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| Modification proposal: | **Connection and Use of System Code (CUSC) CMP381:** Defer exceptionally high Winter 2021/22 BSUoS costs to 2022/2023 | | |
| Decision: | The Authority[1] directs that that WACM4 of this modification be made[2] | | |
| Target audience: | National Grid Electricity System Operator (ESO), Parties to the CUSC, the CUSC Panel and other interested parties | | |
| Date of publication: | 14 January 2022 | Implementation date: | 00:00AM 17 January 2022 |

## Background

Balancing Services Use of System ('BSUoS') charges are the means by which National Grid Electricity System Operator ('ESO') recovers the costs of balancing the system. BSUoS charges are recovered from demand customers and Large Generators based on the amount of energy imported from or exported onto the transmission network (in £/MWh) within each half-hour period[3].

During early 2020, the reduced demand associated with COVID-19 led to increases in the cost of balancing the electricity transmission system, and higher ESO forecasts for BSUoS charges. On 23 June 2020, we approved Workgroup Alternative CUSC Modification (WACM) 2 of CMP345, which applied a cap of £15/MWh to supplier and generator BSUoS charges until 31 August 2020[4]. The deferred charges from the application of this cap were scheduled to be recovered in charging year 2021/22, through an increase in BSUoS charges in all periods. On 13 August 2020, we approved WACM6 of CMP350, which built on CMP345 by reducing the cap to £10/MWh and extended its application until 25 October 2020. CMP350 also introduced a limit of £100m for the amount of deferred BSUoS charges[5].

The unprecedented and unexpected rise in gas and electricity prices over recent months[6] has contributed to significantly higher costs associated with balancing the electricity transmission system. As a result of the market conditions, BSUoS charges have considerably exceeded the ESO forecasts so far this winter.

We have acknowledged the finding of the first Balancing Services Charges Task Force that the costs included within BSUoS should all be treated on a "cost-recovery basis" and should not be charged in a "cost-reflective and forward-looking manner"[7]. We are now considering BSUoS primarily as a cost-recovery charge and our assessments reflect that view. Another

[1] References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day-to-day work.
[2] This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.
[3] Large Generators are those generators that are directly connected to the transmission network and generators that are connected to the distribution network with capacities greater than 100MW. Interconnectors and distribution connected generation smaller than 100MW do not face BSUoS charges.
[4] CMP345: Defer the additional COVID-19 BSUoS costs | Ofgem
[5] CMP350: Changes to the BSUoS Covid Support Scheme | Ofgem
[6] Rising wholesale energy prices and implications for the regulatory framework | Ofgem
[7] Open letter on the balancing services charges taskforce

key conclusion of the Task Force was that "the volatility and inability to forecast BSUoS is adding risk premium costs to all parties exposed to BSUoS".

The second Balancing Services Charges Task Force published its final report in September 2020.[8] The report recommends that Final Demand should pay all BSUoS charges, and that fixing these charges *ex ante* would deliver overall benefits. Following the second Task Force report, we published an open letter supporting its recommendations in principle. We also set out our expectations that industry should develop proposals to modify the Connection and Use of System Code ('CUSC') which covers the charging provisions for BSUoS charges.

CMP308, an existing code modification proposal, was considered as an appropriate way to give effect to part of the Task Force recommendations, namely that liability for BSUoS charges should be moved solely to Final Demand. CMP308 is currently with us for decision. We are minded-to approve its Original Proposal and are currently consulting on our minded-to position[9]. A further CUSC modification proposal, CMP361/2, seeks to enact another one of the Task Force recommendations by making BSUoS an *ex ante* fixed volumetric tariff[10]. This last modification proposal is due to be voted on by the CUSC panel in the coming weeks.

**The modification proposal**

EDF ('the Proposer') raised CMP381 on 16 December 2021. The alleged defect identified by the Proposer is that:

- BSUoS costs are significantly higher than the ESO forecasts so far this winter as a result of exceptional market conditions. Consumers and industry parties could not have reasonably expected or budgeted for these costs.

The Proposer noted that outturn BSUoS costs were £625m higher than forecasted by the ESO for the period August 2021 – November 2021.

