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Third Final Modification Report																				
<h2>CMP344: Clarification of Transmission Licensee revenue recovery and the treatment of revenue adjustments in the Charging Methodology</h2> <p><b>Overview:</b> This modification proposes that the additional revenue allowances for Offshore Transmission Owners (OFTOs) in relation to Income Adjustment Events (IAEs) should be recovered from all demand Users, rather than the Generator directly affected.</p>	<h3>Modification process &amp; timetable</h3> <table><tr><td>1</td><td><b>Proposal Form</b> 21 May 2020</td></tr><tr><td>2</td><td><b>Workgroup Consultation</b> 02 November 2020 to 23 November 2020</td></tr><tr><td>3</td><td><b>Workgroup Report</b> 27 November 2020</td></tr><tr><td>4</td><td><b>First Final Modification Report</b> 12 January 2021</td></tr><tr><td>5</td><td><b>Second Final Modification Report</b> 08 February 2023</td></tr><tr><td>6</td><td><b>Third Code Administrator Consultation</b> 09 May 2025 to 02 June 2025</td></tr><tr><td>7</td><td><b>Third Draft Final Modification Report</b> 19 June 2025</td></tr><tr><td>8</td><td><b>Third Final Modification Report</b> 09 July 2025</td></tr><tr><td>9</td><td><b>Implementation</b> 10 business days after Authority decision</td></tr></table>		1	<b>Proposal Form</b> 21 May 2020	2	<b>Workgroup Consultation</b> 02 November 2020 to 23 November 2020	3	<b>Workgroup Report</b> 27 November 2020	4	<b>First Final Modification Report</b> 12 January 2021	5	<b>Second Final Modification Report</b> 08 February 2023	6	<b>Third Code Administrator Consultation</b> 09 May 2025 to 02 June 2025	7	<b>Third Draft Final Modification Report</b> 19 June 2025	8	<b>Third Final Modification Report</b> 09 July 2025	9	<b>Implementation</b> 10 business days after Authority decision
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<p><b>Have 5 minutes?</b> Read our <a href="#">Executive summary</a></p> <p><b>Have 90 minutes?</b> Read the full <a href="#">Third Final Modification Report</a></p> <p><b>Have 120 minutes?</b> Read the full Third Final Modification Report and Annexes.</p>																				
<p><b>Status summary:</b> This report has been submitted to the Authority for them to decide whether this change should happen.</p>																				
<p><b>Panel recommendation:</b> The Panel has recommended by majority that the Original better facilitates the objectives than the baseline.</p>																				
<p><b>This modification is expected to have a:</b> <b>High impact</b> on Transmission Owners, Transmission Users including Generation and Suppliers; and a <b>Medium</b> impact on NESO</p>																				
<b>Governance route</b>	This modification has been assessed by a Workgroup and the Authority will make the decision on whether it should be implemented.																			
<b>Who can I talk to about the change?</b>	<p><b>Proposer:</b> Tom Steward <a href="mailto:Tom.Steward@rwe.com">Tom.Steward@rwe.com</a></p>	<p><b>Code Administrator Chair:</b> Jess Rivalland <a href="mailto:jessica.rivalland@neso.energy">jessica.rivalland@neso.energy</a></p>																		

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## Executive summary

CMP344 proposes that the additional revenue allowances for OFTOs in relation to IAEs should be recovered from all demand Users, rather than the Generator directly affected.

### What is the issue?

Section 14 of the CUSC lacks clarity on how to treat revenue adjustments related to actual costs for Transmission Licensees during Price Control periods as a result of an OFTO IAEs. ESO<sup>1</sup> published a letter in 2017<sup>2</sup> that states that these should be recovered from the Generator connected to the OFTO in question, however this has not been codified. This is also a sub-optimal approach, economically speaking as Offshore Generators must include the risk of IAEs in Contracts for Difference (CfD) bids, meaning consumers face the cost of an IAE irrespective of if one actually comes about.

### What is the solution and when will it come into effect?

**Proposer's solution:** Scope limited to IAEs approved by the Authority; and for any IAEs approved in a particular year, the OFTO revenue will be adjusted and recovered from all Demand Users.

**Implementation date:** 10 business days after Authority decision

**Workgroup conclusions:** The Workgroup concluded by majority that the Original better facilitated the Applicable Objectives than the Baseline.

**Code Administrator Consultation:** The Code Administrator Consultation received 2 non-confidential responses.

**Panel recommendation:** The Panel has recommended by majority that the Original better facilitates the objectives than the baseline.

### What is the impact if this change is made?

This modification clarifies how Transmission Owners, both Onshore and Offshore, can recover costs through the Transmission Demand Residual (TDR). This will impact demand Users and consumer tariffs. Independent analysis by Cornwall Insight indicates that CMP344 is consistent with reducing costs for consumers as Offshore Generators will no longer be forced to include additional risk premia in CfD bids. The sooner this change is made, the more significant the consumer savings.

### Interactions

None.

<sup>1</sup> Electricity System Operator (ESO) became National Energy System Operator (NESO) in October 2024

<sup>2</sup> Reflecting variations in OFTO revenue in Offshore Local TNUoS tariffs

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## What is the issue?

The defect, that was set out in the Original Proposal Form (see **Annex 1**) is as follows:

### **Recovery of “Maximum Allowed Revenue” (MAR)**

Section 14.14.1 sets out the nature of the cost to be recovered from Users.

Section 14.14.2 specifies that Transmission Network Use of System Charges (TNUoS) are set to recover the MAR.

While it is clear that the intent of Section 14 is to recover the MAR of Onshore and Offshore Transmission Owners, this is not set out explicitly in the CUSC.

### **Treatment of revenue associated with IAEs**

Section 14 of the CUSC does not set out the basis on which revenue adjustments associated with actual costs incurred and costs saved for a Transmission Licensee that occur within Price Control periods are treated. Within Price Control revenue adjustments can occur e.g. as a result IAEs.

