

Workgroup Consultation Response – Pro-Forma

CMP308: Removal of BSUoS charges from Generation

Industry parties are invited to respond to this consultation expressing their views and supplying the rationale for those views, particularly in respect of any specific questions detailed below.

Please send your responses by **8 May 2019** to cusc.team@nationalgrideso.com. Please note that any responses received after the deadline or sent to a different email address may not receive due consideration by the CUSC Modifications Panel when it makes its final determination.

These responses will be included in the Final CUSC Modification Report which is submitted to the CUSC Modifications Panel.

Respondent:	<i>George Douthwaite</i>
Company Name :	<i>npower</i>
Do you believe that the proposed original or any of the alternatives better facilitate the Applicable CUSC Objectives? Please include your reasoning.	<p>For reference, the Applicable CUSC objectives are:</p> <ul style="list-style-type: none"> (a) the efficient discharge by the licensee of the obligations imposed upon it under the Act and by this licence; <p>Neutral</p> <ul style="list-style-type: none"> (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. <p>We do not believe this is better than the baseline for competition because it increases the likelihood of more suppliers going out of business as a result of nearly doubling the risk around BSUoS</p> <ul style="list-style-type: none"> (c) compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency. <p>Neutral regarding cost reflectivity</p> <ul style="list-style-type: none"> (d) compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency. <p>Neutral</p>
Do you support the proposed implementation approach? If not, please state why and provide an alternative	<p>No, we do not support the proposed implementation approach.</p> <p>Firstly, we do not believe the modification should be running ahead of a decision on TCR and in isolation to any changes</p>

suggestion where possible.

resulting from TCR, especially as Ofgem suggested the proposer should not progress the modification in their letter¹ dated 28th November 2018:

“Therefore, it is our view that work on CMP308 should not progress, at least until the conclusions of the Balancing Services Charges Task Force are published. We urge the Proposer and CUSC Panel to consider this.”

In Ofgem’s letter² dated 28th November 2018 when they decided to ask the ESO to launch a task force under the Charging Futures arrangements they stated:

“The Task Force will inform the direction of balancing services charges based on assessing whether: (i) there is value in seeking to improve cost-reflective signals through BSUoS, or (ii) BSUoS should be treated as a cost recovery charge. In the latter case, it may be suitable to apply the same approach that we are proposing for transmission and distribution residual use of system charges through our Targeted Charging Review (TCR).”

This suggests that BSUoS cost recovery should best be dealt with as part of the TCR and should not continue as part of a standalone modification. We believe CMP308 falls into the same category as CMP307 in this regard.

This change is now in consultation ahead of Task Force final report which we believe is premature as Ofgem has not yet given a steer on this.

The Balancing Services Charges task force draft report³ suggests there is no efficient market signal from any component of BSUoS:

“Based on their work the Task Force therefore concluded that: It is not feasible to charge any of the components of BSUoS in a more cost-reflective and forward-looking manner that would effectively influence user behaviour that would help the system and/or lower costs to customers. Therefore, the costs included within BSUoS should all be treated on a cost-recovery basis. The Task Force believes that cost-recovery charges should aim to minimise market distorting signals, to benefit the system and ultimately consumers. However, the current construction of the charge may inadvertently send signals that are detrimental to the system. This should be considered by Ofgem and the industry in the future design of an effective cost-recovery mechanism for BSUoS. The structure of a BSUoS cost-recovery charge is out of scope of this Task Force.”

Furthermore in their TCR minded-to decision document⁴ Ofgem

have already suggested that a separate SCR on BSUoS may be required:

“Balancing System Use of System (BSUoS) charges recover the electricity system operator’s costs of balancing the electricity system and largely function as a cost recovery charge at present⁷. When we launched the review, we indicated that we would consider the applicability of applying any wider TCR reform options to balancing changes. Since then, our Electricity Network Access Project has proposed a review of BSUoS (on which we will shortly be making a decision on whether to launch a Significant Code Review). We will consider the outcome of this work alongside responses to the proposed changes we are setting out in this document.”

All of this reinforces the fact that BSUoS cost recovery should best be dealt with as part of the TCR and should not continue as part of a standalone modification.

Secondly, we do not believe all the risk should be put onto a single set of market participants. We fully understand that the generator businesses would like to avoid BSUoS risk in the future by passing the full risk of BSUoS onto suppliers and customers. If BSUoS is continued to be calculated and charged in the same way, it is only right that this risk is smeared over all market participants, including generators. By focussing all this risk onto suppliers, the BSUoS financial risk is doubled. This would lead to increased likelihood of supplier failure.

Finally, we believe there should be a three year implementation lead time after any date of decision. Supply businesses already have purchased energy from generators, and we believe the amount purchased three years out gives a significant windfall to generators above and beyond any benefit it has been suggested this modification could deliver.