The Proposer requested that CMP381 be treated as an Urgent CUSC Modification Proposal. We granted the request for urgency on 20 December 2021.[11]

CMP381 (the Original Proposal) seeks to:

- Introduce a cap on BSUoS costs of £10/MWh from 1 January 2022 until 31 March 2022.
- Defer the additional BSUoS costs above the cap to the 2022/2023 charging year, with deferred costs recovered using a similar recovery mechanism approved under CMP373[12].
- Introduce a limit of £300m for the cumulative amount of deferred BSUoS costs under this proposal.

[8] second-balancing-services-charges-task-force-final-report.pdf (chargingfutures.com)
[9] https://www.ofgem.gov.uk/publications/cmp308-minded-decision-and-draft-impact-assessment
[10] https://www.nationalgrideso.com/industry-information/codes/connection-and-use-system-code-cusc-old/modifications/cmp361-cmp362
[11] https://www.ofgem.gov.uk/sites/default/files/2021-12/CMP381%20-%20Urgency%20letter%20v1.0.pdf
[12] https://www.ofgem.gov.uk/publications/cmp373-deferral-bsuos-billing-error-adjustment

The Proposer considers that the Original Proposal is positive in terms of Applicable CUSC Charging Objective[13] (ACO) (a) as it will spread the recovery of a portion of what they consider to be exceptional BSUoS costs over a longer period, providing time for market participants to budget for these costs. The Proposer also considers that the Original Proposal will reduce the risk of further destabilisation of market participants, mitigating against further insolvencies that would lead to further market disruption and costs to consumers.

Further, the Proposer considers that the Original Proposal is positive in terms of ACO (b) because, in allowing costs to be spread over a longer period, it is more likely that BSUoS costs will be recovered. It is the view of the Proposer that, should such a proposal not be introduced, cost recovery would need to take place over a shorter period, increasing the risk of insolvency and, with that, the likelihood of stranded costs. Building on the arguments that the Proposer makes regarding ACO (a), it considers that the Original Proposal is positive against ACO (c). It also believes the Original Proposal to be neutral against (d) and (e).

Five alternative solutions were put forward and debated by the Workgroup. These alternatives are different to the Original in three areas: the cap applied to BSUoS in £/MWh, the limit of costs that can be deferred, and the effective date. All five were taken forward and are set out in the table below:

| Proposed solution | Limit to amount deferred under CMP381 | BSUoS Price Cap | Effective Date[14] |
|---|---|---|---|
| **CMP381 Original** | £300m | £10/MWh | From 1 January 2022 to 31 March 2022 |
| **WACM1** | £300m | £10/MWh | From Ofgem Implementation Date to 31 March 2022 |
| **WACM2** | £200m | £10/MWh | From Ofgem Implementation Date to 31 March 2022 |
| **WACM3** | £200m | £15/MWh | From Ofgem Implementation Date to 31 March 2022 |
| **WACM4** | £200m | £20/MWh | From Ofgem Implementation Date to 31 March 2022 |
| **WACM5** | £200m | £50/MWh | From Ofgem Implementation Date to 31 March 2022 |

The Workgroup's detailed discussions are described in the Final Modification Report (FMR).[15]

[13] As set out in Standard Condition C5(5) of NGESO's Transmission Licence, see: https://epr.ofgem.gov.uk/Content/Documents/Electricity%20transmission%20full%20set%20of%20consolidated%20standard%20licence%20conditions%20-%20Current%20Version.pdf

[14] For WACMs 1-5, the legal text provides for Ofgem to stipulate an implementation date as part of its decision. The legal text for each option can be found in Annex 9 of the CMP381 Final Modification Report, available here https://www.nationalgrideso.com/document/230086/download

[15] https://www.nationalgrideso.com/document/230091/download

**CUSC Panel[16] recommendation**

The CUSC Panel considered CMP381 at a meeting on 12 January 2022. The Panel recommended by majority that all of the WACMs better facilitated the ACOs when compared to the Baseline (the existing provisions of the CUSC). The CMP381 Original received 3 votes. The following table summarises the Panel votes:

| Proposed solution | Of the 9 Panel Members, how many considered this option to be better than the Baseline? | Of the 9 Panel Members, how many considered this option to best meet the ACOs? |
|---|---|---|
| **CMP381 Original** | 3 | 2 |
| **WACM1** | 5 | 1 |
| **WACM2** | 6 | 0 |
| **WACM3** | 7 | 3 |
| **WACM4** | 8 | 1 |
| **WACM5** | 8 | 2 |

