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Workgroup Consultation Response Proforma

CMP444: Introducing a cap and floor to wider generation TNUoS Charges

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 to cusc.team@nationalenergyso.com by **5pm** on **29 January 2025**. Please note that any responses received after the deadline or sent to a different email address may not receive due consideration.

If you have any queries on the content of this consultation, please contact cusc.team@nationalenergyso.com.

Respondent details	Please enter your details	
Respondent name:	Chiamaka Nwajagu	
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Which best describes your organisation?	<input type="checkbox"/> Consumer body <input type="checkbox"/> Demand <input type="checkbox"/> Distribution Network Operator <input checked="" type="checkbox"/> Generator <input type="checkbox"/> Industry body <input type="checkbox"/> Interconnector	<input type="checkbox"/> Storage <input type="checkbox"/> Supplier <input type="checkbox"/> System Operator <input type="checkbox"/> Transmission Owner <input type="checkbox"/> Virtual Lead Party <input type="checkbox"/> Other

I wish my response to be:

(Please mark the relevant box)

☒ **Non-Confidential** (this will be shared with industry and the Panel for further consideration)

☐ **Confidential** (this will be disclosed to the Authority in full but, unless specified, will not be shared with the Workgroup, Panel or the industry for further consideration)

For reference the Applicable CUSC (charging) Objectives are:

- 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;
- 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);

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- 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 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*
- e) *Promoting efficiency in the implementation and administration of the system charging methodology.*

* See Electricity System Operator Licence

**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.

For reference, (for consultation questions 5 & 6) the Electricity Balancing Regulation (EBR) Article 3 Objectives and regulatory aspects are:

- a) *fostering effective competition, non-discrimination and transparency in balancing markets;*
- b) *enhancing efficiency of balancing as well as efficiency of national balancing markets;*
- c) *integrating balancing markets and promoting the possibilities for exchanges of balancing services while contributing to operational security;*
- d) *contributing to the efficient long-term operation and development of the electricity transmission system and electricity sector while facilitating the efficient and consistent functioning of day-ahead, intraday and balancing markets;*
- e) *ensuring that the procurement of balancing services is fair, objective, transparent and market-based, avoids undue barriers to entry for new entrants, fosters the liquidity of balancing markets while preventing undue market distortions;*
- f) *facilitating the participation of demand response including aggregation facilities and energy storage while ensuring they compete with other balancing services at a level playing field and, where necessary, act independently when serving a single demand facility;*
- g) *facilitating the participation of renewable energy sources and supporting the achievement of any target specified in an enactment for the share of energy from renewable sources.*

What is the EBR?

The Electricity Balancing Regulation (EBR) is a European Network Code introduced by the Third Energy Package European legislation in late 2017.

The EBR regulation lays down the rules for the integration of balancing markets in Europe, with the objectives of enhancing Europe's security of supply. The EBR aims to do this through harmonisation of electricity balancing rules and facilitating the exchange of balancing resources between European Transmission System Operators (TSOs). Article 18 of the EBR states that TSOs such as the ESO should have terms and conditions developed for balancing services, which are submitted and approved by Ofgem.

Please express your views in the right-hand side of the table below, including your rationale.

Standard Workgroup Consultation questions

1	Do you believe that the Original Proposal	Mark the Objectives which you believe each solution better facilitates:
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	better facilitate the Applicable Objectives?	Original	<input type="checkbox"/> A <input type="checkbox"/> B <input type="checkbox"/> C <input type="checkbox"/> D <input type="checkbox"/> E
		<p>We set out our assessment of the Original Proposal against the Applicable Objectives below.</p> <p>Objective A: The original proposal does not effectively facilitate this objective. Although it reduces uncertainty for projects and allows for competitive generation costs in the north, it may not enhance overall competition in generation. On the contrary the socialisation of the TNUoS charges could distort competition. While more projects might be initiated, others in the south might not proceed. If the redistribution of risk is zero-sum, it seems unlikely to improve competition - it is at best neutral on net investments, but with potential to distort and negatively impact competition.</p> <p>Additionally, the proposal could result in other generators increasing their CfD bids to account for higher charges due to the reduction in the generator adjustment tariff and the impact of the TNUoS Floor on negative charges. Additionally, since most generators in the Capacity Market are not located in Scotland and will not benefit from the cap, the Capacity Market clearing prices may rise due to the reduction in the generator adjustment tariff.</p> <p>Objective B: The proposal does not effectively facilitate Objective B. It reduces cost reflectivity and diminishes strong signals that should lead to more efficient network investment, potentially incentivising more new generation in Northern GB than necessary, making extensive transmission investment a necessity rather than a probability. The farther generation is from the demand centre, the greater the infrastructure required to connect it. Reflecting this incremental cost of TNUoS allows generators to incorporate this into their business models. Introducing a cap and floor on TNUoS removes this, potentially encouraging inefficient generation investment, as the locational effect of generation siting decisions and the associated build costs are not accurately reflected back to the generator, ultimately increasing consumer bills.</p> <p>Objective C: Neutral.</p>	