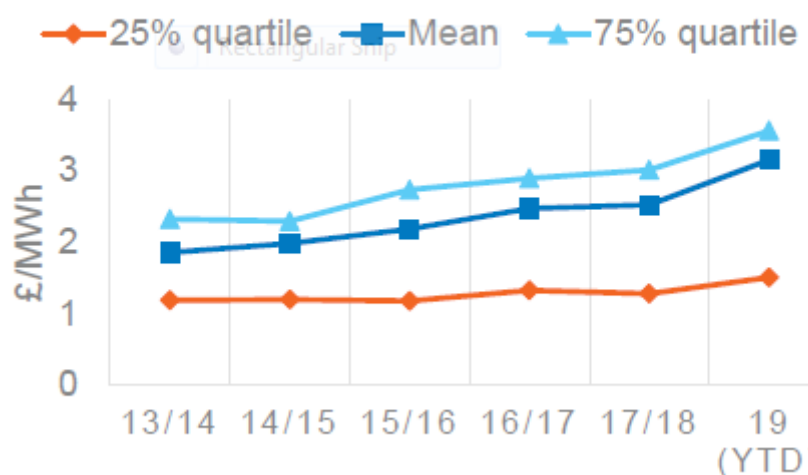
The windfall loss to suppliers is double. They will have purchased energy over this period, which includes BSUoS priced in by the generator. They additionally have sold contracts to customers which will have had a BSUoS price locked in.

We believe that Ofgem should talk directly to supply businesses and generators in confidence to establish the annualised volumes of energy already traded and sold to fixed price customers over a five year time horizon. npower would be happy to share this information with Ofgem on a strictly confidential basis.

	<p>¹https://www.ofgem.gov.uk/system/files/docs/2018/11/cmp308_letter_on_continuation_of_the_mod.pdf</p> <p>²https://www.ofgem.gov.uk/system/files/docs/2018/11/decision_to_launch_a_balancing_services_charges_taskforce.pdf</p> <p>³http://www.chargingfutures.com/media/1330/balancing-services-charges-task-force-draft-report.pdf</p> <p>⁴https://www.ofgem.gov.uk/system/files/docs/2018/11/targeted_charging_review_minded_to_decision_and_draft_impact_assessment.pdf</p>
Do you have any other comments?	<p>We believe this modification could increase overall costs to the end consumer.</p> <p>The introduction of this modification firstly assumes a reduction in power price forward curve.</p> <p>In an efficient market, power prices are based not only on the generation cost stack, but also on what the market can bear.</p> <p>Removing BSUoS from the price stack of generators will give them more scope to lower prices. This will allow more volume to be traded with Europe, and once this happens the market forces to lower prices will reduce, so it is unlikely the power price will reduce by the full amount of BSUoS.</p> <p>In addition the proposer assumes the price of the power purchased over the interconnectors will drop in price by the same amount as the UK market. If this is not the case, or as suggested above, should the UK power price not drop by the full cost of BSUoS, then, depending how much prices do drop by, the price paid by the end consumer could increase. Whether the consumer would be better or worse off is therefore difficult to determine.</p> <p>The analysis spreadsheet presented at the working group can be used to calculate a loss of BSUoS paid by purchasing counterparties in Europe of £9.3 million as a result of this modification, based on an annual 2.5GTWh of power sold to Europe over the interconnectors which would no longer recover BSUoS costs. This is another potential cost the end consumer has to bear.</p> <p>Modified versions of the analysis spreadsheet (available on request) show that the difference between power purchased through interconnectors dropping by the rate of BSUoS and not changing at all results in a swing in costs (increase) of £48.2 million to end consumer costs.</p> <p>A further implication of this is that should the cost of energy purchased through interconnectors decrease, they would lose revenue of up to £40 million (at the full reduction in price by the rate of BSUoS) per year. This may effect current interconnector businesses and could have an impact on business plans for</p>