*The CUSC Panel's assessment*

The table below summarises the Panel Members' assessment of the options against the ACOs. The majority of Panel Members agreed that each of the WACMs better facilitate ACO (a), the impact on competition[17]. Panel Members who positively assessed proposals agreed with the Proposer's comments that applying a cap on BSUoS charges at this time would facilitate effective competition in the generation and supply of electricity. A full definition of each ACO is provided below under 'Our Assessment'.

| Proposed Solution | Applicable Charging Objective | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | A | | B | | C | | D | | E | |
| | +ve | -ve | +ve | -ve | +ve | -ve | +ve | -ve | +ve | -ve |
| Original Proposal | 4 | 5 | 1 | 2 | | 3 | | | | 4 |
| WACM1 | 6 | 3 | 1 | 2 | | 3 | | | | 3 |
| WACM2 | 6 | 3 | 1 | 2 | | | | | | 3 |
| WACM3 | 7 | 2 | 1 | 2 | | | | | | 3 |
| WACM4 | 8 | 1 | 2 | 1 | | | | | | 3 |
| WACM5 | 7 | | 2 | 1 | | | | | | 4 |

*Summary of Panel Member votes. Neutral assessments not shown.*

[16] The CUSC Panel is established and constituted from time to time pursuant to and in accordance with the section 8 of the CUSC.
[17] The Original proposal was not considered to better facilitate ACO (a) by a majority of Panel members.

## Our decision

We have considered the issues raised by the Original Proposal, WACMs 1-5 and the FMR. We have considered and taken into account the responses to the Workgroup Consultation and the Code Administrator Consultation on the modification proposal which are attached to the FMR.[18] We have also considered the votes of the Workgroup and the CUSC Panel and have considered a number of confidential submissions made directly to us. We have concluded that:

- WACM4 would better facilitate the achievement of the ACOs; [19] and
- directing WACM4 be made is consistent with our principal objective and statutory duties.[20]

## Reasons for our decision

We think WACM4 provides a proportionate level of protection to industry parties and consumers. Given the potential for high BSUoS costs associated with the current market conditions to continue, we think implementation of WACM4 will reduce the potential for consumer harm, such as costs associated with supplier failure.

We consider that WACM4 is likely to provide benefits to industry parties, in particular Large Users on pass-through contracts[21], by protecting them from BSUoS costs that may not have been foreseen. It is our view that market intervention may harm competition and so needs to be justified and proportionate. In this case, we consider intervention to be justified and in consumers' interests, and particularly note that this intervention is for a relatively brief period. We consider WACM4's £20/MWh cap to appropriately reflect the higher end of recent BSUoS costs, and potentially reflects a level that users may not have foreseen.

We consider WACM4's £200m deferred cost limit to be appropriate. This limit, combined with the £20/MWh cap level, means WACM4 is likely to avoid potential negative impacts on competition that might arise if the deferred cost limit was reached before the scheme ends. We also think, in avoiding retrospective elements included in the Original Proposal, WACM4 does not introduce uncertainty for users surrounding concluded transactions.

[18] CUSC modification proposals, modification reports and representations can be viewed on the ESO's website at https://www.nationalgrideso.com/industry-information/codes/connection-and-use-system-code-cusc
[19] As set out in Standard Condition C5(5) of the Electricity Transmission Licence, see: https://epr.ofgem.gov.uk//Content/Documents/Electricity%20transmission%20full%20set%20of%20consolidated%20standard%20licence%20conditions%20-%20Current%20Version.pdf
[20] The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Electricity Act 1989 as amended.
[21] In broad terms, many Large Users have electricity contracts with their supplier where some cost elements, such as BSUoS and other network charges, are not built into fixed unit rates, but charged to users on their bills as separate line items. These are known as "pass-through" contracts as these third-party costs are passed through by the supplier on to the customer. Users on such contracts may be more exposed to BSUoS costs, with the risk that BSUoS may be higher than anticipated sitting with them, the demand user, rather than with the supplier.