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		<p>Objective D: Neutral. However, there is a potential correlation between the technologies deployed and their locations, which could lead to associated discrimination between technologies.</p> <p>Objective E: Neutral. However, the proposal is likely to be more complex to administer than the baseline.</p>
2	Do you support the proposed implementation approach?	<p><input type="checkbox"/> Yes</p> <p><input checked="" type="checkbox"/> No</p> <p>We do not support the proposed implementation approach because it does not use what we believe are the appropriate values for setting the cap and floor. While the proposed percentile approach is sensible, the dataset for setting the cap and floor threshold should be based on the highest tariff levels in the existing 2024 NESO 5-year forecast, specifically the last year, 2029/30. This aligns with industry comfort in the 5-year forecast for investment decisions and avoids issues with 10-year projections. It mitigates the risk of charges increasing above the best view on tariffs and reduces the risk of a cap and floor that could increase CfD and CM prices in other parts of GB outside Scotland.</p>
3	Do you have any other comments?	<p>We cannot stress enough the importance of ensuring that existing generators are not negatively impacted by this modification. Implementing a cap value that benefits northern GB generators but disadvantages other generators across GB is concerning. Many generators made investment decisions based on previous unrestricted charges, and an unforeseen high-impact intervention like this could have a significant negative impact on them. It is essential to consider all generators, not just those in Scotland, as the shift from credit to charge or significantly reduced credits due to the proposed cap and floor impacts business cases which in turn hinders investor confidence. If significant changes result from the cap and floor, grandfathering should be provided for existing generation including projects who made investment decision based on the uncapped charges and would be negatively impacted by the cap and floor, just as it is being considered for new generation making decisions based on the cap and floor. It is crucial that the proposed solution to incentivise new generation for CP30 do not negatively impact existing generators, as</p>

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	<p>this will significantly affect investor confidence. A level playing field approach must be applied across the board. Ofgem's directive for this modification highlights the importance of maintaining cost reflectivity and locational signals. Consequently, the modification must strike a balance between enabling paced deployment of new generation and the sustainability of existing investments. A guiding principle should be that existing assets are not required to undermine their expected business cases to subsidise future northern GB generators.</p> <p>Additionally, it is important to maintain cost reflectivity and effective locational signals, which are core TNUoS principles. It is essential to ensure that all generation is subject to a cost-reflective location signal. The further generation is from the demand centre, the greater the infrastructure required to connect it. Reflecting the incremental cost of investment in the TNUoS cost allows generators to incorporate this into their business models, along with other factors such as land cost, wind/solar resources, and cost of capital. Introducing a cap and floor, or setting them at inappropriate levels, risks significantly weakening cost reflectivity. This could ultimately increase consumer bills, as the locational effect of generation siting decisions and build costs are not accurately reflected back to the generator. Until a major and enduring TNUoS reform is developed that addresses the role of TNUoS in its entirety, cost reflectivity remains a core CUSC objective and TNUoS principle.</p> <p>Meeting CP30 has been highlighted as an objective for the cap and floor. Incentivising new generation in northern GB is one part of this objective but it is important to consider CP30 in its entirety. This includes large and necessary investments that could be negatively impacted by a narrow cap and floor regime, such as solar (45-47GW); and maintaining the current level of gas (35GW) to ensure energy security at an affordable cost. We caution against cap and floor levels that prioritise and incentivise generation in northern GB only, as this could significantly alter the trajectory of credits to southern zones and affect investment decisions, ultimately leading to increased costs for consumers. Additionally, it is important to consider the consequence on projects that are in development and are negatively impacted – not only would losing such projects hamper progress towards CP30 ambitions, but they would severely hinder investor confidence ahead of AR7.</p>
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		<p>Lastly, while we recognise the urgency of this modification and the need to provide certainty to generators ahead of the AR7 auction, concerns have been raised about the very compressed timelines for this modification and consultations. The risk of not fully developing a solution could result in suboptimal outcomes – particularly as the drivers behind this modification pre-date major changes in the industry such as the details of CP2030. While acting at pace to deliver change, it remains incumbent on all parties to maintain a view on unintended consequences, and the potential for suboptimal results of not allowing sufficient time to gather the views from all parties.</p>
4	Do you wish to raise a Workgroup Consultation Alternative Request for the Workgroup to consider?	<input type="checkbox"/> Yes (the request form can be found in the Workgroup Consultation Section) <input checked="" type="checkbox"/> No Not currently.
5	Does the draft legal text satisfy the intent of the modification?	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No Click or tap here to enter text.
6	Do you agree with the Workgroup's assessment that the modification does not impact the Electricity Balancing Regulation (EBR) Article 18 terms and conditions held within the Code?	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No We believe the proposal does impact the EBR as follows: <i>EBR objectives a) fostering effective competition, non-discrimination and transparency in balancing markets.</i> <i>e) ensuring that the procurement of balancing services is fair, objective, transparent and market-based, avoids undue barriers to entry for new entrants, fosters the liquidity of balancing markets while preventing undue market distortions.</i> <i>f) facilitating the participation of demand response including aggregation facilities and energy storage while ensuring they compete with other balancing services at a level playing field and, where necessary, act independently when serving a single demand facility.</i>