## What is the solution?

### **Proposer’s solution**

- Scope limited to IAEs approved by the Authority; and
- For any IAEs approved in a particular year, the OFTO revenue will be adjusted and recovered from all demand Users (via the TDR<sup>3</sup> in the following year) rather than the Generator directly affected subsequently being required to repay the cost of the IAE through local TNUoS tariffs.

### **Legal Text**

The legal text for this change can be found in **Annex 3**.

<sup>3</sup> **“Transmission Demand Residual”** definition (introduced by CMP340) implemented on 1 April 2023 and states: “the total sum of annual Transmission Network Use of System revenue to be recovered through the Transmission Demand Residual Tariffs from Final Demand Sites and Unmetered Supplies only”

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## What is the impact of this change?

In the view of the Workgroup, CMP344 will impact:

- i) **Onshore Transmission Owners (TOs):** It will make it clear that Onshore TOs are allowed to recover the costs that are set at each Price Control review and allow the recovery of costs related to IAEs through adjustments to the TDR. This will improve certainty over cost recovery for onshore TOs.
- ii) **OFTOs:** It will make it clear that OFTOs can recover the costs defined at the time of the asset transfer to the OFTO and allow the recovery of costs related to IAEs through adjustments to the TDR. This will improve certainty over cost recovery for OFTOs.
- iii) **Onshore Network Users:** It will ensure that Onshore Network Users are not exposed to costs associated with the recovery of IAEs as a result of changes to locational transmission charges. This will ensure certainty over transmission costs for Onshore Network Users.
- iv) **Offshore Network Users:** It will make it clear that OFTOs can only recover the costs of the network through local charges from the date of the asset transfer and for the life of the OFTO “Price Control period”. It will also ensure that Offshore Network Users are not exposed to costs associated with the recovery of IAEs as a result of changes to local transmission charges. This will ensure certainty over transmission costs for Offshore Network Users.
- v) **Demand Users:** As allowed recovery is proposed via the TDR, there will be an impact on demand Users and ultimately end consumers tariffs; and
- vi) **Consumers:** Cornwall Insight undertook some independent analysis to consider the implications that CMP344 would have for TNUoS charges and the effects on consumers. This is discussed further in the “Workgroup Discussions following Authority decision” section of this document. Cornwall Insight concluded that if an IAE were to occur under CMP344, consumers would pay more in the short term. However, they argued that without CMP344, Generator risk premia would increase as Generators would perceive an increased IAE risk and in the long-run consumers would still be detrimentally impacted.

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## 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> <p>This allows Offshore Generators to compete on a level playing field with other forms of generation that do not face the risk of IAEs being included in local tariffs. Also allows Offshore Generators to more closely compete with each other on the basis of underlying project costs, rather than differences in expectation of risk of IAEs occurring.</p>
(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> <p>IAEs do not constitute a signal that developers are able to respond to – there is no evidence that an Offshore Generator is able to take any action to avoid the occurrence of IAEs. Some have argued that the risk of IAEs gives developers an incentive to ensure a high standard of cable construction. However, under a Generator-build approach to Offshore transmission construction, a developer already has a very strong incentive to ensure a cable is constructed to an exceptionally high standard. Any cable failures (whether granted an IAE or not) result in the Generator being either entirely, or partially, unable to export power – thereby losing significant revenues. Under a pure OFTO-build model, a Generator is not involved in the cable development process and therefore has no influence over the standard of cable</p>

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	construction. The Balancing Services Use of Systems (BSUoS) taskforce showed that a signal which cannot be responded to becomes a pass-through risk and is therefore most efficiently placed directly onto demand.
(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*;	<b>Neutral</b>
(d) Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency **; and	<b>Neutral</b>
(e) Promoting efficiency in the implementation and administration of the system charging methodology.	<b>Positive</b> <p>CMP344 brings clarity to something which is not currently addressed in the CUSC, thereby reducing the risk of lengthy and costly disputes between Users and Transmission Licensees that could arise as a result of the arrangements. CMP344 also reduces the complexity of administration of TNUoS charges – requiring a single stage recovery from demand Users, rather than the current two-stage recovery first from demand Users, and then Offshore Generators in the following Price Control period.</p>
* 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.	

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## Proposer's assessment of the impact of the modification on the stakeholder / consumer benefit categories

Stakeholder / consumer benefit categories	Identified impact
Improved safety and reliability of the system	<b>Neutral</b>
Lower bills than would otherwise be the case	<b>Positive</b> This removes an unnecessary risk to Offshore Generators which would be expected to result in lower CfD bids – reducing overall cost to consumers.
Benefits for society as a whole	<b>Neutral</b>
Reduced environmental damage	<b>Positive</b> It is conceivable that a reduction in CfD bids could leave budget for more renewable generation to be deployed under a CfD auction round than would otherwise have been delivered – bringing environmental benefit through reduced carbon intensity of the electricity mix.
Improved quality of service	<b>Neutral</b>

## Workgroup Considerations

Prior to the publication of the First Final Modification Report (**Annex 8**), the Workgroup convened 3 times to discuss the perceived issue, detail the scope of the proposed defect, devise potential solutions and assess the Proposal in terms of the Applicable Code Objectives. There was agreement from the Workgroup on the Proposer's main points and this section of the report reflects this and further discussions.

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### OFTO licence and Price Control considerations

The Workgroup identified that specific reference to OFTO's in Section 14 is needed to establish when the costs are set. The Workgroup noted clarification was needed if the IAE<sup>4</sup> means that the MAR can't be affected, then how can demand be recovered. The Workgroup held a discussion around what is allowed to be recovered under the OFTO licence. Within the Policy Decision – Income Adjusting Events in Offshore Transmission Owner Licences from 2018, the IAE provisions are set out in paragraphs 14 to 24 of Amended Standard Condition E12-J3 (Restriction of Transmission Revenue: Allowed Pass-through Items) (the IAE Condition) of the OFTO Licence.

