
19 January 2022

National Grid ESO response to the Consultation – CMP308 – Minded-to decision and draft impact assessment

Dear Ruben,

This response is on behalf of National Grid Electricity System Operator (NGESO) and is not confidential. National Grid ESO is the Electricity System Operator for Great Britain. We balance electricity around the country second by second to ensure that the right amount of electricity is where it is needed, when it is needed – always keeping supply and demand in balance. As Great Britain transitions towards a low-carbon future, our mission is to enable the sustainable transformation of the energy system and ensure the delivery of reliable, affordable energy for all consumers. We use our unique perspective and independent position to facilitate market-based solutions which deliver value for consumers.

We are supportive of CMP308 being approved and implemented. We recognise that Ofgem's consultants have demonstrated that moving BSUoS charges to Final Demand would likely result in significant system and consumer benefits, as well as simplifying the BSUoS charging methodology. While the benefits identified in the independent modelling likely do represent a reasonable view of the potential effects of this modification, we have highlighted some considerations on the analysis in our detailed response.

Further to this, we think these benefits would be increased by CMP361 being approved and implemented once it has gone through the code modification process, as it should remove supplier risk premia from consumer bills. We consider that it would be best to implement CMP308 and CMP361 at the same time alongside any consequential framework changes to align with the intent of these modification proposals.

Additionally, we agree with the proposed implementation date of 1st April 2023 on the basis that we can implement for this date and it would enable the benefits of this change to be unlocked sooner. However, we do not have a complete understanding of how industry parties have priced contracts to account for this change, which may affect the consumer benefits of CMP308 - in particular if behaviour has not been as expected.

Our detailed response to specific points raised in the consultation document is appended to this letter.

We welcome the opportunity to further discuss the points raised in this response and look forward to working with both Ofgem and industry as the detail of these reforms are worked through. Should you require further information or wish to discuss this response please contact Jenny Doherty in the first instance at Jennifer.Doherty@nationalgrideso.com.

Yours sincerely

Jonathan Wisdom

Code Change Delivery Senior Manager
National Grid Electricity System Operator

1. Do you agree with our assessment that CMP308 better facilitates the Applicable CUSC Objectives?

The ESO agrees with the assessment that CMP308 better facilitates the Applicable CUSC Objectives. We think that the CMP308 solution is positive against objective (a), as it levels the playing field between transmission and distribution connected generators as well as GB and EU generators by removing the BSUoS liability from transmission connected generators. As noted in the analysis produced by Ofgem's independent consultant, this can also deliver significant consumer benefits.

2. Do you agree that charging BSUoS charges only to Final Demand reduces distortions between Large Generators and other forms of generation? Please explain why.

Removing BSUoS charges from generation should overall reduce distortions between all forms of generation in GB, as well as between generation and interconnected generation (which are already exempt from BSUoS charges). This is important as these different types of generation (excluding interconnectors) directly compete in Ancillary Services, Balancing Mechanism, and wholesale markets.

However, the ESO notes that while this proposal would reduce the distortions between Large Generators and other forms of generation, it would not remove them completely. For example, Behind the Meter Generation (BTMG) would still be able to offset demand and avoid the charge where other types of generation cannot.

3. Do you have any views on the impact of this proposal on Behind the Meter Generation and its competitiveness?

While this change would see all generation be exempt from BSUoS charges, BTMG would continue to be able to offset demand meaning that BTMG would be offsetting greater costs as the BSUoS charges associated with demand would roughly double. It is likely that BTMG would continue to have a similarly sized advantage as it currently does. However, given that BTMG comprises a small share of the market, this should not stop the approval of CMP308 due to the minimal consequences this has in practice. It would be reasonable to keep this under review for the future.

4. Do you have any views on our reasoning on this proposal's effect on price signals or generation dispatch?

In their current form, BSUoS charges do not send a price signal, as per the conclusions drawn by the first BSUoS Taskforce. However, higher BSUoS charges overnight, due to lower demand, may currently incentivise generation to not dispatch overnight when it may otherwise. As per the first BSUoS Task Force, this is likely to reduce the efficiency of the market and increase prices to customers. Removing BSUoS Charges from generation would allow more cost-efficient dispatch of generation which should lead to both system and consumer benefits.

5. Do you have any views on our reasoning on this proposal's effect on competition between different generator types?

The ESO agrees that in general, this proposal should improve competition between different generator types as none of them would be liable for BSUoS. As well as removing the BSUoS costs themselves, generators would not have to price in risk premia associated with BSUoS variability.

Our view is that the results of this proposal should be monitored, including the assessment of any perceived remaining distortions. These could potentially be addressed through future regulatory change.

6. Do you have views on our assessment of the decarbonisation impacts of this proposal, both in respect of emissions from the GB energy system and of overall emissions?

