

CMP361 – an update to our minded-to and draft impact assessment

Subject	Details
Publication date:	15 November 2022
Response deadline:	30 November 2022
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This consultation provides additional information following on from our minded-to position and draft impact assessment of CMP361 published on 21 September 2022. We particularly welcome responses from stakeholders who have previously engaged with our initial consultation. We would also welcome responses from other stakeholders and the public.

This document outlines the scope, purpose and questions of the consultation and how you can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at [Ofgem.gov.uk/consultations](https://www.ofgem.gov.uk/consultations). If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

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Contents

- CMP361 – an update to our minded-to and draft impact assessment 1**
- 1. Context 4**
 - What are we consulting on? 4
 - Context and related publications 5
 - How to respond..... 5
 - Your response, data and confidentiality 6
 - General feedback 7
- 2. The issue..... 9**
 - First Consultation & Final Modification Report..... 9
 - Supplementary information 11
 - Estimated size of the Fund 11
 - Fund classification and operation 12
 - Benefits of CMP361 13
 - Our considerations 14
- 3. Next steps 16**

1. Context

What are we consulting on?

- 1.1. Between 21 September 2022 and 20 October 2022, we consulted on our minded-to position and draft impact assessment in relation to CMP361¹. This previous consultation focused on the consequences of changing BSUoS to an ex-ante volumetric charge and the specific arrangements that would allow the ESO to manage the setting and forecasting of these charges, while managing risks and cash flows. This consultation is a direct addition to this previous publication.
- 1.2. We set out that based on our assessment, we were minded to approve, with effect from 1 April 2023, CMP361 Workgroup Alternative CUSC Modification (WACM) 5 and considered CMP361 WACM5 to better facilitate the achievement of the Applicable CUSC Objectives (ACOs). CMP361 WACM5 provides:
 - 1.2.1. a fixed tariff period of 1 year, with 3 months' notice provided to users ahead of the fixed tariff period.
 - 1.2.2. For the ESO to build up a ringfenced reserve "fund" of money to allow it to better manage the cash flow impacts of setting a fixed charge for unpredictable balancing services costs, after utilising its Working Capital Facility. This fund would be built up over a period of 5 years via an additional charge on users. We set out that we think it is appropriate for the ESO to use a risk-based approach to tariff setting that strikes the right balance between certainty of charges and minimising the amount of consumer money held. WACM5 sets the size of the fund based on a 1 in 100-year event (P99) risk level.
- 1.3. Our draft impact assessment, which we published alongside our minded-to consultation, is informed by the findings of the Workgroup and analytical work carried out by Frontier/LCP. The Frontier/LCP report analysed the system and consumer impacts of the proposed change to the BSUoS regime. Given the information available at the time when the analysis was done, the report did not consider the impact of one

¹ [CMP361/362 - Minded-to decision and draft impact assessment | Ofgem](#)

of the elements which was later added to some of the CMP361 options, the BSUoS Fund ('the Fund').

- 1.4. To our initial consultation, we received 11 responses in total consisting of 6 suppliers, 3 generators, NGENSO and a consumer interest group. After reviewing the responses, we identified as a common theme that there was uncertainty and misunderstanding around the calculation of the size of the Fund and its classification and the operation.
- 1.5. We are publishing this supplementary consultation to address those concerns, providing additional available information and our associated considerations. We are including supplementary information on:
 - 1.5.1. The estimated size of the Fund
 - 1.5.2. Classification and operation of the Fund
 - 1.5.3. Benefits of CMP361
- 1.6. We are seeking views from industry on the implications of this supplementary information for the appropriate elements of ex-ante BSUoS arrangements. This additional information and consultation responses have caused us to reconsider our minded-to position. Specifically, we consider that a P level of P99 is unlikely to be appropriate as discussed in more detail in Section 2. On this basis, we consider it appropriate to re-consult with industry and are seeking views as to how this information affects stakeholders' assessment of the options under CMP361.
- 1.7. We continue to support the principle of fixing BSUoS by April 2023, and are considering the modification options under CMP361, but are also seeking alternative options through the raising of an additional code modification proposal.

Context and related publications

- 1.8. This consultation is linked to our minded-to and draft impact assessment of CMP361, which we published and consulted on from 21 September 2022 to 20 October 2022. It can be found [here](#).

