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## CUSC Alternative Form - Charging

# CMP444 Alternative Request 3

**Overview:** This proposed Alternative introduces a different way of calculating the various caps when compared to the original by introducing a 2 Tier Zonal Grouping as well as 1 SD as opposed to a decile. This is designed to maintain locational differences whilst reducing the risk of TNUoS rising significantly higher than expected for all Users as opposed to just those on the extremities. Instead of redistributing revenues and tariff risk amongst various Generators, NESO will set TNUoS tariffs assuming Generation Tariffs from a revenue perspective are not capped. This maintains the Adjustment Factor at the level it would have been set at before the cap. NESO can then determine how best to collect the Allowed Revenue. Treat as under recovery or increase the Demand Residual.

**Proposer:** Damian Clough SSE Generation

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

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## What is the proposed alternative solution?

### Defect with Original proposal

- Fails to provide materially better certainty for investors in zones 8-12
- Removes locational signal between zones 1-12, but retains elsewhere
- Redistributes tariff risk amongst Generators

### Proposed alternative methodology

- **Zones 1-7 cap:** Average of zones 1-7 plus 1 standard deviation
- **Zones 8-27 cap:** Average of zones 8-12 plus 1 standard deviation
- **Tariffs are set in the tariff model assuming there is no cap on Generation tariffs. This results in the Adjustment Factor remaining unaffected by this modification**

### Cost reflectivity vs Original

- **Better cost reflectivity in zones 1-12:** Better meets Ofgem statement: *“retains regional/location differentials in charges and between technology types through a single GB cap and floor;”*

### Effective competition vs Original

- **Better certainty for zones 8-12:** Better meets Ofgem statement: *“We think this balance will be best achieved by reducing uncertainty around the future range of TNUoS charges, particularly in Northern GB where projected charge increases published by NGEN last year were particularly high and not necessarily aligned with our long-term TNUoS policy direction.”*

### Efficiency in implementation and administration vs Original

- **Neutral – Retains simplicity of single cap, but with a step:** Meets Ofgem statement: *“NGESO and other participants in any new proposal should give regard to the specific reasons for our rejection of CMP413, particularly the complexity of the methodology and deliverability.”*

(On the same rationale, there could also be a case for a three-step cap to have a separate cap for zones 13-27)

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\*Open Letter: Seeking industry action to develop a temporary intervention to protect the interests of consumers by reducing the uncertainty associated with projected future TNUoS charges

### Problems with Using a GB Average mean and 2 Standard Deviations.

Using a mean or deciles is attractive from a statistical perspective as it dampens the impact of outliers. However, with TNUoS and locational charges the outliers are not outliers in a statistical sense. They are an attempt at cost reflective charges calculated based on the location of the connection point in relation to the centre of demand. As Demand is the centre of system a calculation utilising a normal distribution would be better suited to demand charges.

*"We think this balance will be best achieved by reducing uncertainty around the future range of TNUoS charges, particularly in Northern GB where projected charge increases published by NGESO last year were particularly high and not necessarily aligned with our long-term TNUoS policy direction."*

*"retains regional/locational differentials in charges and between technology types through a single GB cap and floor;"*

As clearly noted in Ofgem's Open Letter relative differences should be maintained but large variances in potential charges should be removed and the tariff rises themselves limited.

Using 2 Standard Deviations caps charges at 95% of the mean. Therefore, the cap will **by design** only apply to the minority when clearly Ofgem stated the defect lay within Northern GB.

Using 1 SD, by design, caps tariffs at 68% of the mean with a normal distribution. This adjusted cap when compared to 2 SD's does now impact upon Northern GB. It does however remove all locational differences in these regions and in some zones reduces existing Tariffs.

The Original Solution proposed must use a Single Cap as that is what Ofgem stated the original solution should look like. However, Ofgem did also state this;

*"As any proposal progresses through the Workgroup process, it will be open to parties to raise Workgroup Alternative Code Modifications ('WACMs'). Should parties wish to raise WACMs, we would encourage that a clear rationale for the alternative is brought forward explaining how it would better facilitate achievement of the ACOs than the status quo and the proposal brought forward by NGESO, as required by the open governance procedure."*

Our argument, and the basis for this WACM is that by having a Single Cap using a GB average using 2 SD's or deciles, you by design only impact upon a minority of tariffs and by doing you have little to no impact upon those likely to bid into AR7. You also remove locational differences between key areas where new investment and connections will happen

When you connect new Generation, exports flow through the System, flipping circuits and increasing tariffs in a rippling effect. New Low Carbon also changes the ratio of Low Carbon to Carbon pushing more Year Round MWkm into the Year Round Not Shared pot as opposed to the Year Round Shared Pot. So the argument may go further upon the cap not impacting upon certain areas but by not impacting upon certain areas you may create a situation that more Generation is encouraged to connect in those areas, and the costs and impacts of doing so, are paid for by nearby areas where the cap doesn't bite. Arguably this is a skewing of competition and inefficient cost spend.

Using 1 SD does more than just limit rises but actually reduces current tariffs and removes all locational tariffs in Northern GB.

