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CUSC Alternative Form – Non Charging

CMP448 Alternative Request 2: Reducing the PCF Value by a Factor of 10

Overview: An alternative request to reduce the magnitude of the Progression Commitment Fee (PCF) by a factor of 10. A project's PCF will increase at a rate of £250/MW at 6 monthly intervals up to a maximum cap of £1,000/MW (after 24 months). The alternative would not change the "trigger metric" or "trigger threshold".

Proposer: Joe Colebrook, Innova

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



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Guidance for Alternative Proposers

Who can raise an Alternative? Any CUSC or BSC Party, or Citizens Advice can raise an Alternative Request in response to the Workgroup Consultation.

How do Alternative Requests become formal Workgroup Alternative Modifications? The Workgroup will carry out a Vote on Alternatives Requests. If the majority of the Workgroup members or the Workgroup Chair believe the Alternative Request will better facilitate the Applicable Objectives than the CUSC Modification Proposal, the Workgroup will develop it as a Workgroup Alternative Modification.

Who develops the legal text for Alternatives? NESO will develop the Legal text for all Workgroup Alternative Modifications and will liaise with the Alternative Proposer to do so.

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What is the proposed alternative solution?

A project's PCF will increase at a rate of £250/MW at 6 monthly intervals up to a maximum cap of £1,000/MW (after 24 months). The PCF scenarios have been updated in Figure 1 to reflect the alternative proposal

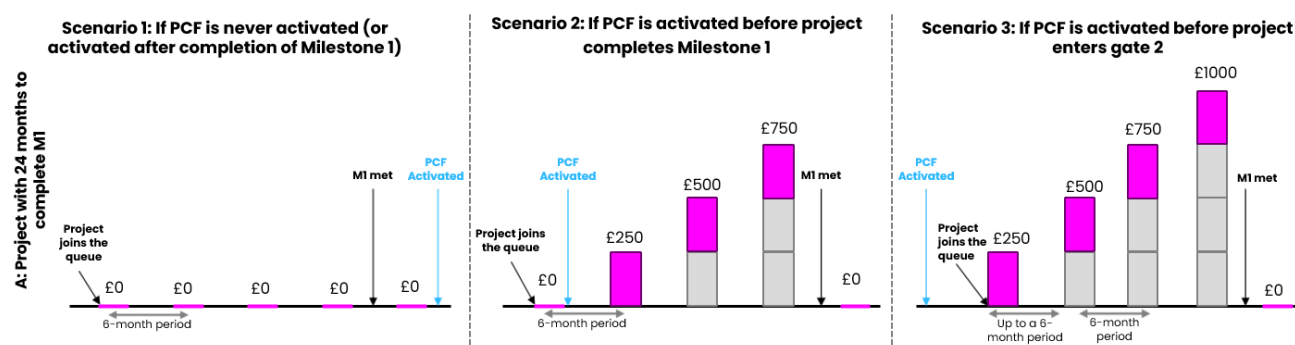


Figure 1: CMP448 Alternative 2 Example Scenarios

Why is the Change Needed?

The proposed PCF exposes customers to significant upfront liabilities that may not reflect the project's final scale or probability of success. This extraordinary financial cost proposed risks reducing market competition and innovation and halting or severely delaying renewable energy deployment in the UK up to and beyond 2030.

Innova believes that the proposed £10k/MW fee is disproportionate, noting the following key concerns:

- 1) Developers bear all the grid costs and development expenditure at risk, and the forecast PCF costs could make large-scale projects unviable from inception.
- 2) Where the PCF costs can be borne by projects, these will be passed on through the asset values and eventually onto the UK consumer.
- 3) The proposed fee structure will lead to a less diverse developer market, with reduced competition, less innovation and overall fewer projects being developed that may not align to Clean Power 2030 (CP30) ambitions, Net Zero, and wider system needs.

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Development Risk

Developers, who already bear all grid application costs, typically spend up to £1m on a transmission-connected battery development, but for a 400 MW project, the proposed financial commitment would be £4m – 400% more than typical development costs and potentially exceeding the project's value to the developer. Financing this fee at 15% interest cost over 2 years could add £1.2m in project costs, raising total costs to £2.8m and escalating financial risks that threaten project viability and add huge operational costs to small and medium-sized businesses' development.

Project Costs

The PCF development 'carry' cost increase for each project, noted above, will need to be borne within the future increase in asset values. This cost not only includes the PCF financing cost for successfully developed projects but also the costs to developers for financing the PCF for failed projects. These costs are likely to be borne eventually by the UK consumer through the increased risk premium faced by UK developers.

Developer Market and Model

The UK energy development market operates as a funnel, with numerous small, medium, and large developers successfully taking and mitigating technical, commercial and financial risk in advancing projects through the early stages of development. Typically, larger, more risk-averse firms later acquire these "project rights" to build and operate them.

The development model in the UK and Europe is a high-risk endeavour, and a developer must look at probabilistic returns or risk: reward to proceed with a development.

