting BSUoS tariffs, combining a notice period with a fixed period to enhance predictability and stability. Our approval of CMP408, also published today, introducing a 3-month notice period, and CMP415, extending the fixed period to 12 months, create a combined period length of 15-month framework that aligns with the BSUoS Task Force's recommendations. By approving CMP415, we provide a timeframe that allows suppliers to adopt more predictable tariff structures. With a longer period of certainty, they can spread their financial risks over a more extended horizon and consumers benefit from lower and more predictable energy costs.

*Internal review*

Our internal review assessed the levels of tariff stability provided by NESO's £300m combined with different tariff structures under current market conditions and at the time of the CMP361 & CMP362 decisions. Under current market conditions, the implementation of a 12-month fixed period would result in a P-level between P-95 and P-99 considering a £300m WCF[5], a substantial improvement compared to the P-77 level associated the solution approved under CMP361 & CMP362. This improvement is primarily driven by a reduction in market volatility, with standard deviations returning to levels closer to those observed before the energy crisis exceptional circumstances. This return to relatively

[4] As set out in Standard Condition E2 of the Electricity System Operator Licence. Please see: https://www.ofgem.gov.uk/sites/default/files/2024-09/Complete_ESO_Licensing_Direction_and_Licence_Terms_and_Conditions_decision_e-signed_and_dated_FINAL.pdf
[5] For standard deviation calculated from the data for April 2023 to February 2024.

more stable balancing costs enables high P-levels even under extended fixed periods, creating more certainty without requiring financial cover, making the 12-month fixed period the option that provides more consumer benefits when combined with the 3-month notice period approved by CMP408.

The rationale for WACM1's seasonal approach is supported by the analysis in Annex 5 of the FMR, which highlights that the single fixed tariff proposed in the Original Proposal is more likely to lead to under-recovery during summer and over-recovery in winter. This increases the risk of breaching the WCF during certain periods and thus increasing the likelihood of mid-year tariff resets. The seasonal tariff structure (spring-summer and autumn-winter) better aligns with variations in costs incurred by NESO and reduces this risk of breach, providing suppliers with greater certainty and ultimately benefiting consumers.

The evidence supports the shift to a 12-month seasonal tariff structure for setting BSUoS tariffs. The increased P-levels provided by the current WCF align with the objectives of CMP415 to enhance stability and predictability of costs even in an environment where tariffs are fixed for 12 months. The seasonal approach also allows for better management of cash flow by aligning tariffs with periods of varying demand, while still providing suppliers with the certainty of knowing their costs 12 months in advance.

We have considered our decisions on CMP408 and CMP415 in tandem to ensure that a cohesive solution is put in place. We have published today our decision to approve CMP408. Together with CMP415, these decisions will result in a 3-month notice and 12-month fixed period with seasonal tariffs (spring-summer and autumn-winter).

ACO assessment

We consider the Original Proposal will better facilitate ACO (b) and has a neutral impact on ACOs (a), (c) and (d). We consider WACM1 will better facilitate ACO (b) and has a neutral impact on ACOs (a), (c) and (d). Overall, we have concluded that WACM1 is the best solution and our reasons are set out below.

***(b) Facilitating effective competition in the generation and supply of electricity, and (so far as consistent therewith) facilitating such competition in the sale, distribution and purchase of electricity;***

The Panel recommended unanimously that the Proposer's Original Proposal and by majority WACM1 has a negative impact on ACO (b), primarily due to concerns about financial instability and the potential for mid-period tariff resets under a single 12-month fixed period. Panel members raised concerns that these resets could lead to higher risk premia, which would in turn increase costs for consumers, and reduce effective competition in the market.

The Panel by majority viewed WACM1 more favourably, if CMP408 was implemented. Panel members believed that WACM1's seasonal tariff structure would better align tariffs with actual costs throughout the year, reducing the risks of under- or over-recovery and minimising the likelihood of disruptive mid-period tariff resets. They considered that the combination of CMP408's shorter notice period and WACM1's seasonal tariffs would create a more stable and predictable pricing environment, likely leading to lower risk premiums and lower costs for consumers.

