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CUSC Alternative Form – Non Charging

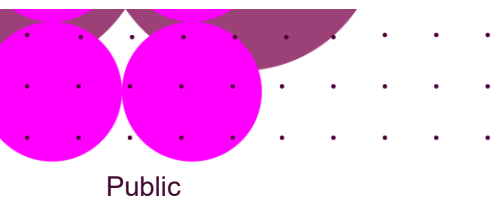
CMP470 Alternative Request 7:  
Liabilities Floor

**Overview:** This alternative differs from the original proposal under 3 criteria

- 1. The OTCF commences at a value of £2000/MW with increments of £2000/MW at each 6 monthly charging blocks, capped at a total of £8000/MW
- 2. The OTCF value is a floor on the project liabilities (securities are calculated from the liabilities value as per the existing CUSC methodology)
- 3. The OTCF finishes when the User has met connection Queue Management milestone (QM8)

**Proposer:** Rob Smith, Enso Energy

☒ I/We confirm that this Alternative Request proposes to modify the non - charging section of the CUSC only



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### What is the proposed alternative solution?

1. The OTCF commences at a value of £2000/MW with increments of £2000/MW at each 6 monthly charging block, capped at a total of £8000/MW
2. The OTCF value is a floor on the project liabilities (securities are calculated from the liabilities value as per the existing CUSC methodology)
3. The OTCF finishes when the User has met connection Queue Management milestone QM8

### What is the difference between this and the Original Proposal?

It is important that any additional fee is sufficient to incentivise the intended outcome or behaviours. However, any requirement to post additional funds above and beyond that value is inefficient and leads to funds being uneconomically sterilised with no greater societal benefit. The original proposal is a best guess as to the appropriate value of the OTCF and is not supported by any quantitative assessment as to whether it is the efficient value.

This alternative proposal sets a value of £2000/MW with increments of £2000/MW at each 6 monthly charging blocks, capped at a total of £8000/MW

This value is derived from the analysis submitted by NESO and accepted by Ofgem in the CMP448 Project Progression Fee (PCF) CUSC proposal.

The PCF analysis suggested that £2,200/MW (CMP448 proposer rounded up to £2,500/MW) ramping up to a cap of £10,000/MW was sufficient to make the opportunity cost of holding on to a slightly negative NPV project too expensive (Assuming an 8% funding rate to secure the monies to fund this security)

We believe the cost of securing these funds were underestimated as it was assumed it would be funded by debt. In our view this OTCF will be funded by equity until FID at which point it will be funded part equity and part debt.

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Therefore, given the increased cost of funding the OTCF (which is a cost that will not be recovered even when the project is commissioned) we believe it is appropriate to apply a modest discount to the £2200/MW value. Therefore, it is more appropriate to have a £2000/MW increment capped at £8000/MW

The original proposal requires that the OTCF should be a floor on securities. A significant number of companies, who cannot secure parent company guarantees will need to lodge this security in cash. This could be a considerable or unmanageable burden on smaller developers and effectively sterilises working capital that could be put to more productive use. This is inefficient and raises costs which would ultimately be passed on to the end consumer.

Therefore, it is more appropriate to put this floor on the underlying liabilities that the project incurs, and which forms the basis of the cancellation charge. The ultimate cost exposure does not change but it reduces the upfront monies that must be posted. Therefore, this is more efficient. We note there was some concern that this could lead to a risk that, in the event of projects subsequently cancelling their connection, they might default against their cancellation charges. Whilst we accepted this is a non-zero risk, historical data provided by NESO has demonstrated that for the 211 projects that cancelled their connection between 2022 and 2026, none have defaulted against their connection charges. Therefore, when assessed against the amount of capital that would effectively be made non-productive, we believe this has an acceptable trade off.

The defect identified in this proposal is that projects are staying in the queue and either a) have no intention of building their project or b) have not decided whether or not to build their project.

We would argue that if a project has met Queue Management Milestones QM7 & QM8, this is no longer the case. To meet QM 7 & 8, a party has provided director commitment that the project is going to proceed, and NESO can ask for additional information to demonstrate this via photos that construction has commenced. Coupled with this, the relevant Network site engineer is likely to have had considerable and continuous dialogue with the connecting party and is able to flag if there is any suspicious behaviour in the parties progress. In the overwhelming proportion of cases, the developer will also be starting to incur nontrivial liabilities by this point which will not be recovered if they don't complete

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their project. One must also question what the benefit is in staying in the queue at this point.

We are also concerned with the uncertain timeframe with which a project would need to maintain the OTCF if it completed on commissioning. Even under the current project connection rate, commissioning dates can be varied greatly from the original date. We forecast that with the need to increase the connection capacity rate to approximately 5 times existing rates, coupled with the need to secure outages to commission significant ASTI network reinforcements, this volatility will only increase. It would seem inappropriate for developer cost exposure to be at the mercy of this uncertainty.

### What is the impact of this change?

This change better addresses the defect in that the value of the OTCF is more efficient as it will drive the appropriate behaviours without leading to unnecessary sterilised developer capital.

It also ensures that the OTCF is only focused on the defect. That is, parties remaining in the queue with no intention, or uncertain intension, to complete their projects. Parties such as those that have entered construction, and so do not meet the definition of the defect are no longer exposed to the cost of the solution.

| Proposer's assessment against CUSC Non-Charging Objectives   |  |
|--|--|
| Relevant Objective   | Identified impact  |
| (i) The efficient discharge by the Licensee of the obligations imposed on it by the Act and by this licence*;  | <b>Neutral</b>   |
| (ii) 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; | <b>Positive</b><br>Better facilitate competition in the generation and supply of electricity in that it will lead to a more efficient construction of needed |

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|   |   |
|---|---|
|   | generation and network infrastructure in a timeframe to better facilitate the CP2030 targets.   |
| (iii) Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency **; and | <b>Neutral</b>  |
| (iv) Promoting efficiency in the implementation and administration of the CUSC arrangements.  | <b>Positive</b><br>Better promotes efficiency in that it reduces the extent of the change to CUSC securities and liabilities methodology and administrative processes |

\* See Electricity System Operator Licence

\*\*The Electricity Regulation referred to in objective (iii) is Regulation (EU) 2019/943 of the European Parliament and of the Council of 5 June 2019 on the internal market for electricity (recast) as it has effect immediately before IP completion day as read with the modifications set out in the SI 2020/1006.

## When will this change take place?

### Implementation date:

As per the original solution

Implemented into CUSC soon after Ofgem decision

### Implementation approach:

Activated in the first biannual securities statement after both:

- All offers from G2tWQ have either been signed or lapsed

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- All first CMP434 Gated Window Applications have been assigned a Gate 1 status (as requested to be a Gate 1) or assigned a Gate 2 status following the outcome of strategic alignment checks and queue formation, as notified by NESO

Commented [CG1]: These will need completing or 'as per the original'

### Acronyms, key terms and reference material

| Acronym / key term | Meaning                                  |
|--------------------|--|
| CUSC               | Connection and Use of System Code        |
| MW                 | Mega Watt                                |
| NESO               | National Energy System Operator          |
| NPV                | Net Present Value                        |
| OTCF               | Oversubscribed Technology Commitment Fee |
| QM8                | Queue Management milestone               |

Commented [CG2]: Meaning?