Paragraph 15 of the IAE Condition defines what constitutes an IAE, as follows:

*"An income adjusting event in 'relevant year t' may arise from any of the following:*

- a. an event or circumstance constituting force majeure under the STC.*
- b. an event or circumstance resulting from an amendment to the STC not allowed for when allowed transmission owner revenues of the Licensee were determined for the relevant year t; and:*
- c. an event or circumstance other than listed above which, in the opinion of the Authority, is an income adjusting event and is approved by it as such in accordance with paragraph 21 of this licence condition,*

*where the event or circumstance has, for relevant year t, increased or decreased costs and/or expenses by more than [£500,000]/ [£1,000,000] (the "threshold amount").*

#### **Paragraph 15 c. of the IAE Condition is further assessed via these factors:**

- 1) whether the OFTO knew of the event or circumstance before it arose or ought to have known of it.
- 2) whether the risk of damage of that type was reasonably foreseeable (even if the particular way in which the damage has occurred may not have been).
- 3) whether there are nevertheless exceptional factors in the relevant case that mean that the event or circumstance, or its consequences, could not have been reasonably foreseeable, and

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<sup>4</sup> As detailed in The IAE provisions are set out in paragraphs 14 to 24 of Amended Standard Condition E12-J3 (Restriction of Transmission Revenue: Allowed Pass-through Items) (the IAE Condition) of the OFTO Licence

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- 4) the ability of the OFTO to manage the risk or impact by putting in place and pursuing risk management arrangements such as insurance, commercial recourse against third parties and/or operating practices.

There are sections in the OFTO licence which direct to IAE's and where they are permitted and the IAE's for Onshore are permitted under the TO licences. It was confirmed under 14.14.2, a MAR defined for these activities and those associated with pre-vesting connections is set by the Authority at the time of the TO's Price Control review for the succeeding Price Control period. TNUoS is set to recover the MAR as set by the Price Control (where necessary, allowing for any  $K_t$  adjustment for under or over recovery in a previous year net of the income recovered through pre-vesting connection charges).

### **ESO's<sup>5</sup> letter dated 27 July 2017**

The Proposer's solution looks specifically at amending Section 14 'Charging Methodologies' of the CUSC. 14.14.2, as this section sets out the MAR, as well as new paragraphs 14.14.13 and 14.14.14 which cover the treatment of IAEs specifically the CUSC currently does not have any arrangements for revenue adjustments and the solution seeks to change the MAR to ensure it is clear for both Onshore and Offshore TOs and what will need to be paid. If the Price Control settlement allows for revenue adjustment, then the MAR can be recovered by the Onshore TOs.

The MAR set at the time of the Price Control can be recovered, it is not the intention to defer anything as this should be recovered by the TO's. It was noted by the Workgroup that the IAE means that the MAR is unable to be affected, therefore not able to be recovered through demand. The Workgroup agreed that the ambiguity needs to be removed and the definition of costs clear.

NESO's revenue team attended Workgroup meeting 2 to discuss the letter. The Workgroup concluded post discussion that whilst the letter was useful when published, the need for the CUSC to be updated is still relevant.

The Workgroup also considered Ofgem's policy decision on 28 November 2018 (Paragraph 4.6)<sup>6</sup> that industry needed to address this issue regarding IAE. This had not been undertaken until this proposal was raised and sent to be developed by this Workgroup.

<sup>5</sup> Electricity System Operator (ESO) became National Energy System Operator (NESO) in October 2024

<sup>6</sup> <https://www.ofgem.gov.uk/publications-and-updates/offshore-transmission-generic-ofto-licence-and-guidance-tr6>

## Recovery via the Transmission Demand Residual

The Proposer used the example of the Sloy<sup>7</sup> income adjusting event of 7 July 2009 (and subsequent determination). Whilst this was an IAE, this was recovered through MAR. The recovery in this instance was not targeted at local Users, and as such could be used as an example of a precedent, on which this modification follows, as recovery through the TDR would be across all demand Users and not targeted specifically at local Users. Recovery through the TDR is the fairest, least distortive method of recovery due to this, and this is further elaborated on page 8, where the Workgroup's considerations on interactions with other TDR modifications is explored, and also below in the consideration of Offshore Local Circuit Tariffs.

## Offshore Local Circuit Tariffs

The Workgroup agreed with the Proposer's solution, that the methodology for Offshore Local Circuit Tariffs should be brought in line with the methodology for Onshore Local Circuit Tariffs as unforeseeable events (such as IAEs) are not included in the calculations. The Proposer stated that these are costs associated with the total system, and as such should be recovered as part of the demand residual to avoid discriminatory treatment of particular Users.

The Workgroup noted that there would be a corresponding benefit to consumers from the reduction in the risk associated with IAE which is currently recovered through local charges. This reduction in risk should be reflected in a lower cost of capital for Offshore projects, and potentially in lower CfD prices. This should result in the removal or uncertainty over cost recovery of Income Adjusting Events, manifesting a cost of capital benefit for Offshore TOs. Analysis on this point was completed after the First and Second Send Backs, available in **Annexes 11, 12 and 16**.

## Workgroup Consultation Summary

The Workgroup Consultation ran between 2 November and 23 November 2020 and received 8 responses. The full responses can be found **Annex 4**. Of the 8 responses received, 7 responses were fully supportive of the Original Proposal better facilitating the Applicable Objectives All 8 responses were supportive of the implementation approach. One respondent provided commentary on the incentive to ensure good manufacture and installation of Offshore cable remains, regardless of whether this modification is implemented or otherwise. No Alternate proposal was raised.

<sup>7</sup> <https://www.ofgem.gov.uk/ofgem-publications/52604/tirg-sloy-determination-pdf>

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## Post Workgroup Consultation Considerations

The Workgroup noted the EDF) submission with regards to incentives on parties to maintain economic and transmission arrangements. The submission highlights that these incentives remain undiminished in event of CMP344 being approved by the Authority. The Workgroup recognised this and supported the input from EDF on this matter.

## Workgroup Vote

The Workgroup met on 24 November 2020 to carry out their Workgroup Vote, which can be found in **Annex 6** of this report.

## First Code Administrator Consultation

The First Code Administrator Consultation was run from 01 December 2020 to 5pm on 22 December 2020 and there were 4 responses. The full responses can be found in **Annex 7**.

## First Panel recommendation vote

The CUSC Panel met on 08 January 2021 to carry out their recommendation vote.