## Our assessment against Applicable Charging Objectives

Our assessment against the ACOs is that the solutions proposed under CMP381 better facilitate ACOs (a) and (b), negatively impact ACO (e) and have a neutral impact on the other applicable objectives, with the exception of the Original Proposal and WACM1 which have a negative impact on ACO (c). Of these solutions, we think WACM4 better facilitates ACOs (a) and (b), is neutral against (c) and (d) and is negative against (e).

***(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;***

*Workgroup and Panel Views*

We note most Workgroup participants considered this proposal to provide competition benefits, for example by potentially avoiding market distortions and ensuring costs could be recovered over the longer term. The potential for reduced volatility and improved market confidence were cited as specific competition benefits.

Some Workgroup members supported 1 January 2022 implementation, suggesting later implementation would see continued harm from BSUoS costs. Others felt that retrospective implementation would lead to less certainty in the market. We note that a number of stakeholders expressed other concerns in the Workgroup Consultation, including the lack of targeting to specific vulnerable market participants, concerns around the competition impacts of unjustified interventions, and the accessibility of the process.

In the Code Administrator Consultation, most respondents were supportive of a cap, with most preferring lower levels, such as the £10/MWh proposed in the Original and WACMs 1 & 2. Most cited the perceived exceptional nature of costs, and the benefits to competition that might arise from lower volatility and improved market confidence. Some participants felt that higher caps, such as £20/MWh and higher (as seen in WACMs 4 & 5), could result in the amount of deferral being less than the overall limit, though they still considered these options to represent an improvement on the baseline methodology. Others felt that lower caps had the potential to lead to the deferral limit being met before the defined scheme end, and for market participants to lose the assurance that a cap might provide.

Two respondents expressed concerns regarding ACO (a). One was concerned about the justification for intervention, the corresponding potential for distortions, and the potential additional costs for growing suppliers due to the deferred recovery, which they considered may harm competition. Another respondent felt that capping non-exceptional levels of BSUoS would be detrimental and would add to consumer costs.

The CUSC Panel voting statements were generally supportive of proposals with regards to ACO (a). While concerns were expressed around retrospective application, and the potentially limited benefit of higher cap levels, most proposals were thought to better facilitate the objective, in particular through reducing volatility and risk premiums. One member noted that while there are benefits to the proposals, the primary driver of supplier

risk is wholesale prices, rather than BSUoS costs. They suggested that ACO (a) would be best facilitated by a cap set at the "right" level, considering WACMs 3 & 4 to be more appropriate than options with lower or higher caps. One member suggested that previous BSUoS caps (CMP345 & CMP350) were driven by events outside the energy industry, while wholesale and BSUoS cost increases are within industry parties' areas of responsibility. They suggested that lower caps potentially reward poor risk management, which they considered to be worse for competition. Another member agreed that lower caps were too low when considered against the market conditions, with only higher caps reflective of unforeseeable or extreme costs.

Others noted the chance of the limit to the deferred costs ("the pot limit") being reached means some options were less positive, as protection would end sooner. One member felt that competition was best served by options that provided the largest possible amount of support, both in financial terms and in terms of timeframe. One member felt that, based on their assessments, only WACM5, with its higher £50/MWh cap, would better facilitate this objective, while others felt a cap at this level was too high to reduce risk premiums.

*Our considerations regarding ACO (a)*

We have considered a range of competition impacts on different market participants including suppliers and generators. We have also considered a range of impacts on other parties, such as Large Users and the ESO.

*Level of the cap*

We accept that costs that may not have been foreseen may harm competition, as effective competition requires that efficiently incurred costs be passed through in the long run. We think capping high BSUoS costs for this limited period reduces the potential for supplier failure and harmful impacts on end consumers. A reduced potential for supplier failure may improve competition in the longer term. We think to the extent that suppliers and end consumers will be protected from high costs for the duration of the scheme, all cap levels are likely to provide a benefit, with lower caps giving better protection but increasing the chance that the scheme may close early. In this respect, the Original and WACMs 1-3 provide the best protection, with WACM4 providing less protection and WACM5 less still. There is potentially a trade-off between the level of protection and the likelihood that that protection will extend for the full period of the scheme.

