

Daniel Norton
Deputy Director Price Protection
Ofgem
10 South Colonnade
Canary Wharf
London
E14 4PU

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Dear Daniel,

Call for input on reflecting potential changes to BSUoS charges in the price cap

We welcome Ofgem's call for input regarding potential changes to the BSUoS allowance in the price cap to reflect the new BSUoS charging arrangements under CUSC modifications CMP361 and 362 (should Ofgem approve them). We have previously urged Ofgem to proceed with modifications CMP361 and CMP 362 in time for implementation by April 2023, and agree with Ofgem that CMP361 will provide suppliers with greater certainty over their upcoming costs, thus reducing industry financing costs.

Our response to the issues raised in the call for input is in Annex 1. Our main points are as follows.

- We have suggested two possible approaches to calculating a transitional adjustment to be recovered in subsequent cap periods. Both approaches result in an adjustment of around £30 per customer (before losses).
- We do not believe there is any justification for offsetting against the headroom allowance, and even if Ofgem wished to do so, there would be no objective basis for calculating the offset amount.
- We agree with Ofgem's preference for Option A (Actual data method) to deal with periods for which actual BSUoS costs are not yet available.
- We suggest allocating the adjustment under Annex 8, Adjustment Allowance.

Please do not hesitate to contact me if you have any questions regarding this response.

Yours sincerely,



Richard Sweet
Director of Regulatory Policy

CALL FOR INPUT ON REFLECTING POTENTIAL CHANGES TO BSUoS CHARGES IN THE PRICE CAP – SCOTTISHPOWER RESPONSE

1. Introduction

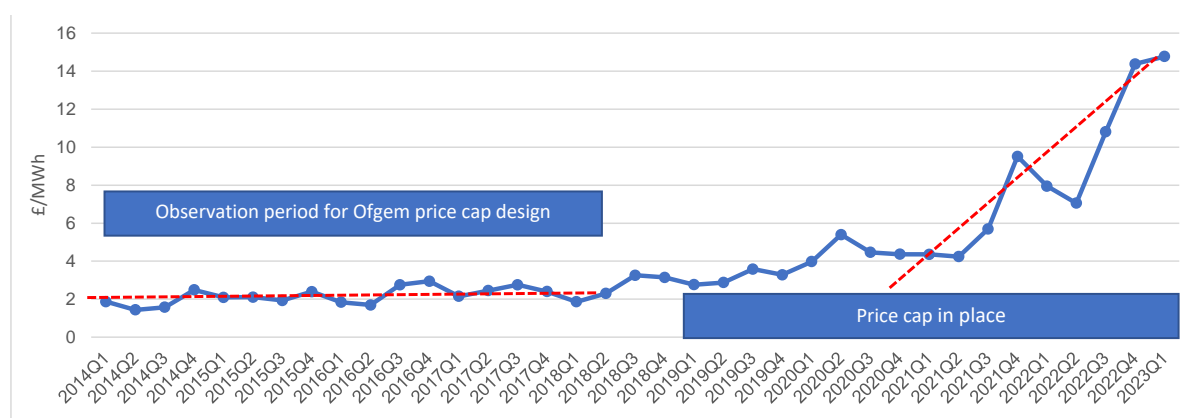
CMP361, if approved by Ofgem, will move BSUoS charging to an ex-ante fixed tariff, with three months' notice and a tariff period of one year, beginning in April 2023. We respond to Ofgem's call for input regarding potential transitional adjustments to the BSUoS allowance in the price cap to reflect these changes under the following headings:

- Calculating the shortfall/surplus in the BSUoS charge;
- Offsetting against headroom allowance;
- Calculating the surplus/shortfall in the absence of actual data for entire period;
- Duration of adjustment;
- Allocation of adjustment in price cap.

2. Calculating the shortfall/surplus in the BSUoS charge

The BSUoS allowance is currently calculated based on actual BSUoS costs incurred in a prior period, referred to as pass-through on a lagged basis in Ofgem's 2018 decision¹. In other words, it appears that the allowance is intended to be a deferred payment for the costs incurred in the *prior* period rather than a proxy/estimate for the costs incurred in the *current* period. If this interpretation is correct, suppliers would have received a double payment for costs incurred in 2018 (first through normal competitive markets during 2018 and second via the price cap in 2019), and would miss out on payment for costs incurred in the final period of the price cap. As noted below, Ofgem appears to have glossed over this issue in its final decision because BSUoS costs had been more or less stable over the observation period which informed the price cap design (Figure 1), and Ofgem therefore assumed that the over- and under-recovery would more or less balance out.