The Workgroup unanimously concluded that the Original Proposal, and by majority, that WACM1 did not better facilitate ACO (b) than the Baseline. However, the Workgroup also concluded unanimously that WACM1, and by majority, the Original Proposal, would better facilitate ACO (b) than the Baseline were the change to Section 14 as proposed in CMP408 to be implemented.

*Our view*

We believe that the Original Proposal and WACM1 will better facilitate ACO (b).

The extension of the fixed price period from six to 12 months, as proposed in both the Original Proposal and WACM1, provides suppliers with greater tariff certainty over an extended period. This additional stability allows suppliers to plan their pricing strategies with greater confidence, as they can forecast their costs more accurately over a 12-month period, reducing the need to incorporate large risk premia to hedge against price fluctuations. With risk premia minimised, suppliers can offer more competitive pricing to end consumers, ultimately leading to a more dynamic and competitive market. Moreover, our internal review indicates that under current market conditions, the 12-month fixed period can sustain a high P-level (P-95 to P-99), reducing the risk of tariff resets. This enhanced cost predictability is more likely to provide a stable environment for both suppliers and consumers, which promotes healthy competition in the market by allowing suppliers to focus on pricing competitiveness rather than risk management.

Building on the benefits of extending the fixed period, the seasonal variation approach introduced in WACM1 further improves upon the Original Proposal by addressing the fluctuations in BSUoS costs throughout the year. By splitting the year into two periods, WACM1 allows NESO to manage cash flow more effectively, reducing the risk of under-recovery during seasons of higher balancing costs. WACM1 supports the objectives of ACO (b) by further mitigating NESO's financial risks, thereby further reducing the likelihood and the inclusion of risk premia in prices. This intensifies electricity market predictability, likely enabling suppliers to be even more competitive and offer lower prices to end consumers.

As such, we assess both the Original Proposal and WACM1 to better facilitate ACO (b) but for the above-mentioned reasons we believe that WACM1 is the better option.

**Future market conditions**

As stated in the CMP408 & CMP415 decision letters, approved changes to the fixed BSUoS tariff structure are preferable to the Baseline because current market conditions have evolved since CMP361 & CMP362 decisions. However, future market developments could introduce similar levels of uncertainty as those experienced by industry in 2022. In such cases, it will be open to parties to raise CUSC modification proposals, which we would evaluate based on their merits.

**Fixed BSUOS tariff reset mechanisms**

The tariff stability anticipated from the arrangements approved in CMP408 & CMP415 should be complemented by clear tariff reset mechanisms adopted by NESO. We expect NESO to incorporate these mechanisms into the CUSC to provide greater certainty for all parties.

**Implementation Date**

The implementation date for CMP408 and WACM1 of CMP415 is set for 1 April 2025, marking the start of the new charging year. However, this does not mean that BSUoS final tariffs published under the current 9-month notice and 6-month fixed periods will be reset or replaced immediately. The existing final tariffs (Fixed BSUoS Tariffs 4 and 5[6]) will continue to apply and run their full course, as well as the final tariff scheduled to be published in December 2024 (Fixed BSUoS Tariff 6), until their 6-month fixed period ends

[6] BSuoS Fixed Tariff Final Tariff 5 (Apr 2025-Sep 2025) Draft Tariff 6 (Oct 2025-Mar 2026)

in April 2026. In December 2025, NESO will publish the first seasonal tariffs (Fixed BSUoS Tariffs 7 and 8) under the new arrangements, 3 months before Fixed BSUoS Tariff 6 ends, for a 12-month period. Subsequent tariffs will then be published every December.

**Decision notice**

In accordance with Standard Condition E2 of the Electricity System Operator Licence, the Authority hereby directs that WACM1 of CMP415: *Amending the Fixed Price Period from 6 to 12 Months* be made.

**Pedro Arcain**

**Head of Electricity Network Charging, Energy Systems Management & Security**
Signed on behalf of the Authority and authorised for that purpose.