	<p>future interconnectors, putting at risk the Ofgem target of having 30% of the system peak managed by interconnectors.</p>
<p>Do you feel it is more efficient for BSUoS to be handled by customers / suppliers rather than customers / suppliers and generators?</p>	<p>The question is not about efficiency of process but about efficiency of handling risk and the moving of the whole risk to one side of the market whilst de-risking the other. It is worth noting that under proposal CMP250 (Fixed BSUoS price) National Grid SO were unwilling to handle this risk by themselves despite the provision of an over/under recovery mechanism with financial incentives included. This modification would put all the risk on one set of market participants with no under/over recovery mechanism.</p> <p>BSUoS costs are extremely volatile and difficult to forecast (see Balancing Services Charges task force draft report³)</p> <p>In September/October 2018 as well as in March 2019 BSUoS peaked due to outages in Western Link. All market participants (suppliers, generators, customers on pass-through contracts) will have lost money over these time periods. These costs cannot be recovered in future prices with customers due to the highly competitive market forces. We would expect that the this would be a similar problem for generators as it is for suppliers. We fully understand that the generator businesses would like to avoid suffering these losses in the future by passing the full risk of BSUoS onto suppliers and customers. If BSUoS is continued to be calculated and charged in the same way, it is only right that this risk is smeared over all market participants, including generators. By focussing all this risk onto suppliers, the BSUoS financial risk is doubled for suppliers. This would lead to increased likelihood of supplier failure.</p> <p>For information, based on calculations using 6 monthly NGC SO BSUoS forecasts of June and December, it can be seen that should market participants be using the best view forecast, they will have lost £335 million over the 12 months to April 2019. For the 9 months to April, had they used the NGC-SO High error band forecast, this would reduce to £117 million. Of this, £201 million (Best View forecast) is attributable to the 3 months of September/October 18 and March 2019 (£151 million attributable of the High Error band forecast). This reinforces the point that these are increasingly volatile and unforecastable charges.</p> <p>See also Figure 4 from Balancing Services Charges task force draft report³ below which shows the increase over time of the BSUoS cost and volatility.</p>

Figure 4: Evolution of mean and volatility of BSUoS



We still believe that of all the parties within the industry, NGC-SO are best placed to manage this risk under a fixed price BSUoS modification similar to CMP250, or by managing BSUoS costs as a cost recovery in a similar way to TNUoS and DUoS residuals since they would be able to recover such losses under the under/over recovery mechanism.

Any BSUoS risk premia currently applied to BSUoS is likely to increase, under either the current arrangements or the proposal, due to the changing and challenging nature of balancing the UK system, thus increasing costs to the end consumer.

If CMP308 were to be implemented, what would your thoughts be in regards to combined/net risk premia?

CMP308 offers a win-win to generators and a lose-lose proposition for all other market participants.

Regarding risk premia, it has been argued that this can most efficiently be managed in one place. The generator community, through this modification working group, suggest that there is no issue with a single set of market participants handling this risk. They also suggest that in the interests of process efficiency, it makes sense to reduce the number of market participants who need to calculate and manage this risk.

BSUoS by its very nature is inherently difficult to forecast and as a result there is considerable risk associated with it. (refer to Figure 4 from Balancing Services Charges task force draft report³ above)

As a supply business we are strongly opposed to having this risk passed solely onto the demand side. We believe that the risk around BSUoS should be shared by all market participants.

As stated by the BSUoS Task Force, a supplier is completely exposed to BSUoS as they are unable to change their behaviour and cannot provide meaningful forward looking signals to their customers to change their behaviour.

We do not have a view on how generation calculate BSUoS risk

	<p>premium, and whether this is greater or less than suppliers who may have differing risk appetites. Ofgem need to be mindful that risk premium is not the only measurement to consider as some participants may have a central forecast which may be inflated to exclude an explicit premium and be higher than the risk adjusted forecast of another market participant. Therefore we cannot comment on whether it is more efficient to combine the premium under a single set of market participants.</p> <p>Since the generator community are keen for this risk to be borne by a single set of market participants and do not perceive any issue with this concept, we would suggest they are the best participants to take on this risk.</p> <p>We therefore propose that a better way of handling BSUoS risk would be the introduction of fixed price BSUoS notified 15 months in advance to be charged to demand side participants. The half hourly volatility of costs around this fixed price would then be passed through to generation side as either a credit or debit. This would provide the price reduction generation requires to compete in Europe.</p>
<p>What do you feel would be a sufficient lead time for the implementation of this modification? Would you support a non-April (i.e. October) implementation date in any given year? Please provide an explanation for your response</p>	<p>We believe there should be a three year implementation lead time after any date of decision.</p> <p>Supply businesses already have purchased energy from generators, and we believe the amount purchased three years out gives a significant windfall to generators above and beyond any benefit it has been suggested this modification could deliver.</p> <p>The windfall loss to suppliers is doubled. They will have purchased energy over this period, which includes BSUoS priced in by the generator. They additionally have sold contracts to customers which will have had a BSUoS price locked in.</p> <p>We believe that Ofgem should talk directly to supply businesses and generators in confidence to establish the annualised volumes of energy already traded and sold to fixed price customers over a five year time horizon. npower would be happy to share this information with Ofgem on a strictly confidential basis.</p>
<p>Has the Analysis comprehensively considered consumer/system benefits, or can you identify any area which may need more consideration by the workgroup?</p>	<p>We do not believe analysis has considered consumer benefit.</p> <p>The analysis shows that BSUoS increases, to not quite double, should the generators stop paying BSUoS and pass this full saving on as a reduction in power prices.</p> <p>The analysis shows that BSUoS will not double. This is because some of the power used to meet demand if delivered via the Interconnectors who do not pay BSUoS.</p> <p>The analysis assumes that the UK power prices as well as power</p>