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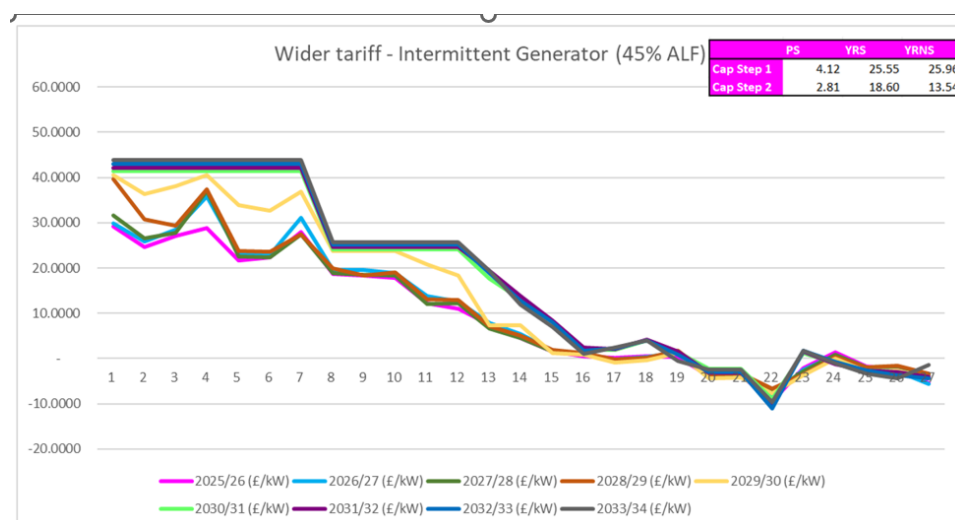
Therefore, the conclusion is, the Single GB Cap based on a GB average itself is the problem and limiting factor.

This WACM therefore introduces a two step cap process. Zones 1-7 and Zones 8 to 27 have separate caps. The Use of 1 SD limits the tariffs far more appropriately and ensures the caps bite appropriately. How YRNS is applied to zones naturally means that there are locational differences

In terms of future Zoning changes, the two step process will be mostly aligned to the proposed Zones 1 and 2 according to the latest work within CMP419 but this is something for the CMP419 to assess, and how the various solutions may impact upon the baseline.

To not do something because of a potential future change is not good governance but it can easily be dealt. Comparisons should always be made to the current baseline when assessing modifications.

The impact of the new solution is shown below.



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

The WACM introduces a two step cap. Zone 1 to 7 and Zones 8 to 27 based on existing zones.

It uses 1 standard deviation as opposed to deciles

Under the Original locational tariffs are capped which reduces the amount of revenue to be returned back via the negative adjustment factor. This solution calculates the negative adjustment factor pre capping, i.e. as if there is no cap. This will lead to either an under recovery or an adjustment to be made to the Demand Residual to ensure revenue recovery.

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## What is the impact of this change?

Proposer's Assessment against CUSC Charging Objectives	
Relevant Objective	Identified impact
(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;	<b>Positive:</b> Ofgem clearly state that they want to limit future rises but at the same time not to eliminate and remove locational differences. Removing locational differences skews competition by removing any existing cost reflectivity, and results in existing generators located nearby bearing an 'unfair' brunt of costs for new connections. It can unfairly shift the merit order of projects within the various auctions with the end consumer paying extra due to that shifting. By not reducing the negative adjustment factor due to capping, this stops the shifting of risk and cross subsidisation of locational investment from one set of Generators to all Generators.
(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 accordance with the STC) incurred by transmission licensees in their transmission businesses and which are compatible with standard licence condition C11 requirements of a connect and manage connection);	<b>Positive:</b> Ofgem state that new investment is likely to be more centrally planned and to meet 2030 targets Generation will be required to
(c) That, so far as is consistent with sub-paragraphs (a) and (b), the use of system charging methodology, as far as is reasonably practicable, properly takes account of the	<b>None:</b>

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developments in transmission licensees' transmission businesses and the ISOP business*;	
(d) Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency **; and	<b>None:</b>
(e) Promoting efficiency in the implementation and administration of the system charging methodology.	<b>Slight negative:</b> A slight added level of complexity but is more than offset by the positives
<p>* See Electricity System Operator Licence</p> <p>**The Electricity Regulation referred to in objective (d) 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.</p>	

## When will this change take place?

### Implementation date:

The modification is not required to be implemented for a number of years but the decision date needs to be in time to be taken into account in future auctions.

### Implementation approach:

Forecasted tariffs will be impacted but actual tariffs will not be impacted for a number of years

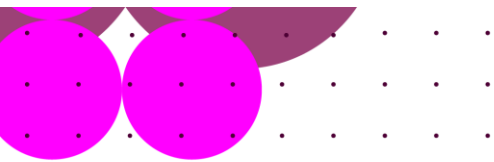
## Acronyms, key terms and reference material

Acronym / key term	Meaning
None identified	

**Commented [KH(1)]:** Section not completed

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**Commented [O13]:** Insert any acronyms or key terms used in this document and their meaning.



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