They assessed whether a change should be made to the CUSC by assessing the proposed change and any Alternatives against the code objectives. The full vote can be found in the First Final Modification Report (see **Annex 8**).

Ahead of the vote taking place, the Panel considered the legal text amendments proposed as part of the First Code Administrator Consultation and agreed that they were not required for CMP344. However, the Panel noted National Grid Electrical Transmission (NGET's) concern that the proposed legal text implies that allowed revenues for Onshore TO cannot change once set, other than for under- or over-recoveries. Panel clarified that, in their view, the current wording in CMP344 does not preclude the Onshore TOs allowed revenue changing from what is set originally by the Price Control.

## First Authority Decision to send back

On 05 May 2021, the Authority sent back CMP344 (see **Annex 9**).

## Approach was agreed at CUSC Panel to address this

CUSC Panel on 28 May 2021 agreed next steps following the First Send Back on 5 May 2021:

- They noted that Ofgem are asking the Final Modification Report and legal text to be revised and resubmitted.

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- They agreed that this needs to be assessed by a Workgroup (*there is no Workgroup Consultation, or Workgroup Report and no further Workgroup Alternatives can be raised*).
- They agreed the Workgroup's Terms of Reference; and  
They agreed (following the assessment by the Workgroup) that a Code Administrator Consultation is needed to be run before it is re-presented to Panel for Recommendation Vote.

## Workgroup Discussions following First Authority Send Back

The Workgroup met on 09 September 2021 and 31 October 2022 to address the agreed Terms of Reference, and these discussions and conclusions are set out below:

### **a) Consider whether or not the Offshore Transmission Network Review might provide a better forum to propose any changes to the charging arrangements for participants in the OFTO regime**

The Proposer was unclear in which of the Offshore Transmission Network Review (OTNR) workstreams, the issue that CMP344 seeks to resolve would be housed in, and this was echoed by Workgroup members. The Workgroup also noted that the scope of OTNR is wide and OTNR is still in early stages with the conclusions of the consultation not due to be published until early 2022. Ofgem's July 2021 consultation<sup>8</sup> did not touch on any topic areas that would include the defect that CMP344 has identified. The Workgroup also raised concerns that adding further to the scope of OTNR at this stage would impact its overall purpose deliverability and agreed that it would be prudent for CMP344 to be progressed and considered separately and ahead of the wider OTNR<sup>9</sup>.

### **b) Clarify in the Final Modification Report which OFTO costs that CMP344 applies to**

The Workgroup agreed that the scope of CMP344 will be limited to IAEs.

### **c) In the Legal Text**

- 1) clarify which OFTO costs that CMP344 applies to and;
- 2) clearly sets out the exact methodology ESO should follow:

1. The Workgroup agreed that the scope of CMP344 will be limited to Income Adjustment Events (IAEs).

<sup>8</sup> Consultation - Changes intended to bring about greater coordination in the development of offshore energy networks

<sup>9</sup> Note that the same evidence was presented by the Proposer to the CUSC panel ahead of CMP344 being returned to the Workgroup.

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2. In CUSC 14.14.2, NESO have removed MAR as the term is not used in any licence for example ESO only talks about “maximum revenue”. ESO improved the final part of 14.14.2 that talks about  $K_t$  as it appears to be a general statement, but this detail is not required in this section as it is the licence that determines what can be recovered and licences are clear about  $K_t$  and its treatment already. In terms of the rest of the text, ESO updated that any IAE approved in a particular year will mean the OFTO revenue is adjusted and that is recovered via the Transmission Demand Residual<sup>10</sup> in the following year – which aligns with how the cash flows and the OFTOs get paid in accordance with the System Operator Transmission Owner Code (STC). There is a carveout though that says “unless otherwise approved by the Authority” which should allow some flexibility should the situation arise where you get to the end of an OFTO set revenue period and an IAE were to be approved – as there isn’t currently a mechanism to deal with adjustments after the period has ended. A ESO Workgroup member proposed that this risk would be picked up as part of the work on options for the end of the fixed period in which regulated revenues are paid to Offshore Transmission Owners (rather than as part of CMP344).

The Implementation Approach can be found in **Annex 10**.

- In theory, CMP344 can be implemented as soon as practicable after Ofgem approval (if Ofgem approves) as there would not be any impact on revenue collection or tariff setting until the beginning of RIIO 3, (Revenue = Incentives + Innovation + Outputs 3.)
  - Current processes (not codified) would lead to revenue collection from the Transmission Demand residual in the year following an IAE being approved (subject to sufficient timescales to be included in TNUoS tariffs) – Step 1; and
  - Charges are then levied via a Generators’ local tariff from the beginning of the next Price Control – Step 2.
- Under CMP344, Step 1 does not change. However, Step 2 would be removed irrespective of when an IAE might be approved (if CMP344 is implemented). This avoids any risk of need to reopen tariffs, even if an IAE were to be approved prior to CMP344 being implemented. The only caveat is that the above assumes CMP344 is implemented prior to RIIO-3.

<sup>10</sup> **“Transmission Demand Residual”** definition (introduced by CMP340) to be implemented on 1 April 2023 and states: “the total sum of annual Transmission Network Use of System revenue to be recovered through the Transmission Demand Residual Tariffs from Final Demand Sites and Unmetered Supplies only”

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- It sets out a number of combinations of possible order of events, demonstrating, in the view of the Proposer, that in all reasonable scenarios, revenue collection in the current Price Control is unaffected by when CMP344 is implemented.

### **d) Ensure consistency between the Final Modification Report and Legal Text**

Checked in Final Modification Report before issuing to Ofgem.

### **e) Provide quantitative analysis as to how CMP344 impacts each set of network users.**

The Proposer commissioned Cornwall Insight to carry out the relevant analysis. This was to establish the impact of the treatment of TNUoS charges and potential IAEs by Offshore wind Generators and the implications these have for consumers noting that CMP344 proposes that the additional revenue allowances for OFTOs in relation to IAEs should be recovered from all demand Users, rather than the Generator directly affected. Cornwall Insight considered the implications that this would have for TNUoS charges and the effects on CfD strike prices.