As an example, on a transmission-connected battery, a developer would seek, on a successful consented project, at least a 10x return against its development costs (in terms of a premium to be received for the sale of project rights).

The reason at least 10x is required is because of the failure rate of projects, which is very high at the beginning of the development cycle and reduces as projects

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progress and the risk of failure due to planning, grid costs, and archaeology, etc, are removed.

The minimum 10x valuation is due to the operational costs of running a development business, as well as the risks of pricing being lower upon selling the project (due to the myriad factors already outlined). In short, if a developer didn't make this kind of return on successful projects, once you net off the other operational costs and the costs of projects that have failed, the development company would not make a profit.

Typically, a developer will spend £1m on developing a 400MW battery. Therefore, it would like to sell that project for £10m of project rights.

If you use the same metrics but now simply only include the financing costs or 'carrying cost' of the PCF, then assuming just 2 years of interest on £4m of debt (£10k/MW), that would make the total development expenditure £2.2m, meaning the required project rights sales price increases to £22m.

This proposed material change in costs simply turns the risk: reward profile on its head, as a developer has no route to increasing the value of its projects by almost 150%. This results in many future projects being unviable or, in the best case, financing costs being passed onto the total project value and eventually borne by the UK consumer.

Innova has proposed an Alternative that reduces the maximum PCF by 10x as this better reflects the methodology the industry uses to value pre-construction projects and will only increase development costs and, therefore asset values by ~10%.

What is the difference between this and the Original Proposal?

An alternative request to reduce the magnitude of the PCF by a factor of 10. A project's PCF will increase at a rate of £250/MW at 6 monthly intervals up to a maximum cap of £1,000/MW (after 24 months).

The alternative would not change the "trigger metric", "trigger threshold" or any other aspects of the Original.



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What is the impact of this change?

Users subject to the PCF will need to provide a security (as per the Original) for a smaller amount, and this will reduce the financial burden of the PCF on Users.

Innova believe the PCF will still provide an incentive for projects to exit the queue as soon as customers are aware the project is stalled or commercially unviable. Innova believe the Alternative is better than the Original against Objectives a), b), and c), although the Alternative would still be negative against objectives b) and c) and therefore, overall, is not better than the Baseline.

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*;	<p>Positive</p> <p>CMP435 will remove a significant number of projects from the connections queue, and it will be aligned with the Clean Power 2030 Action Plan. Innova believe new projects will need to be developed over the next decade to allow the UK to meet the Clean Power 2030 plan and Net Zero. At a time when an increase in new projects will be required to replace stalled or unviable projects within the Clean Power 2030 plan, the Progression Commitment Fee (PCF) will create a barrier to entry and be a deterrent to new projects entering the connections queue.</p> <p>Setting the maximum PCF at £1,000MW should still incentivise developers to progress as projects will still be commercially viable once the cost of financing the PCF is considered.</p>

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	When activated, the PCF will incentivise projects that are stalled or unviable to leave the connection queue and allow viable projects to be delivered earlier.
(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;	<p>Negative</p> <p>Fewer renewable energy projects will be developed, and it increases barriers to entry for new entrants, particularly Small and Medium Enterprises (SMEs), to the market.</p> <p>The PCF increases development costs, which will be passed through to consumers through asset values.</p> <p>It will increase cost and reduce competition in the supply of electricity and would, therefore, be negative against objective b.</p>
(iii) Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency **; and	<p>Neutral</p> <p>The Alternative does not have an impact on the compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency, and is therefore neutral against Objective c.</p>
(iv) Promoting efficiency in the implementation and administration of the CUSC arrangements.	<p>Negative</p> <p>PCF partially duplicates User Commitment and Final Sums and will add a significant administrative burden to NESO and the connecting projects. Therefore, it is negative against objective d.</p>

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* See Electricity System Operator Licence

**The Electricity Regulation referred to in objective (c) 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:

The implementation date for this Alternative is the same as the original.

CMP448 has been designated as Urgent by the Authority and will proceed upon the Urgent timeline issued by the Authority. It is proposed to be implemented prior to Users having to sign (to accept) their project Gate 2 Offer. These Gate 2 Offers are currently expected to be issued by the end of the calendar year 2025 and, therefore, implementation of CMP448 (if approved) is currently scheduled for the end of the calendar year 2025.

Implementation approach:

The implementation approach for this Alternative is the same as the Original.

The Alternative would need to be implemented prior to Gate 2 Offers being issued (by NESO plus DNOs / transmission connected iDNOs, to those developers that applied for Gate 2) and applied to all projects between their acceptance of the project's Gate 2 Offer and Milestone 1. NESO system changes will be required to monitor the Trigger Metric and Trigger Threshold prior to the potential activation of the PCF. If the PCF is activated, then post-activation systems will be required by NESO to track and collect applicable project liabilities for the PCF.

Acronyms, key terms and reference material

Acronym / key term	Meaning
PCF	Progression Commitment Fee
DNO	Distribution Network Operator

1.