	<p>purchased over the interconnectors reduces by the full amount of BSUoS rate.</p> <p>However, we do not know how well founded these assumptions are and so are concerned whether there are consumer benefits or dis-benefits.</p> <p>The status quo modelled includes an additional £9 million cost for consumers due to loss of BSUoS recovery on power sold over the interconnectors.</p>
<p>Are there any thoughts on the impact of CMP308 on the generation mix, be that short or long term? Will there be any significant IT costs to change your systems as a result of CMP308? If so please give detail.</p>	<p>No comment.</p>
<p>Are there any unintended consequences of CMP308 which have not as yet been considered by the workgroup?</p>	<p>TCR covers the BSUoS task force. We do not believe this modification should have been raised ahead of a decision on TCR, in isolation to any changes resulting from TCR or ahead of the final report from the Balancing Services Charging task force. In this respect, should this modification continue in isolation then there could be unintended consequences.</p> <p>We do not believe the modification should be running ahead of a decision on TCR and in isolation to any changes resulting from TCR, especially as Ofgem suggested the proposer should not progress the modification in their letter¹ dated 28th November 2018:</p> <p><i>“Therefore, it is our view that work on CMP308 should not progress, at least until the conclusions of the Balancing Services Charges Task Force are published. We urge the Proposer and CUSC Panel to consider this.”</i></p> <p>In Ofgem’s letter² dated 28th November 2018 when they decided to ask the ESO to launch a task force under the Charging Futures arrangements they stated:</p> <p><i>“The Task Force will inform the direction of balancing services charges based on assessing whether: (i) there is value in seeking to improve cost-reflective signals through BSUoS, or (ii) BSUoS should be treated as a cost recovery charge. In the latter case, it may be suitable to apply the same approach that we are proposing for transmission and distribution residual use of system charges through our Targeted Charging Review (TCR).”</i></p>

	<p>This suggests that BSUoS cost recovery should best be dealt with as part of the TCR and should not continue as part of a standalone modification. We believe CMP308 falls into the same category as CMP307 in this regard.</p> <p>This change is now in consultation ahead of Task Force final report which we believe is premature as Ofgem has not yet given a steer on this.</p> <p>The Balancing Services Charges task force draft report³ suggests there is no efficient market signal from any component of BSUoS:</p> <p><i>“Based on their work the Task Force therefore concluded that: It is not feasible to charge any of the components of BSUoS in a more cost-reflective and forward-looking manner that would effectively influence user behaviour that would help the system and/or lower costs to customers. Therefore, the costs included within BSUoS should all be treated on a cost-recovery basis. The Task Force believes that cost-recovery charges should aim to minimise market distorting signals, to benefit the system and ultimately consumers. However, the current construction of the charge may inadvertently send signals that are detrimental to the system. This should be considered by Ofgem and the industry in the future design of an effective cost-recovery mechanism for BSUoS. The structure of a BSUoS cost-recovery charge is out of scope of this Task Force.”</i></p> <p>Furthermore in their TCR minded-to decision document⁴ Ofgem have already suggested that a separate SCR on BSUoS may be required:</p> <p><i>“Balancing System Use of System (BSUoS) charges recover the electricity system operator’s costs of balancing the electricity system and largely function as a cost recovery charge at present⁷. When we launched the review, we indicated that we would consider the applicability of applying any wider TCR reform options to balancing charges. Since then, our Electricity Network Access Project has proposed a review of BSUoS (on which we will shortly be making a decision on whether to launch a Significant Code Review). We will consider the outcome of this work alongside responses to the proposed changes we are setting out in this document.”</i></p> <p>All of this reinforces the fact that BSUoS cost recovery should best be dealt with as part of the TCR and should not continue as part of a standalone modification.</p>
<p>Will there be any specific impact on renewable or distributed generation, be that long or short term?</p>	<p>As discussed in the workgroup report, so long as the TCR treats distributed generation in the same was as transmission connected generation, then we do not believe distributed</p>

	<p>generation would be significantly disadvantaged by this mod.</p> <p>However, without seeing final proposals and specific wording from Ofgem regarding TCR we are unable to verify whether this is the case.</p>
<p>Will there be any significant IT costs to change your systems as a result of CMP308? If so please give detail.</p>	<p>We do not have a view of the IT change costs at this time.</p> <p>We question making system changes on the basis of this modification in isolation of a TCR decision on BSUoS as further or contradictory changes may be required.</p>