The full analysis and covering slides are included as **Annex 11** and **Annex 12** respectively.

### **Conclusions from Cornwall Insight**

- IAE claims have been rare, and none have been approved by Ofgem so far. However, the risk of IAEs occurring is likely to be impacting the prices ultimately paid by consumers.
  - Based on Generators taking an assumption of a 1 in 50 (central case) chance of an IAE with a £10m TNUoS impact occurring in any given year, Cornwall Insight estimate:
    - the TNUoS risk of IAEs for Generators increases CfD strike prices by £0.03/MWh.
    - For anticipated CfD Allocation Round 5, 6 and 7 assets alone the total benefit to consumers of applying CMP344 would be ~£50m over the lifespan of their CfDs. If precedent continues and no IAE claims are approved, there is no offsetting cost to consumers – CMP344 is “upside only”.
- If an IAE were to occur, there would be a short-term cost to consumers under the CMP344 solution. If CMP344 were not approved, Generators would increase risk premia as a result of an IAE being approved. Even when accounting for time value of money (the cost is upfront while the CfD benefit accrues later), the benefit of removing additional risk premia more than offsets the cost.

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- CMP344 only removes one element of Offshore cable outage risk. A significant cost to developers will remain from lost productivity in the event of a cable failure. Hence developers will remain heavily incentivised to construct Offshore infrastructure to high standards of reliability. CMP344 will not meaningfully diminish this incentive. The additional risk to generators from exposure to IAE expenses is not a useful market signal.

## CMP344 Impact Summary

If an IAE were to occur under CMP344, consumers would pay more in the short term. But the counterfactual without CMP344 would see generator risk premia increase as generators would perceive an increased IAE risk. So, in the long run consumers would still be detrimentally impacted.

	No IAE	An IAE occurs
CMP344 adopted	<p>Ideal outcome – no consumer cost in TNUoS or CfDs</p> <ul style="list-style-type: none"> <li>• No recovery required</li> <li>• Future CfD risk premia related to IAEs removed</li> <li>• Consumers benefit overall</li> </ul>	<p>Good outcome – consumers face upfront cost of IAE but no reactive increase in future CfD costs</p> <ul style="list-style-type: none"> <li>• Permitted costs recovered from all demand users via TNUoS, consumers pay more short term...</li> <li>• ...but CfD IAE related risk premia remain zero</li> <li>• Consumers benefit overall</li> </ul>
CMP344 rejected	<p>Poor outcome – consumers fund risk premia in bids despite no cost ever being incurred</p> <ul style="list-style-type: none"> <li>• No recovery required</li> <li>• Consumers continue to fund CfD risk premia</li> <li>• Consumer detriment overall</li> </ul>	<p>Poor outcome – customers still exposed to upfront costs (albeit paid back in RIIO) as well as to reactive increase in CfD risk premia</p> <ul style="list-style-type: none"> <li>• Permitted costs recovered from Generator</li> <li>• Consumers save in short term...</li> <li>• ...but CfD risk premia increase based on higher perceived IAE risk Consumer detriment overall</li> </ul>

### Workgroup thoughts on Conclusions

The Workgroup welcomed the analysis provided and concluded that this addresses the asks from Ofgem and sets out what the benefit could be of implementing CMP344. A Workgroup member suggested that benefits depend on your view as to whether or not risk premia will always be applied if CMP344 is rejected.

At this stage (post Workgroup Consultation and post Workgroup Vote), ESO provided Tariff Analysis which illustrates the potential impact of CMP344 on the demand residual, based on figures from the current Price Control. The Workgroup had noted that this analysis was being prepared, but did not review this analysis in time for publication of the First Final Modification Report (FMR). This analysis is contained as **Annex 5** to this report.

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## Second Code Administrator Consultation

The Second Code Administrator Consultation ran from 16 December 2022 to 5pm on 17 January 2023 and received 5 non-confidential responses. The full responses can be found in **Annex 13**.

### Second Panel recommendation vote

The Panel met on 27 January 2023 to carry out their recommendation vote. They assessed whether a change should be made to the CUSC by assessing the proposed change and any Alternatives against the Applicable Objectives. The full vote can be found in the Second Final Modification Report (**Annex 14**).

While the changes are believed to enhance the Applicable CUSC Objectives by ensuring consistent treatment for all Generators, there are concerns that they may lead to increased costs for consumers without guaranteeing that Generators will adjust their risk premiums. Overall, although the modification could improve consistency, challenges related to cost recovery and Generator incentives remain critical considerations.

### Second Authority Decision to send back

On 12 February 2024, the Authority sent back CMP344 (**Annex 15**).

#### Approach was agreed at CUSC Panel to address this

CUSC Panel on 23 February 2024 agreed next steps following the Second Send Back on 12 February 2024:

- They noted that Ofgem are asking the Final Modification Report and legal text to be revised and resubmitted.
- They agreed that this needs to be assessed by a Workgroup (*there is no Workgroup Consultation, or Workgroup Report and no further Workgroup Alternatives can be raised*).
- They agreed the Workgroup's Terms of Reference; and
- Following the assessment by the Workgroup, a Code Administrator Consultation is needed to be run before it is re-presented to Panel for recommendation vote.

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## Workgroup Discussions following Second Authority decision

The Workgroup met once on 24 February 2025 to address the below Terms of Reference, and the discussion and conclusions are set out below:

- a) Provide the charging arrangements which are considered to be the Onshore equivalent to cost recovery of IAEs and the justification for that position.**
- b) Explain and evidence the charging methodology which NESO currently follows for the cost recovery of IAE events and the equivalent Onshore comparator, setting out perceived inconsistent treatment if/ where evident.**
- c) Consider an explanation as to which aspects of Onshore and Offshore charging arrangements the Proposer considers should be aligned and how that would be achieved by this modification.**

To address these first three Terms of Reference, the NESO representative and the Proposer gave a presentation on how the IAE process currently works and how this follows the CUSC. As well as how the nearest equivalent process works for Onshore. This can be found in **Annex 17**.