The ESO agrees that bearing these impacts in mind is important in the context of the effort to achieve a net zero energy system. In terms of considering how this modification could contribute to achieving net zero, the ESO agrees that the decarbonisation impacts of this proposal should be viewed in the wider context of GB and European emissions, rather than focussing solely on GB emissions.

Moreover, the ESO agrees that the likely result of this proposal would be increased emissions accounted for in GB due to reduced interconnector imports, while European emissions would likely drop due to less marginal plant being run (these typically are fuel types which produce CO₂).

7. Do you have views on whether and the extent to which the changes proposed in this modification have already been incorporated into supplier decisions?

The ESO has no view on whether this modification has already been incorporated into supplier decisions, as such information is not available to us.

8. Do you have views on the impact of this proposal on existing supply contracts, including the possibility of costs or delayed benefits to consumers stemming from windfall gains to industry parties, or double payments?

As per our response to question 7, the ESO has no view on how this modification would affect supply contracts.

We do note that if it has not been accounted for, there could be double counting for parties who have forward bought contracts. This modification should only be implemented for 1st April 2023 if there is confidence that this double counting will not happen.

Equally, there could be windfalls if CMP308 were not approved, and market participants were to have taken action with the expectation it would be implemented in April 2023. Given the general support for this modification and that April 2023 has always been aimed for as an implementation date, there may be less risk of windfalls if it is implemented for this date.

9. Do you have views on this proposal's impacts on generator and supplier risks, including on exposure to volatile charges?

This proposal would remove risk from generators as they would no longer be liable for BSUoS. It would increase BSUoS charges and risk exposure for suppliers, and negatively impact large demand sites compared to the status quo by increasing the amount they will have to spend on BSUoS charges. In the long term, suppliers would benefit from reduced generator costs being passed through to them.

It would seem appropriate to consult on the default tariff Price Cap methodology to consider making it reflective of a reformed BSUoS charging methodology. It would be worth considering this in light of both CMP308 and CMP361/2, as they would both see BSUoS change significantly to the extent it would not be well aligned with the current Price Cap methodology.

Although in isolation CMP308 could be challenging for suppliers implementing CMP361/2 would move BSUoS charges to an ex-ante fixed price tariff. This would help mitigate the risk of the volatility of BSUoS charges. The risk would then be associated with tariffs being reset, which could be

mitigated by having a 3-month notice period and including a BSUoS Fund up to P99 as part of the tariff. A shorter notice period would ensure a more accurate forecast of BSUoS costs, and a larger BSUoS Fund would help manage periods where BSUoS costs are higher than foreseen.

10. Do you have views on the interactions between this proposal and other changes in the sector, including other BSUoS charging reform proposals?

The ESO's view is that this modification interacts positively with CMP361/2, as CMP361/2 would reduce the risk to suppliers that they would be taking on if CMP308 were to be approved. The Second BSUoS Taskforce recommended the changes put forward in CMP308 and CMP361/2 with the consideration that they would work well in tandem.

We note that a decision on CMP308 is required to allow P419 ('Enhanced Reporting of Demand Data to the NETSO to facilitate BSUoS Reform') to be implemented, given the nature of P419 as a follow-on modification.

We do not think that CMP308 interacts with CMP377 ('Clarification of Section 14 BSUoS Charging Methodology') or CMP381 ('Defer exceptionally high Winter 2021/22 BSUoS costs to 2022/2023').

CMP308 would interact with CMP363/4 ('TNUoS Demand Residual charges for transmission connected sites with a mix of Final and non-Final Demand & Definition changes for CMP363'), which would update the definitions of Final Demand and Non-Final Demand in Section 11 of the CUSC. The CMP308 workgroup discussed this, and the conclusion was that CMP308 could go forwards with those definition changes coming as part of CMP363/4. This needs to be accounted for when considering a decision for CMP308.

11. Do you have views on the modelled assessment of consumer and energy system benefits? Please provide quantitative analysis and any further information.

It is difficult to either fully support or dispute the findings from the modelled assessment, given the report does not provide much information about the model used. While we appreciate the full model details are not required, it is important we understand the sensitivity of the model's findings to the study assumptions.

In particular, we are concerned about the wholesale power price assumptions. The report states that, "The relationship between the cost of generation and prevailing market prices has been assessed based on historical data and current forward power prices". However, this report was produced prior to the extreme gas and electricity prices observed over the last 6 months, and therefore use gas prices of below approximately 70p per therm. Given that this price has roughly tripled since then, it would be prudent to reassess the validity of the results of the analysis.

Our second point is that it is not clear from the analysis whether cost reduction benefits which would have happened regardless are being attributed to the code change. Specifically, much of the increase in BSUoS costs is offset by reduction of low carbon support payments. These payments would reduce independently of the code change, as a result of technological efficiencies. It is unclear from the study whether only directly related cost reductions are included.