How to respond

- 1.9. We want to hear from anyone interested in this consultation. Please send your response to the person or team named on this document's front page.
- 1.10. We've asked for your feedback in each of the questions throughout. Please respond to each one as fully as you can.
- 1.11. We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

Your response, data and confidentiality

- 1.12. You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.
- 1.13. If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.
- 1.14. If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in domestic law following the UK's withdrawal from the European Union ("UK GDPR"), the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 4.
- 1.15. If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

General feedback

1.16. We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?

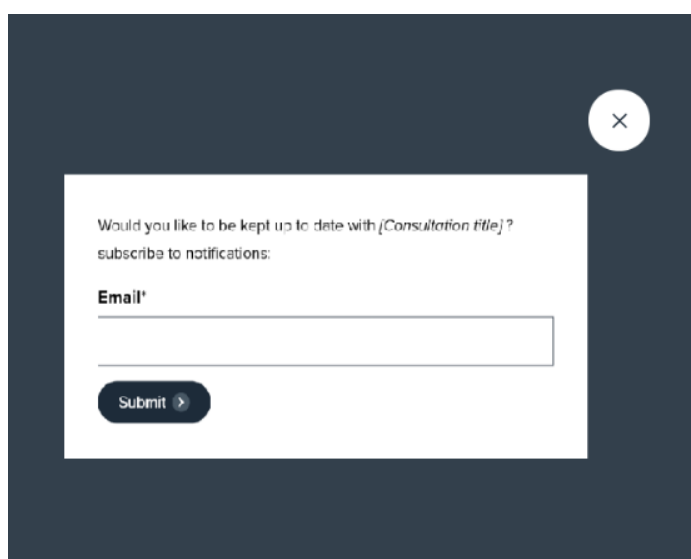
Please send any general feedback comments to stakeholders@ofgem.gov.uk

How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website.

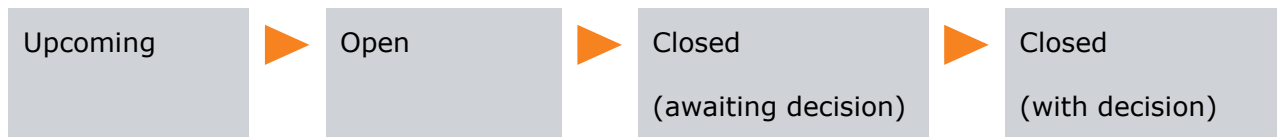
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The screenshot shows a dark-themed modal window with a white background for the form. At the top right of the modal is a close button (X). The form text reads: "Would you like to be kept up to date with [Consultation title]?" followed by "subscribe to notifications:". Below this is a label "Email*" and a text input field. At the bottom of the form is a "Submit" button with a right-pointing arrow.

Once subscribed to the notifications for a particular consultation, you will receive an email to notify you when it has changed status. Our consultation stages are:



2. The issue

Question 1: What do you consider to be the right level of risk (P level) to set the value of the BSUoS Fund? Given the BSUoS Fund estimates shared in this document, would you support a lower P Level than P99 as in our minded-to position (WACM5)? If so, what level would you consider to be most appropriate? We particularly welcome confidential responses from suppliers regarding the level of risk that they consider to be appropriate, and if this should be analogous to the level of risk they incorporate for managing BSUoS cost risk under the current arrangements.

Question 2: Do you have any further views on the trade-off between certainty of fixed tariffs not having to be revised in-period and the potential cost to consumers of providing that certainty?

Question 3: Considering the supplementary information provided in this document, would you change any of part of your response to our initial consultation?

First Consultation & Final Modification Report

- 2.1. We stated in our minded-to document that a move to fixed volumetric BSUoS charges, set *ex ante*, would provide significant benefits to suppliers, through a reduction of risk premia. We also stated that we considered that options with a BSUoS Fund would bring greater certainty but that we ought to be mindful of the impact of this Fund in consumers' bills. Section 3 of our minded-to consultation provides explanations for the elements within CMP361 that make up the various options available and our minded-to position.
- 2.2. Further, in our consultation and draft impact-assessment of CMP361 we shared that we were minded to approve CMP361 WACM5, which has a notice period of 3 months, a fixed period of 12 months and a BSUoS Fund set at a P99 level, recovered over 5 years. The "P level" is a representation of a given proposal's likelihood to provide tariffs that, under normal circumstances once set, will not change, based on the number of years out of 100 that tariffs would be expected remain certain. Therefore, a higher P level of certainty requires the Fund to be sized accordingly to prevent Tariffs being reset. For example, a P99 level reflects a 1 in 100-year probability of tariffs needing to be reset within the fixed period, with a Fund size to cover this level of probability.