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		<p>This modification could give CfD generators an undue advantage over other merchant generators, such as batteries in the BM, especially if P462 is implemented. Therefore, could hinder effective competition, be discriminatory, result in a balancing service procurement that is unfair on participants and prevents a level playing.</p> <p><i>EBR b) enhancing efficiency of balancing as well as efficiency of national balancing markets; and</i> <i>d) contributing to the efficient long-term operation and development of the electricity transmission system and electricity sector while facilitating the efficient and consistent functioning of day-ahead, intraday and balancing markets.</i></p> <p>The modification could facilitate a redistribution of generation that leads to a distortion that either promotes or compromises the efficiency of balancing. It could also have unintended consequences on the efficient long-term operation and development of the electricity transmission system. If the cap and floor send distorted signals, it could result in excessive generation investment in Northern GB, necessitating further and inefficient transmission network investment.</p> <p><i>EBR g) facilitating the participation of renewable energy sources and supporting the achievement of any target specified in an enactment for the share of energy from renewable sources.</i></p> <p>The modification could encourage the participation and share of renewable energy sources in the balancing market, however risks giving certain renewable generators unfair advantage.</p>
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Specific Workgroup Consultation questions

7	Do you believe the cap and floor should have an end date? If so, how long or what is the appropriate trigger.	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
		<p>Yes, we believe the cap and floor should have an end date. Leaving it open-ended implies it is in place indefinitely, which sends the wrong signal to potential developers.</p> <p>A preferred approach would be to define a trigger for when the cap and floor will be removed to a REMA milestone, such as the finalised decision on zonal or national pricing, with an additional grace period for the</p>

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		<p>transition to an enduring solution. This allows for an enduring solution that aligns with the development and implementation of REMA decisions. However, we recognise the challenges of accurately identifying and hinging a trigger to this milestone given the uncertainties of the REMA program and lack of clarity on the information that will accompany the REMA decision.</p> <p>An alternative would be a 10-year expiry date with a renewal clause linked to REMA or mid-way review of its necessity, covering the next few allocation auction rounds, providing CfD generators with certainty and meeting CP30 targets. It is important to note that the 10-year period offers certainty within the CUSC capacity and will be superseded by wider policy interventions like REMA.</p> <p>While the above alternative of a 10-year expiry date is the preferred option, another option that may be worth considering is to apply the cap and floor only to new generation needed to achieve CP30, such as projects planning to submit bids in upcoming CfD AR7 and AR8 auctions, and projects with connection dates of 2031-2035 that may need to accelerate connection dates to fill gaps created by attrition of pre-2030 projects. This approach removes the need to consider end dates for the cap and floor, although not its duration for the applicable generators. Clear guidelines on the qualifying generation will be essential.</p>
8	<p>What level of certainty would be required from this modification to best support investment decisions? Please justify any additional protection required (for example grandfathering rights or any other levels of protection).</p>	<p><input type="checkbox"/> Yes <input type="checkbox"/> No</p> <p>We consider CMP 442 a better option for providing certainty that supports investment decisions, as it ensures cost reflectivity and locational signals are fully preserved while offering all generators the option to fix wider tariffs for an extended period.</p> <p>If this modification must be implemented, it should provide a sufficient level of certainty for a duration that aligns with the capacity of the CUSC to provide. A cap and floor mechanism in place for only 2-3 years would not suffice as an investment signal. Therefore,</p>