It would have been beneficial to model based on different net zero pathways, rather than one net zero pathway and the non-net zero pathway, steady progression. This would have allowed comparison of the effects of CMP308 in different net zero pathways, which significantly differ in

terms of their energy mixes out to 2050. For example, the amount of CCGT installed varies noticeably across the different FES, as well as the amount of CCUS which is installed alongside natural gas plant.

12. Is our assessment of non-monetised costs and benefits reasonable? Are there any other factors we should consider?

The ESO agrees that there are non-monetised benefits related to resilience, simplification, and transparency to be gained through this proposal. These are particularly realised for generators who would no longer be liable for BSUoS. It also simplifies the BSUoS charging process by reducing the number of BSUoS customers.

Further non-monetised benefits are realised through the combined implementation of CMP308 and CMP361/2. CMP361/2 would simplify the BSUoS charging process for BSUoS liable customers and mitigate the increased risk faced by a reduced charging base. It would enhance the transparency of future BSUoS charges.

13. Do you consider the consumer and system benefits identified in our consultants' modelling to represent a reasonable view of the potential effects of this modification?

While the benefits identified in the independent modelling likely do represent a reasonable view of the potential effects of this modification (i.e., within the same order of magnitude), we have highlighted some considerations on the analysis in our response to question 11.

14. Do you consider that Ofgem has duly considered all relevant consumer and system benefits? Are there any areas which could benefit from further analysis?

Please refer to our answer for question 11.

15. Our modelling assumes that CfD adjustment payments designed to compensate contract holders for the BSUoS charges they face will no longer be paid in the event generation is not liable for BSUoS charges. Do you agree with this assumption, and do you have views on our assessment of the risks associated with existing CfD contracts?

Please refer to the third paragraph of our answer to question 11.

16. Do you have views on the impacts of this proposal on end consumers, including large users and vulnerable users?

This proposal would likely benefit users which own large generation BMUs, as these would no longer be liable for BSUoS. Impacts related to increased BSUoS costs associated with the final demand assets owned by these same users could be mitigated through CMP361/2, which would fix these costs ahead of time.

Large users who are mostly final demand would face higher BSUoS costs (roughly doubled) and so increased risk due to the inherent volatility of BSUoS. However, the impact of exposure to increased volatility in cost would be mitigated if CMP361/2 were implemented at the same time as CMP308.

Our engagement with Citizen's Advice, combined with the analysis conducted by Ofgem's independent consultant, suggests little to no negative impact on vulnerable users. The main impact would be the positive consumer benefits estimated in a scenario where this proposal is approved and assumptions about the effects this would have on risk premia hold true.

17. Do you agree with our assessment that reduced costs to generators are likely to feed through into lower wholesale prices?

The ESO assumes that reduced costs to generators would likely feed through into lower wholesale prices. This is because generators would not only remove the cost of BSUoS charges themselves, but also the cost of any associated risk premia to cover for the volatility of BSUoS. Price discovery should be easier as there would be reduced distortion between different types of generation.

18. Do you agree with our assessment that this policy will not have any significant material impacts on vulnerable users?

See answer to question 16.

19. Do you agree with our assessment that this modification is unlikely to lead to any significant impacts on essential services or supply chains?

We agree with the point made in the consultation, that the long-term nature of this reform means there has been a clear signal of change for several years.

Furthermore, we agree that any impacts on essential services or supply chains would be mitigated by CMP361/2 if it were implemented at the same time as CMP308, as it would make BSUoS costs known ahead of time.

20. We would note that increases in demand costs will need to be incorporated into the Price Cap methodology. Do you have any views on this area?

Please refer to the second paragraph of our answer to question 9.

21. Do you agree with our proposed implementation date of 1 April 2023? Please provide your reasoning.

The ESO agrees with an implementation date of 1st April 2023, as it allows the consumer, system, and emissions benefits to be unlocked sooner. The ESO would be able to implement an updated charging methodology for this date.

However, we do note that the short-term impacts on the end consumer, due to CMP308, would be affected by how industry parties have prepared for this potential change.

It is also worth considering that implementation on 1st April 2023 was recommended by the second BSUoS taskforce and is therefore a date that all of industry has been aware of for a long period of time.

This proposed implementation date best works on the basis that CMP361/2 would have the same implementation date. This reduces the risk suppliers would face with respect to BSUoS volatility. It would also be easier for the ESO to deliver a single set of changes to the BSUoS charging methodology.

It would also be prudent to consider Price Cap changes to be implemented by 1st April 2023, to ensure alignment and reduced risk for suppliers.

22. Do you have any other information which is relevant to this consultation?

Nothing in addition to our CMP308 consultation responses.