Figure 1: Trends in BSUoS costs (£/MWh) 2014-2023



As can be seen from Figure 1, this assumption has not turned out to be correct, with BSUoS prices starting to rise in 2019 and then rising sharply since the start of 2021

¹ Default Tariff Cap: Decision, Appendix 5 – Policy and network costs', Ofgem, 6 November 2018, page 14

As Ofgem suggests in its call for input, this means that it will be necessary to introduce a transitional adjustment to account for the surplus/shortfall in BSUoS recovery. The surplus/shortfall in BSUoS recovery can be calculated as follows:

$$\sum_{i=1}^N (c_i - a_i) * 3.1 * w_i$$

Where c_i is the BSUoS cost in Quarter i (£/MWh), a_i is the BSUoS allowance in Quarter i (£/MWh), 3.1 is the typical annual consumption per customer (MWh), w_i is the quarterly consumption weight, and i runs from 2019 Q1 to 2023 Q1. As shown in Table 1, this results in a total shortfall over the period of £29.83 per customer (using the latest ESO forecasts for BSUoS costs for the last three quarters²). All BSUoS costs are *before* uplifting for losses.

Table 1: Estimated shortfall in BSUoS recovery between January 2019 and March 2023

	BSUoS cost (£m)*	BSUoS volume (TWh)*	BSUoS cost (£/MWh)	BSUoS allowance (£/MWh)	Consumption weight	Surplus/ (shortfall) (£/cust)
2019 Q1	364.8	131.8	2.77	2.30	28.8%	-£0.41
2019 Q2	313.1	108.8	2.88	2.61	21.9%	-£0.18
2019 Q3	374.2	104.5	3.58	2.61	21.0%	-£0.63
2019 Q4	429.6	130.9	3.28	3.01	28.3%	-£0.24
2020 Q1	497.5	125.0	3.98	3.01	28.8%	-£0.87
2020 Q2	483.4	89.6	5.40	3.11	21.9%	-£1.55
2020 Q3	449.2	100.6	4.46	3.11	21.0%	-£0.88
2020 Q4	541.4	123.9	4.37	3.97	28.3%	-£0.35
2021 Q1	546.3	125.3	4.36	3.97	28.8%	-£0.35
2021 Q2	495.2	116.7	4.24	4.49	21.9%	£0.17
2021 Q3	634.5	111.4	5.70	4.49	21.0%	-£0.79
2021 Q4	1,290.5	135.6	9.52	4.35	28.3%	-£4.53
2022 Q1	1,075.3	135.2	7.95	4.35	28.8%	-£3.21
2022 Q2	833.4	118.2	7.05	6.07	21.9%	-£0.67
2022 Q3	1,089.4	100.8	10.81	6.07	21.0%	-£3.10
2022 Q4	1,824.7	126.9	14.38	7.66	28.3%	-£5.90
2023 Q1	1,792.2	121.3	14.77	7.66	28.8%	-£6.34
Total						-£29.83

* BSUoS costs and volumes taken from 'Annex_3_-_network_cost_allowance_methodology_elec_v1.10', except the last three quarters which are taken from ESO forecasts.

An alternative method of calculating the shortfall is to consider the extent to which costs in the period 2017 Q3 to 2018 Q4 were over-recovered in subsequent quarters and costs in the period 2022 Q1 to 2022 Q3 under-recovered (Table 2). This gives a very similar result of £29.62 per customer under recovery (before uplifting for losses). (The slight difference arises because the quarterly BSUoS volumes (TWh) do not exactly match Ofgem's % quarterly consumption weights).

² [bsuos-forecast-report.pdf \(nationalgrideso.com\)](#)

Table 2: Under/(over) recovery of BSUoS costs in the periods 2017 Q3 to 2018 Q4 and 2022 Q1 to 2022 Q3

	BSUoS cost (£m)*	BSUoS volume (TWh)*	BSUoS cost (£/MWh)	Consumption weight	% Over/ (under) recovery in subsequent quarters†	Over/ (under) recovery (£/cust)
2017Q3	303.6	110.1	2.76	21.0%	28.8%	£0.52
2017Q4	331.2	137.7	2.40	28.3%	28.8%	£0.61
2018Q1	265.9	142.8	1.86	28.8%	71.7%	£1.19
2018Q2	259.2	112.6	2.30	21.9%	71.7%	£1.12
2018Q3	356.8	109.6	3.26	21.0%	100.0%	£2.12
2018Q4	415.4	132.0	3.15	28.3%	100.0%	£2.76
2022Q1	1,075.3	135.2	7.95	28.8%	-42.9%	-£3.04
2022Q2	833.4	118.2	7.05	21.9%	-42.9%	-£2.05
2022Q3	1,089.4	100.8	10.81	21.0%	-100.0%	-£7.05
2022Q4	1,824.7	126.9	14.38	28.3%	-100.0%	-£12.63
2023Q1	1,792.2	121.3	14.77	28.8%	-100.0%	-£13.17
Total						-£29.62

* BSUoS costs and volumes taken from 'Annex_3_-_network_cost_allowance_methodology_elec_v1.10', except the last three quarters which are taken from ESO forecasts.