The Workgroup discussed the differences between Onshore and Offshore processes and the equivalent mechanisms. For Onshore, when a significant event occurs (such as a force majeure event or a major repair), the mechanism used is a Cost and Output Adjusting Event.

For a Cost and Output Adjusting Event, the baseline that the TO is measured against is adjusted to identify if an overspend is subject to sharing or not. If this results in an increase to revenue for the TO, then the additional revenue will be picked up via the TDR, as this charge is used to collect the additional revenue which has not been recovered through locational charges. For Offshore processes, when an IAE is approved, this will directly increase the allowed revenue for the OFTO by the amount of the IAE, and this will initially be picked up by an increase to the TDR in the same way. However, in the subsequent Price Control, the Offshore Local Circuit Tariffs are adjusted to recover these costs from the Generators using the Offshore link, rather than from demand Users.

The Workgroup also discussed another Onshore comparison with the Scottish Hydro Electric Transmission Ltd (SHETL) subsea cable reopener which only applies to SHETL. This is used to recover the costs of addressing any additional subsea cable faults or addressing issues that were unforeseen at the start of the Price Control. It was introduced for RIIO-2 and is designed to cover high cost, low probability events. In making its determinations, Ofgem said that it would not be appropriate to provide baseline funding for such low probability events, but that having the reopener would allow SHET to address

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events that could have a significant detrimental impact on the network and consumers. The costs of such a reopener would be funded through TNUoS via the TDR.

The Workgroup discussed the importance of clearly outlining the similarities and differences between these processes to ensure that the proposal is well understood and justified. By providing a detailed explanation of how costs are recovered in both Onshore and Offshore scenarios.

### Legal Text discussion following Second Authority decision

The Workgroup considered whether additional clarity was needed in the legal text, with the Proposer and Workgroup members contributing to an example of Offshore Transmission Operator (OFTO) cost pass through. There was an action for ESO legal to review the additional proposed legal text and identify the most appropriate place to add it. On reviewing this, ESO were of the view that while there's no issue adding an example as there are many in Section 14, it was suggested that it is not particularly necessary and best to exclude this as the existing legal text already:

- Introduces the term “Income Adjusting Event” which the CUSC was previously silent on
  - Explains that an IAE will affect an OFTOs revenue
  - Explains that recovery is through the Transmission Demand Residual only (for the proposer's solution)
  - States which year the TDR will be affected
- d) Consider whether the analysis, produced for the Second Final Modification Report (FMR), could be adapted or supplemented to provide a more holistic view of the potential impacts.**

The Workgroup was provided the additional Cornwall Insights analysis prior to the Workgroup meeting, which can be found in **Annex 16**. The Proposer will consult with the Authority representative to talk through the data in more detail.

#### **e) Ensure that send back deficiencies on both letters have been addressed**

The Workgroup considered that the send back deficiencies on both letters have been addressed by meeting all the Terms of Reference.

#### **Further discussion points raised:**

The Proposer discussed the Sloy example contained within the First Final Modification Report (FMR) that was initially used to illustrate a point about Onshore processes.

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However, it was deemed that the Sloy example is not the best comparison for the Offshore income IAE process. The Workgroup decided that instead of using the Sloy example, it would be more effective to clearly outline the processes for both Onshore and Offshore cost recovery. This involves detailing how costs are recovered through tariffs and the mechanisms in place for both Onshore and Offshore scenarios.

As per the Authority's suggestion, CUSC Section 14.15.81 and 14.15.91 was reviewed, with the Workgroup view that no additional actions or deliberation was needed.

The Workgroup concluded that these actions address the asks from Ofgem.

## Third Code Administrator Consultation Summary

The Third Code Administrator Consultation was issued on the 09 May 2025 closed on 02 June 2025 and received 2 responses. The full responses can be found in **Annex 20**.

### Third Code Administrator Consultation summary

#### Question

Do you believe that the CMP344 Original Proposal better facilitates the Applicable CUSC Objectives?

A respondent suggested the following objectives of the proposed solution better facilitated objectives d) e) and h) better facilitated and added CMP344 establishes a fairer tariff system that levels the playing field for offshore generators, making it easier for them to compete with other forms of generation and each other. It recognises that offshore generators cannot mitigate the risk of IAEs and therefore supports direct cost recovery from demand users as the most efficient and straightforward approach. The proposed approach eliminates the two-stage recovery process, reducing complexity. Moreover, CMP344 clarifies existing regulations, reducing the potential for disputes and making the administration of TNUoS charges clearer and more efficient.

A second respondent noted the proposal aims to regulate revenue adjustments related to IAEs but does not codify the current treatment of these

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	<p>adjustments. Instead, it proposes recovering IAE costs from a different set of Network Users. This represents a significant change in transmission network charging policy, aiming to increase the costs recovered via the Transmission Demand Residual. There is concern whether the CUSC modification is the appropriate path for this policy change. We recommend addressing issues arising from the CfD regime through that regime rather than through network charging policy.</p>
Do you support the proposed solution?	<p>One respondent indicated a preference for the baseline solution, while another expressed a preference for the Original.</p>
Do you support the proposed implementation approach?	<p>One respondent indicated they did not agree with the implementation approach, the other respondent advised they fully agreed with they approach.</p>
Do you have any other comments?	<p>One Respondent noted that the Proposer seeks to formalise revenue adjustments related to IAEs by recovering costs from a new set of Network Users. This represents a significant shift in transmission network charging policy. We question whether the CUSC modification process is the appropriate avenue to evaluate such a policy change. It is our recommendation that issues stemming from the CfD regime be addressed within that regime, rather than through modifications to the network charging policy. The other respondent appreciated OFGEM's dedication in the second send-back letter to make a prompt decision and urged the regulator to decide before AR7, so the appropriate level of risk premiums can be reflected in CfD bids.</p>
<b>Legal text issues raised in the consultation</b>	

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No legal text issues were raised.
<b>EBR issues raised in the consultation</b>
No EBR issues were raised.

## Panel Recommendation vote

The Panel met on the 27 June 2025 to carry on their recommendation vote.

They assessed whether a change should be made to the CUSC by assessing the proposed change and any alternatives against the Applicable Objectives.