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		<p>implementing protection for an extended period may be needed to ensure long-term certainty of charges. However, it is important to inform the industry that the validity of this modification will potentially end with REMA's implementation, as any arrangement resulting from REMA will supersede this modification and should be applicable to all generators, including those with a cap and floor.</p> <p>It might be worth considering solutions that categorise based on connection dates. Those that can support delivery of CP30 (i.e. have connection dates before 2030) need a certain level of certainty to progress and have an immediate role to play in meeting targets. For that reason, it may be worth thinking of a set of arrangements that applies specifically to those projects, and only to those projects.</p>
9	Does the Original proposal with no specific end date provide Developers with sufficient confidence to make an investment decision? Please justify.	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No <p>No. Until REMA has established a firm view on how locational signals will be incorporated, any temporary solution will fall short of giving developers the full confidence needed for investment decisions.</p>
10	Does the Original Proposal and any of the Alternatives raised achieve the objectives of the Ofgem letter?	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No <p>No, the original proposal and the alternatives raised do not fully achieve the objectives of the Ofgem letter. While the original proposal and some alternative (i.e. Alternative 7) come close, none fully meet the objectives, and when assessed against the CUSC objectives, none of the proposed solutions achieve this. In particular, we do not see how the original proposal and alternates achieve the Ofgem direction to maintain locational signals through TNUoS sufficiently, which emerges when looking at the impact on cost objectives (as mentioned in our response to Question 1). More appropriate solutions are needed to fully align with the stated objectives.</p>
11	Do you agree with the data set proposed for	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No

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	<p>the calculation of the cap and floor? If not, what data set would you propose? What is your view on the use of NESO's 5-year forecast of April 2024?</p>	<p>No, we do not agree.</p> <p>Using the average of the 5-year forecast for setting the cap and floor means using a set of tariffs already accepted by the industry, which risks setting the cap at a lower level than necessary and increases risk to existing and other generators across GB. A more appropriate use of the 5-year forecast could be to apply percentiles for setting the cap threshold to 2029/30 tariffs, allowing for the tariff levels in the April 2024 five-year forecast to occur but preventing the onset of the tariffs in the 10-year projections.</p> <p>Importantly, this modification and Ofgem's letter instructing it pre-date any details of CP2030. The contracted background will likely differ significantly from what was used in the Transport & Tariff model to create the 5-year forecasts and the 10-year projection. This could lead to a notable deviation from the estimated recovery from the cap and floor, thereby imposing additional liabilities on all generators.</p> <p>NESO cannot conduct a meaningful impact assessment if the data being used is incorrect. At the very least, NESO should bring forward this year's forecasts and rerun the numbers for the CP30 targets. As mentioned in the response to question 3, the risk of not fully developing a solution based on the most appropriate dataset could result in suboptimal outcomes, and additional liabilities for generators.</p> <p>Ofgem's direction on this matter should be sought.</p>
12	Please provide your assessment of the Original Solution and the 7 Alternative Requests discussed by the Workgroup (additionally, please indicate your preferred solution with associated justification):	
Alternative Request		Assessment
Original Solution		<p>The proposal does not fully meet Ofgem's objective, as it significantly reduces the existing locational differences in charges. Additionally, the dataset used for setting the cap and floor dampens cost reflectivity and results in tariffs that deviate considerably from current uncapped tariffs, disadvantaging existing generators across GB. Using only the highest tariffs in the 5-year forecast, specifically for 2029/30, would allow for a more cost-reflective cap and better proportionality in generators' TNUoS liabilities.</p>
Alternative Request 1		<p>We do not believe this meets Ofgem's objectives. In practical terms this would further incentivise new</p>