We also take the view that for effective competition, suppliers and generators should take reasonable steps to manage risks, and to this end, the potential benefits from protection must be weighed against potential detriment to competition from a cap that is too high or too low.

Previous BSUoS caps were concerned with direct pandemic impacts, which are more obviously unforeseen events. Under the current market conditions, increased market prices are contributing to increased BSUoS costs. We consider that forecasting future market prices is a central part of many industry parties' core business functions. We might therefore expect them to have a greater understanding of the potential for higher prices caused by market conditions as opposed to a pandemic. It is therefore incumbent in

circumstances where there is a greater degree of potential foreseeability that the justification for intervention takes account of this.

The modification defect refers to costs that could not be "reasonably expected or budgeted for". WACM5, which sets a cap at £50/MWh, has a strong case for reflecting an exceptional level of costs on the basis that BSUoS costs at that level had not been seen before September 2021. WACM4's £20/MWh cap reflects the higher end of recent BSUoS costs[22] and, in our view, better reflects a level of cost that a market participant may not have budgeted for. Lower cap levels of £10/MWh and £15/MWh are linked to historic trends and historic perceived "high" levels.

We think that it is reasonable to expect market participants to have accounted for the possibility that these historic levels would be exceeded or occur more frequently. We think it is important for industry to consider the potential for future changes to trends as well as performance against trends. As a result, we think these lower caps provide protection in excess of what is justifiable, which is likely to be less beneficial for competition, particularly in the short-term. We think that WACM3's £15/MWh is less justifiable given it is the level of BSUoS cost that was put forward in the CMP345 discussions as a "high" level. This cannot therefore continue to be argued to reflect an exceptional level that may not have been foreseeable. For that same reason, we consider £10/MWh, as seen in the Original and WACMs 1 & 2, as too low to be justified.

*Targeted Support*

We note that the support offered by a cap is not targeted at vulnerable market participants e.g. suppliers. We note that none of the proposals brought forward suggested that support should be targeted at any such vulnerable parties. In any case, it is not clear the extent to which targeted interventions would better facilitate effective competition.

*Risk and Uncertainty*

We think that there is potential for harm to competition from uncertainty that may arise from retrospective application, and so the options that include effective dates before the date of this decision are less likely to better facilitate competition. The Original Proposal includes retrospective application, and so performs worse than WACMs 1-5 in this area. The Original would provide protection over a notionally longer period but achieves this by adjusting the BSUoS charges payable for periods where charges have already been incurred. We do not consider justification to have been made as to why this would be appropriate.

There are likely to be benefits to competition from reduced perception of risk from all levels of cap, with potentially greater benefits to lower cap levels. The extent to which parties will incorporate the potential for exceptional costs into risk premiums will differ between parties. That said, we think it is reasonable to assume risk premiums incorporated by generators or suppliers into their activities could fall if a cap is in place, as the potential

[22] The ESO have used the mean plus two standard deviations for the 2021 calendar year to arrive at this cap level.

range of future costs is limited by the cap for as long as the scheme remains open. As lower caps are likely to lead to more deferred costs in the time period, they may defer costs to the point that the available deferred cost limit is reached i.e. lower caps may more quickly fill the available pot. In this event, the scheme would close early.

We would expect options where the cap level and limit are suitably matched to increase the likelihood that protection will last for the full period. On the other hand, lower caps and/or lower limits mean the chance of the scheme ending earlier is higher. This could mean more protection for parties acting in the initial weeks and no protection in later weeks. Different levels of protection for parties acting in earlier or later periods is less desirable, and may lead to different treatment of parties. We consider that it is possible that volatile prices will continue throughout the period to which this modification applies. We think it is preferable for any protections to last as long as possible within this time period and provide a consistent protection for all parties rather than having a large impact at the beginning of the period and no protection for parties at the end. Early closure may also lead to step-changes in BSUoS levels, though we recognise that ESO will provide a reporting service to mitigate this risk.