For reference the Applicable CUSC (charging) Objectives are:

- d) *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;*
- e) *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);*
- f) *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\*;*
- g) *Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency \*\*; and*
- h) *Promoting efficiency in the implementation and administration of the system charging methodology.*

\* See Electricity System Operator Licence

\*\*The Electricity Regulation referred to in objective (g) 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.

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**Vote 1:** Does the Original facilitate the Applicable Objectives better than the Baseline?

Panel Member: **Andrew Enzor, User' Panel Member**

	Better facilitates AO (d)?	Better facilitates AO (e)?	Better facilitates AO (f)?	Better facilitates AO (g)?	Better facilitates AO (h)?	Overall (Y/N)
Original	Y	Y	–	–	Y	Y
Voting Statement						
<p>My view has not changed since the previous Panel recommendation vote, copied below:</p> <p>C-CO(d): Better facilitated by aligning the treatment of onshore and offshore generators in respect of unforeseeable events, enabling competition between onshore and offshore generators. It also ensures offshore generators compete (e.g. for subsidy under CfDs) on a consistent basis, rather than being differentiated by assumptions relating to IAE risk.</p> <p>C-CO(e): The current treatment of IAEs does not give a useful signal to offshore generators. If CMP344 were implemented, generators would continue to be incentivised (under a generator-build model) to build reliable offshore networks to avoid outages which prevent them from generating. The additional cost of IAEs in local circuit charges therefore does not provide a useful signal which generators can act upon, and is not cost-reflective.</p> <p>C-CO(f): Neutral</p> <p>C-CO(g): Neutral</p> <p>C-CO(h): Better facilitated by clarifying the approach in respect of IAEs.</p>						

Panel Member: **Andy Pace, Consumers' Panel Member**

	Better facilitates AO (d)?	Better facilitates AO (e)?	Better facilitates AO (f)?	Better facilitates AO (g)?	Better facilitates AO (h)?	Overall (Y/N)
Original	–	N	–	–	–	N
Voting Statement						
<p>This modification places the impact of any income adjusting events within a price control period fully on consumers rather than an individual generator connected via an OFTO. This will reduce the cost reflectiveness of charges and removes any incentive of generators to manage this risk. We assess this mod as not better facilitating applicable objective (b), that compliance</p>						

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with the use of system charging methodology results in charges which reflect, as far as is reasonably practicable, the costs incurred by transmission licensees in their transmission businesses. We therefore prefer the baseline option.

### Panel Member: **Binoy Dharsi, Users' Panel Member**

	Better facilitates AO (d)?	Better facilitates AO (e)?	Better facilitates AO (f)?	Better facilitates AO (g)?	Better facilitates AO (h)?	Overall (Y/N)
Original	Y	-	-	-	Y	Y
Voting Statement						
<p>There is a clear risk posed to offshore generators who face unforecastable costs related to a potential Income Adjusting Events that cannot be reasonably forecast. The proposal does offer a solution to ensure distortions are removed from these generators. Against CUSC Applicable Objective d) this solution will improve competitiveness amongst generators. Against Objective e) there is perceived improvement in the clarity in the way cost recovery is achieved between onshore and offshore generators. The impact to consumers who will bear this risk going forward, on balance, may be an appropriate trade off. For that reason, it has been judged to be neutral. Against CUSC Objective h) This modification will provide clarity which in turn is judged to improve efficiency.</p>						

### Panel Member: **Daniel Arrowsmith, NESO Panel Member**

	Better facilitates AO (d)?	Better facilitates AO (e)?	Better facilitates AO (f)?	Better facilitates AO (g)?	Better facilitates AO (h)?	Overall (Y/N)
Original	Y	N	-	-	Y	N
Voting Statement						
<p>NESOs position on this modification is unchanged from our previous votes. In our view this does not better facilitate the applicable CUSC objectives overall, as any potential benefit from better facilitating competition does so by making charges less cost-reflective and likely leading to worse outcomes: This solution would result in any adjustments associated IAEs being recovered through adjustments to the Demand Residual (less cost-reflective), which would likely result in higher costs for end consumers (worse outcomes).</p>						

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Panel Member: **Garth Graham, Users' Panel Member**

	Better facilitates AO (d)?	Better facilitates AO (e)?	Better facilitates AO (f)?	Better facilitates AO (g)?	Better facilitates AO (h)?	Overall (Y/N)
Original	Y	Y	-	-	Y	Y
Voting Statement						
Voting Statement not provided.						

Panel Member: **Joe Dunn, Users' Panel Member**

	Better facilitates AO (d)?	Better facilitates AO (e)?	Better facilitates AO (f)?	Better facilitates AO (g)?	Better facilitates AO (h)?	Overall (Y/N)
Original	Y	Y	-	-	Y	Y
Voting Statement						
<p>Objective D: Better Facilitates</p> <p>The Original Proposal better facilitates effective competition by removing the risk for generators of IAEs being included within local tariffs. The removal of IAEs enables competition based on underlying project costs and could reduce projects risk premia, benefiting end consumers.</p> <p>Objective E: Better Facilitates</p> <p>CMP344 ensures consistency between onshore and offshore generators for the risk associated from IAEs. Risks should be placed with parties who are able to mitigate and manage them. To date there is no evidence that generators can mitigate the risk of IAEs. Therefore, it is appropriate for the risk to be socialised, better ensuring cost reflective pricing for generators.</p> <p>Objective H: Better Facilitates</p> <p>The original better facilitates the admin of the charging arrangements by removing potential ambiguity within the CUSC.</p> <p>Objective F &amp; G: Neutral</p>						

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Panel Member: **Kyran Hanks, Users' Panel Member**

	Better facilitates AO (d)?	Better facilitates AO (e)?	Better facilitates AO (f)?	Better facilitates AO (g)?	Better facilitates AO (h)?	Overall (Y/N)
Original	Y	Y	-	-	Y	Y
Voting Statement						
Voting Statement not provided.						