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	Scottish generation but risks discouraging merchant generation investment in Southern GB, which is also needed to achieve CP30. Additionally, it could lead to higher pricing bids and auction levels for CfD and CM generation to reflect the increased charges from the impact of a more stringent floor. This imbalance could hinder the overall objective of achieving CP30 by not adequately supporting necessary investments across all regions.
Alternative Request 2	This alternative does not adhere to Ofgem directives of a single cap. Also, it results in larger residuals/socialised costs to be recovered from all generations, leading to notable swings in wider tariffs of other generators. Therefore, we do not agree with the proposer's statement that this alternative reduces the risk of TNUoS rising significantly higher than expected for all users as opposed to just those on the extremities.
Alternative Request 3	This approach does not adhere to Ofgem's directive of a single cap. However, it allows existing generation and generation in other parts of GB to remain whole by recovering residuals from capped tariffs through the demand residual and retaining the uncapped generation adjustment tariff. While this may increase TNUoS liabilities on demand, it will reduce the risk of higher CfD bids by southern generators and higher CM prices, maintaining a neutral effect on southern-based generators and preserving investment signals there. The increase in TDR needs to be assessed against the potential for higher CM and southern CfD bids. This alternative could potentially remove the costs in the CfD auctions that arise from locational differences. However, it also relies on the assumption that CfD costs will decrease, ensuring that consumers do not bear excessive risk.
Alternative Request 4	N/A
Alternative Request 5	We do not agree this alternative meets both the CUSC and Ofgem objectives nor does it accurately address the stated additional policy context for setting the cap and floor. This alternative is akin to a postage stamp charge and will create significant distortion in the signal sent by TNUoS, indicating that major generation should be concentrated in the north, which undermines cost reflectivity. As with any proposal that does not balance

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	<p>investor certainty with the need to maintain some locational signalling, it could lead to:</p> <ul style="list-style-type: none"> • Increased generation in the north, necessitating further grid investment and perpetuating a vicious cycle • Support primarily going to the build-out of offshore and onshore projects in northern GB, while discouraging investment in other regions that are also crucial for achieving CP30. This distortion will raise the CfD clearing price for technologies like solar and likely increase costs for consumers. • A negative impact on battery projects in the south, reducing the diversification of generation needed for efficient system operation and raising system balancing costs, which again increases consumer costs. • Higher Capacity Market (CM) costs. <p>Overall, this approach does not achieve the stated policy objectives, nor does it meet the applicable CUSC objectives.</p>
Alternative Request 6	<p>We do not agree this alternative meets the applicable CUSC objectives or better than the original proposal. Removing the 2029/30 tariffs, which NESO confirms a high level of confidence in, to set an even lower cap level than the original proposal will further diminish cost reflectivity. This goes beyond preventing the onset of the early 2030s tariffs to disproportionately discount the charges in northern GB in the years before 2030. This approach increases the socialised costs to generators and unfairly penalises non-Scottish generators through increased charges or significantly reduced credits, thereby disproportionately benefiting Scottish generators and discriminating against generators located across GB.</p> <p>We reiterate setting the cap and floor based on the 2029/30 tariffs from NESO's five-year forecast. Using the 2029/30 tariffs aligns with industry confidence in the five-year forecast for investment decisions and avoids the early 2030s tariffs from the 10-year projections, which was the primary reason for the proposed cap and floor intervention. It mitigates the risk of charges increasing above the best view on tariffs and reduces the risk of a cap and floor that could raise CfD and CM prices in other parts of GB outside Scotland.</p>

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Alternative Request 7	<p>The proposal meets Ofgem's objective to some extent and partially embeds the existing differentials. However, we do not agree with the proposed dataset used. It should use the same dataset as the original or, more appropriately, utilise solely the highest tariffs in the 5-year forecast, specifically 2029/30. The recommended approach allows for a more cost reflective cap and better proportionality in generators' TNUoS liabilities. Out of all the options, this alternative significantly reduces costs for generation north of Scottish boundary, with a lesser but still notable impact on southern locations. Assuming the above points about relevant datasets are addressed, this could be the preferred solution.</p>
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