We think all options are likely to better facilitate ACO (a), but the options that, based on the costs seen in the recent months, would be expected to close early, as the Original, WACM1 and WACM2 might be expected to do, are likely to perform less well, while WACMs 3-5 are likely to perform better.

*Overall*

Taken in the round, we think that WACMs 3-5 are most likely to best facilitate competition as per ACO (a), followed by WACM2 and WACM1, with the Original likely to be least well placed to improve competition.

Considering the protection available to industry, the justification of the cap level, and other factors, we see higher caps as more likely to facilitate ACO (a). Whilst we think that any of the caps suggested better facilitate ACO (a) than the Baseline, we think that higher caps are more justifiable because they better reflect costs that a market participant may not have been able to foresee. We also recognise that a cap that is too high may have insufficient impact towards reducing the risk of harmful impacts from potentially unforeseen costs. All things considered, we think WACM4's cap of £20/MWh reflects an appropriate balance of competition considerations.

***(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 in accordance with the STC) incurred by transmission licensees in their transmission businesses and which are compatible with standard condition C26 (Requirements of a connect and manage connection);***

*Workgroup and Panel Views*

Many Workgroup and Panel members considered that this objective was less relevant, given the view shared by Ofgem and industry that BSUoS is a cost-recovery charge, and so considered proposals to be neutral against ACO (b). Some felt that as long as the relevant costs were recovered, this ACO would be equally well facilitated as in the Baseline methodology. Some Panel members felt the proposals were positive against ACO (b) without providing supporting context. One member thought that all options were worse for cost reflectivity, though they noted that the cost-recovery nature of BSUoS, combined with the fact that the current form of the charge provides some perverse incentives, means reduced cost-reflectivity is not a concern. We might read this as a potentially positive effect.

*Our considerations regarding ACO (b)*

The proposed solutions would all reduce BSUoS charges to some extent over the remaining periods of charging year 2021/22, and defer a level of charges until charging year 2022/23. Ofgem's view, which it shares with the first BSUoS Task Force[23] is that BSUoS is a cost-recovery mechanism and does not send effective forward-looking signals.

While there is an argument that cost-reflectivity is worsened if costs are moved between years, and potentially users (if the market configuration changes over the time when costs were incurred versus when they are recovered), given the cost-recovery nature of the charge and the ongoing BSUoS reform work, we do not consider there to be real harm to cost-reflectivity as we are now primarily considering BSUoS as a cost-recovery charge.

We think it is possible that cost-reflectivity may be improved in periods of high costs through these proposals. Higher BSUoS charges may lead to a perverse incentive to reduce demand in high BSUoS cost periods driven by low demand or excess generation, despite such actions adding to system cost. To the extent that these signals are diluted, a cap may improve cost-reflectivity, though this is a small effect and one that is improving the cost reflectivity of other market signals, rather than improving the cost-reflectivity of BSUoS itself. We consider all options to be slightly positive for ACO (b), with lower caps likely to best facilitate this ACO.

***(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;***

*Workgroup and Panel Views*

We note most Workgroup and Panel participants considered the Original Proposal and all WACMs to be neutral against ACO (c). Three Panel members felt that the Original Proposal and WACM1 should be considered to be negative against ACO (c). These proposals deviate from the ESO's proposed £200m limit to deferrals, which is informed by the level of working capital that the ESO considers feasible to commit to these purposes, recognising their duty to manage their finances in a responsible manner.

*Our considerations regarding ACO (c)*

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The Proposer considers the CMP381 Original Proposal to be positive in terms of ACO (c) without providing significant detail. We recognise that the inclusion of a limit to the amount of BSUoS costs that can be deferred will help to ensure the continued financeability of the ESO.[24] The ESO consider the practical limit of the deferral to be £200m, rather than the £300m of the Original Proposal and WACM1.

Following discussions with the ESO, we recognise that there is a limit to the amount of liquidity that can be provided by ESO, under current regulated financial arrangements, and we accept their rationale for supporting the lower limit of £200m. We consider that solutions which provide a limit of £200m are better in line with current regulated financial arrangements than options of £300m that require an amount the ESO considers too high.