Panel Member: **Mark Duffield, Users' Panel Member Alternate**

	Better facilitates AO (d)?	Better facilitates AO (e)?	Better facilitates AO (f)?	Better facilitates AO (g)?	Better facilitates AO (h)?	Overall (Y/N)
Original	Y	-	-	-	Y	Y
Voting Statement						
<p>While a very rare event I accept the compelling arguments and analysis in the Cornwall Insight (CI) report that passing through the costs to consumers rather than the OFTO-connected offshore generator of an IAE in the manner proposed would be marginally more efficient than the baseline.</p> <p>Areas that I cannot currently determine are whether commercial insurance products might be available at lower cost to the generator than the 1 in 50 "self-insurance" analysis put forward in the CI report. I am also uncertain about whether the competitive pressures in the CfD auction would in reality see this type of additional cost associated with a very low risk event be further reduced in CfD strike prices. However I cannot judge these in sufficient detail to say that they would materially overturn the results of the CI analysis so on balance I am minded to say that the amendment proposal does better facilitate the Applicable CUSC Objectives.</p>						

Panel Member: **Paul Jones, Users' Panel Member**

	Better facilitates AO (d)?	Better facilitates AO (e)?	Better facilitates AO (f)?	Better facilitates AO (g)?	Better facilitates AO (h)?	Overall (Y/N)
Original	Y	N	-	-	Y	Y

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### Voting Statement

Voting statement is the same as for the last vote. This does reduce cost reflectivity compared with the baseline by not charging IAE to the affected generator, but the focus should be on fair and effective cost recovery and no useful signal to the generator has been lost as a consequence. The solution produces consistent treatment with other types of generator and an efficient mechanism for reflecting changes in revenue associated with IAEs. Cornwall Insight analysis suggests a net gain for consumers.

### Vote 2 – Which option best meets the Applicable Objectives?

Panel Member	Best Option	Which objectives does this option better facilitate? (If baseline not applicable).
Andrew Enzor	Original	d),e) and h)
Andy Pace	Baseline	N/A
Binoy Dharsi	Original	d) and h)
Daniel Arrowsmith	Baseline	N/A
Garth Graham	Original	d),e) and h)
Joe Dunn	Original	d), e) and h)
Kyran Hanks	Original	d), e) and h)
Mark Duffield	Original	d) and h)
Paul Jones	Original	d) and h)

### Panel Conclusion

The Panel has recommended by majority that the Original better facilitates the objectives than the baseline.

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## When will this change take place?

### Implementation date

10 Business Days after Authority decision

### Date decision required by

As soon as possible

### Implementation approach

In theory, CMP344 can be implemented as soon as practicable after Ofgem approval (if Ofgem approves) as there would not be any impact on revenue collection or tariff setting until the beginning of RIIO 3.

## Interactions

- |   |  |  |                                |
|---|--|--|--------------------------------|
| <input type="checkbox"/> Grid Code              | <input type="checkbox"/> BSC                               | <input type="checkbox"/> STC                 | <input type="checkbox"/> SQSS  |
| <input type="checkbox"/> European Network Codes | <input type="checkbox"/> EBR Article 18 T&Cs <sup>11</sup> | <input type="checkbox"/> Other modifications | <input type="checkbox"/> Other |

None.

## Acronyms, key terms and reference material

Acronym / key term	Meaning
BSC	Balancing and Settlement Code
BSUoS	Balancing Services Use of Systems
CfD	Contracts for Difference
CMP	CUSC Modification Proposal
CUSC	Connection and Use of System Code
EBR	Electricity Balancing Regulation
EDF	<u>Électricité de France</u>

<sup>11</sup> If the modification has an impact on Article 18 T&Cs, it will need to follow the process set out in Article 18 of the Electricity Balancing Regulation (EBR – EU Regulation 2017/2195) – the main aspect of this is that the modification will need to be consulted on for 1 month in the Code Administrator Consultation phase. N.B. This will also satisfy the requirements of the NCER process.

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ESO	Electricity System Operator
FMR	Final Modification Report
IAE	Income Adjusting Event(s)
ISOP	Independent System Operator Planner
MAR	Maximum Allowed Revenue
NESO	National Energy System Operator
NGET	National Grid Electricity Transmission
OFTO	Offshore Transmission Owner
OTNR	Offshore Transmission Network Review
RIIO-3	Revenue = Incentives + Innovation + Outputs
SHETL	Scottish Hydro Electric Transmission Ltd
SQSS	Security and Quality of Supply Standards
STC	System Operator Transmission Owner Code
T&Cs	Terms and Conditions
TDR	Transmission Demand Residual
TNUoS	Transmission Network Use of System charges
TO	Transmission Owner

## Reference material

Offshore Transmission: Generic OFTO Licence and Guidance for TR6. Publication date 30 November 2018.

Generic Offshore Transmission Owner (OFTO) Licence

National Grid Letter 27 July 2017, "Reflecting variations in Offshore Transmission Owner (OFTO) revenue in Offshore Local TNUoS Tariffs"

May 2016 TCMF Slides

Investment project SLOY Determination

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## Annexes

Annex	Information
Annex 1	CMP344 Original Proposal
Annex 2	CMP344 Terms of Reference
Annex 3	CMP344 Legal Text
Annex 4	CMP344 Workgroup Consultation Responses
Annex 5	CMP344 Tariff Analysis
Annex 6	CMP344 Workgroup Vote
Annex 7	CMP344 First Code Administrator Consultation Responses
Annex 8	CMP344 First Final Modification Report
Annex 9	CMP344 First Authority Send Back Letter
Annex 10	CMP344 Implementation approach timing
Annex 11	CMP344 Cornwall Insight Analysis
Annex 12	CMP344 Cornwall Insight Analysis Summary slides
Annex 13	CMP344 Second Code Administrator Consultation Responses
Annex 14	CMP344 Second Final Modification Report
Annex 15	CMP344 Second Authority Send Back Letter
Annex 16	CMP344 Cornwall Insight Additional Analysis
Annex 17	CMP344 Onshore and Offshore processes
Annex 18	CMP344 First Final Modification Report and Annexes
Annex 19	CMP344 Second Final Modification Report and Annexes
Annex 20	CMP344 Third Code Administrator Consultation responses