† Derived from quarterly consumption weights of quarters in which costs are recovered

We believe Ofgem should use one or other of the above approaches to estimate the shortfall in cost recovery which needs to be reflected in the transitional adjustment.

3. Offsetting against headroom allowance

In its decision on the cap, Ofgem considered that the lagged recovery of BSUoS minimised uncertainty regarding the estimation of BSUoS costs, but that there were two remaining elements of uncertainty:³

1. Using the initial settlement run charges rather than final settlement runs. (Ofgem's analysis of historic data suggested there was no clear pattern of under or overstating the final settlement value, with the variance under 3% of the BSUoS charge); and
2. Under-recovery over the lifetime of the cap in the event BSUoS charges systematically increase over time. (Ofgem noted there was considerable uncertainty over future trends in BSUoS charges, which could rise or fall in the future; however, even if BSUoS charges increased, the materiality of the impact of the lag on suppliers' costs was likely to be relatively small).

Ofgem then went on to suggest that the first of these elements of uncertainty could be accommodated within the headroom allowance:

We recognise there is uncertainty associated with BSUoS charges. However the cap design directly addresses the vast majority of this uncertainty through providing an allowance of lagged actual values. Whilst there is a small amount of residual

³ '[Appendix 2 – Cap level analysis and headroom](#)', Ofgem, 6 November 2018, page 29, paragraphs 3.77 to 3.79.

uncertainty due to the differences between settlement runs, we consider that this can be addressed in the round in the headroom allowance absolute value without the need to amend the licence to change the categories of cost to which headroom is applied.⁴

Ofgem's decision was silent as to whether it considered the 'under-recovery over the lifetime of the cap' issue to be accommodated within the headroom. Even if Ofgem did consider it to be accommodated when it designed the cap methodology in 2018 (which we think is doubtful), Ofgem would not have anticipated the magnitude of the shortfall that has actually transpired. In view of this, and the fact that un-allowed costs have already likely exceeded the headroom allowance,⁵ we think there is no justification for Ofgem to reduce the transitional adjustment in respect of headroom allowances.

Furthermore, if Ofgem did wish to proceed with offsetting the transitional element against the headroom allowance, it need to calculate the proportion of the headroom allowance which it deemed was intended to cover this aspect of BSUoS uncertainty. This calculation would be highly complex, given that the headroom covers a multitude of different uncertainties which would all require consideration.

4. Calculating the surplus/shortfall in the absence of actual data for entire period

Ofgem lists three options for calculation of the likely shortfall in costs recovered.

- Option A, Actual data method;
- Option B, Float and true-up method;
- Option C, Deferred Method.

Of these, we agree Option A is the most appropriate. Under Option A, the surplus/shortfall relating to January 2022 – December 2022 would be recovered in price cap period 10a (the subsequent cap), and the surplus/shortfall from January 2023 – March 2023 recovered in price cap period 11a. The objective of the proposed ex-ante method is to provide greater cost certainty to suppliers. Using actual data to calculate BSUoS charges, instead of an estimation and 'true-up' method, aligns with the objective of certainty.

5. Duration of adjustment

Ofgem is considering the duration over which to apply the transitional adjustment, under any of the chosen options. We support using the actual data method, Option A, and using as short a recovery period as possible, which is likely to be two quarterly cap periods. A shorter recovery period would allow suppliers to recoup their incurred BSUoS charges effectively, while reducing the duration customers are charged for past supplier charges. With the Government's Energy Price Guarantee providing security for consumers, and the volatile retail market hastening the need for suppliers to recover costs (to mitigate volume risks in falling markets), we believe the shorter recovery period is the most appropriate option.

⁴ Ibid, paragraph 3.103.

⁵ See ScottishPower's response of 17 December 2021 to Ofgem's November 2021 Policy consultation on 'Reviewing the potential impact of increased wholesale volatility on the default tariff cap'

6. Allocation of adjustment in price cap

We think it would be more appropriate to include the transitional amount in the Annex 3 for reasons of transparency. It will be clearer that these costs relate to BSUoS (rather than to other wholesale costs) if they are included with the main BSUoS allowance in Annex 3 rather than the wholesale cost adjustment allowance in Annex 8.

ScottishPower
October 2022