We therefore consider the Original Proposal and WACM1 to facilitate this objective less well than the baseline and are negative for ACO (c), as it may undermine the financeability of the ESO and work against our duty to have regard to the financeability of the regulated entities. WACMs 2-5 are neutral for ACO (c), as it is in-line with current regulated financial arrangements and well below the regulated limit.

***(d) compliance with the Electricity Regulation and any relevant legally binding decisions of the European Commission and/or the Agency;***

*Workgroup and Panel Views*

It was the view of the Panel members that this was not a relevant consideration for this proposal.

*Our considerations regarding ACO (d)*
We believe that ACO (d) is not relevant for the modification and our decision and the impact is therefore neutral.

***(e) promoting efficiency in the implementation and administration of the system charging methodology.***

*Workgroup and Panel Views*

The CUSC Panel members broadly agreed that these proposals would be negative against ACO (e) when compared to the Baseline, though some stressed the impact would be minimal. Some members supported their view of a negative impact by citing the need for additional reporting, as well as greater complexity. One Panel member considered only WACM5 to be negative against this ACO, as they considered the administration to come without benefit. One other member considered retrospective implementation in particular to be negative against this ACO, though noted that these periods would not yet have been billed.

[24] We have a duty under s3A of the Electricity Act 1989 to have regard to the need to ensure the financeability of the regulated entities.

*Our considerations regarding ACO (e)*

We consider this modification, which requires additional, manual administration by ESO to be negative against ACO (e). While there are not expected to be significant implementation and administration costs due to this proposal reusing the processes established under previous modifications, this work will need to be revisited to be applied in the present circumstances and additional reporting will also be required. We consider this to be negative but should stress this is a minor consideration compared to the assessments set out under the other ACOs. We might also add that if these arrangements prevent supplier failure, which comes at significant administrative cost, it may have a positive impact.

**Impact Assessment**

In our letter regarding urgency on 20 December 2021, we decided that CMP381 should be treated as an Urgent CUSC Modification Proposal.[25] In the reasons, it was noted that '[w]e are satisfied that the progression of this modification proposal is related to a current issue that if not urgently addressed may cause a significant commercial impact on parties, consumers, or other stakeholders(s)", noting that the actual extent of that impact is still uncertain.'

Section 5A of the Utilities Act 2000 imposes a duty on the Authority (its "Section 5A duty") to undertake an impact assessment in certain circumstances. In particular, that applies where it appears to the Authority that a proposal is important. A proposal is important for these purposes if its implementation would be likely to, among other things, "have a significant impact on persons engaged in commercial activities connected with the … generation, transmission, distribution or supply of electricity." Where this applies, the Authority is obliged to carry out an impact assessment.

The Authority has not found it necessary to reach a decision on the implications of the reasons set out in our letter for the application of its Section 5A duty. This is because of the exceptions to this duty. These apply if it appears to the Authority that the urgency of the matter makes it impracticable or inappropriate for the Authority to comply with the Section 5A duty.

The Authority considers it is both impracticable and inappropriate to comply with the Section 5A duty for this decision. The timeline for decision proposed in the FMR does not allow for a full impact assessment in line with our guidance.[26] The urgency of the matter makes it both impracticable and inappropriate for the Authority to comply with the Section 5A duty for this decision.[27] Within the time available, however, we have considered (to the extent practicable) the potential impacts of the proposed options on consumers, suppliers, generators and the ESO. Recognising the limitations of the analysis undertaken, we have taken account of those potential impacts in this decision.

[25] https://www.ofgem.gov.uk/sites/default/files/2021-12/CMP381%20-%20Urgency%20letter%20v1.0.pdf
[26] https://www.ofgem.gov.uk/publications-and-updates/impact-assessment-guidance
[27] Section 5A of the Utilities Act 2000 imposes a duty on the Authority (its "Section 5A duty") to undertake an impact assessment in certain circumstances.

## Assessment against the Authority's principal objective and statutory duties

In making a decision on this modification proposal, we have to act in accordance with our principal objective and statutory duties. In this regard, we consider that WACM4 takes the most proportionate approach to the recovery of exceptional BSUoS costs in a manner which is in the best interests of future and existing consumers. We have considered the expected impacts in the short, medium and long term in the context of the more efficient pass through of costs and the reduction of potential adverse impacts on competition of significant losses related to balancing costs that may not have been anticipated.

We have a duty to have regard to the financeability of the regulated entities, and recognise that there is a limit to the amount of liquidity that can be provided by the ESO, under current arrangements. With this in mind, we have duly considered the ESO's financing ability and consider that a £200m limit to the BSUoS costs that can be deferred is acceptable.

We recognise that a £200m deferral amount is substantial, however we believe that the costs associated with providing this are relatively low and this is primarily a cashflow measure. We therefore consider that the overall consumer impact of this modification is likely to be low, particularly when compared to the cost of individual supplier failure events.

## Implementation

CMP381 WACM4 will be implemented from the first settlement period of 17 January 2022 (00:00-00:30 on 17-01-2022), taking account of the importance and urgency of the modification for the reasons set out in this letter.

To the extent that a licence change is required to facilitate the recovery of the deferred costs, we will seek to progress the licence modification imminently. We are also aware that a small change to the CUSC legal text will be required for consistency to any required licence change.

## Other issues

We note that some stakeholders expressed concern at the very short timescales for CMP381, and their concern that this may undermine regulatory certainty and investor confidence. We agree it is important to provide as much regulatory predictability as possible but also note that CMP381 has been designed to tackle high BSUoS charges, which some parties consider exceptional and unforeseen. Given this context, there has been a need to develop proportionate solutions.

Under the Original Proposal, this modification would have retrospective application from the 1st of January 2022. Although it is our established view that retrospectivity should be avoided[28], we recognise that in exceptional circumstances it may be appropriate for us to consider modifications with retrospective effect. Some of these circumstances may be situations where a fault is attributable to central arrangements, situations where a

[28] ofgem-guidance-on-code-modification-urgency-criteria_0.pdf

combination of circumstances could not have been reasonably foreseen, or where the possibility of retrospective effects has been clearly flagged to participants.

We have considered whether retrospective application would be appropriate in the current circumstances and concluded that it would not, due to the potential to increase uncertainty for market participants by potentially undermining commercial decisions that have already been taken and market confidence more generally (due to perception of increased market risk). Certainty is important for market functioning, and we consider that retrospective changes may therefore be detrimental to competition. We do not think that justification for retrospective application has been provided which would outweigh our concerns.

We consider it the responsibility of market participants to manage the risks to which they are exposed, including during periods of volatility, on an ongoing basis. We consider that these proposals may be a proportionate way to aid market participants and allow them to adjust to market conditions. Following the conclusion of this support, we would expect parties to have adjusted their business plans to ensure they have considered the potential for further challenging market conditions, such that further assistance will not be required. That said, forecasting is a significant part of the ESO's role, and we think that it is important that the ESO take reasonable steps to ensure good quality forecasts are available to users. We understand new forecasting approaches are being developed.

**Obligations of Balancing Mechanism (BM) participants**

On 20 December 2021, we published an open letter to all BM participants regarding the trends in balancing costs in 2021[29]. We have been closely monitoring the accuracy of the information submitted to the ESO from BM participants. Market participants will be aware of a number of actions that we have taken against companies that have been found to have breached their obligations under REMIT and the Grid Code in recent years[30].

We will not hesitate to take action if we find evidence of market manipulation. We would like to take this opportunity to remind all BM participants of their obligations under existing regulations.

**Decision notice**

In accordance with Standard Condition C10 of the Transmission Licence, the Authority, hereby directs that WACM4 of modification proposal CMP381: *Defer exceptionally high Winter 2021/22 BSUoS costs to 2022/2023* be made with effect from the first settlement period of 17 January 2022 (00:00-00:30 on 17-01-2022).

**Charlotte Ramsay & Richard Smith**
**Directors of Energy Systems Management & Security**
Duly authorised on behalf of the Authority

[29] Open letter on trends in balancing costs in 2021 (ofgem.gov.uk)
[30] See our April 2020 finding relating to InterGen, our December 2020 finding in relation to EDF Energy (Thermal Generation) Ltd, and our August 2021 finding relating to ESB Independent Generation Trading Limited and Carrington Power Limited.