- 2.3. In response to our minded-to consultation, we received a significant volume of responses, which we are taking into account. We noted that a common concern voiced during the consultation was that a lack of detail had been provided on the potential size of the BSUoS Fund.
- 2.4. The size of the Fund for various probability levels was discussed and presented at Workgroup. The Final Modification Report (“FMR”)² presented examples which suggested that a fund as high as £574m, on a yearly basis, might be required to avoid resetting in-period tariffs at P99. However, the fund values related to a period before the current volatility in energy markets. Further to this, these forecasts did not take account of a new model introduced by ESO to forecast BSUoS in February 2022, and presented to industry on 27th June 2022.³
- 2.5. Further, a number of consultation responses indicate that the way in which the Fund is proposed to be classified and operate is not clear. Some respondents suggested that the Fund should be Supplier-owned and that Suppliers would own a share of it as a proportion of their market share. They also stated that it was their understanding that this Fund would form part of their balance sheet.
- 2.6. In our minded-to consultation, we refer to ESO having access to a Working Capital Facility for the management of BSUoS, and the interactions to the Fund. In the FMR⁴, it was set out “that the ESO can currently provide £300m working capital fund now therefore anything above £300m would be the BSUoS fund requirement, however this may change in the future depending on the circumstances of the ESO”. It was proposed that for WACMs with a Fund, it “would be collected as part of the BSUoS tariff”, and would be “a pot of money funded by industry which will be ringfenced for BSUoS funding purposes and can be returned”. Further, it clarified that “should the outturn of BSUoS result in there not being a sufficient working capital facility to cover Balancing Service spend (i.e. both ESO WCF and the BSUoS Fund are forecast to be used up), then tariffs would need to be re-set within the fixed period.”

² [CMP361 & CMP362: 'BSUoS Reform: Introduction of an ex ante fixed BSUoS tariff & Consequential Definition Updates' | National Grid ESO](#)

³ [BSUoS Fixed Tariff Consultation - Introduction Webinar \(June 2022\)](#)

⁴ We will consider in more detail how much capital is needed from ESO and the form this takes.

Supplementary information

Estimated size of the Fund

- 2.7. Recent information provided by the ESO through their updated analysis, for which they have previously shared their methodology with industry via charging methodology webinars and forums, has clarified the potential size of the Fund, reflecting recent increases in BSUoS costs.
- 2.8. The P level determines the total combined money required to cover BSUoS under the specified risk level for the fixed period, including the Main Tariff Recovery (MTR), ESOs Working Capital Facility (WCF) and the Fund. Analysis would be undertaken on an annual basis, in conjunction to the Tariff setting process, to determine the required Fund for the year ahead. Table 1 sets out ESOs 2023/24 forecast for the Total Capital Requirement to manage BSUoS cost risk above the MTR, alongside resultant Fund sizes and annual costs after taking into account the WCF that ESO have indicated in the FMR is available for this purpose.

Table 1: Estimated size of Capital Requirements and BSUoS fund required for different certainty levels (£million) – data provided by ESO

P Level	Total capital requirement above MTR	ESO WCF⁵	Fund size	Annual cost of the Fund (built up over 2 years)	Annual cost of the Fund (built up over 5 years)
P70	£500m	£300m	£200m	£100m	£40m
P75	£700m	£300m	£400m	£200m	£80m
P80	£900m	£300m	£600m	£300m	£120m
P85	£1100m	£300m	£800m	£400m	£160m
P90	£1300m	£300m	£1000m	£500m	£200m
P95	£1700m	£300m	£1400m	£700m	£280m
P99	£2400m	£300m	£2100m	£1050m	£420m

- 2.9. As Table 1 shows, according to the most recent estimates from the ESO, the BSUoS Fund to support Ofgem’s minded-to position (WACM5) may need to be as large as £2.1bn to meet the P99 level. If this was recovered over 5 years, this would translate

⁵ Assuming a ESO WCF of £300m as stated in the FMR

into approximately £420M a year, that would need to be incorporated into the BSUoS tariff and be payable by suppliers.

Fund classification and operation

2.10. The total combined cost of the MTR and the Fund, as well as ESO internal costs and any other elements that have been agreed to be added, would be included within the combined Tariff after dividing it by the forecast Volume.

$$\text{Combined Tariff } (\text{£/MWh}) = \frac{\text{MTR } (\text{£}) + \frac{\text{Total Fund based on P Level } (\text{£})}{\text{Fund Recovery Period } (\text{yrs})} + \text{ESO Internal costs } (\text{£}) + \text{Other elements } (\text{£})}{\text{Volume Forecast } (\text{MWh})}$$

2.11. Consequently, the annual cost of the Fund would translate to a component in £/MWh of the combined Tariff which would increase based on the P Level. For further detail on these new arrangements, we would invite industry to visit the ESO's recently published draft BSUoS tariff⁶.

2.12. Additionally, if an ex-ante BSUoS modification option with a fund were to be approved, we propose that the additional contributions included in the Tariff, as set out in p.2.10 would, pending separate consultation and decision, be incorporated into the Default Tariff Cap.

2.13. Further to the information provided in the FMR, we can clarify that if CMP361 is approved with a Fund to enable ESO to manage volatility in BSUoS, the legal text provides that such a Fund would be held in a separate ESO ring-fenced account^{7a}. Our expectation therefore is that the Fund would be in the control but not ownership of the ESO. The legal text also provides that this Fund would only be used for the specified purpose of paying for Balancing Services activities in the event that the ESO has recovered insufficient revenue from the MTR and the ESO's Working Capital Facility has been used in its entirety^{7b}.

2.14. We recognise some ambiguities in the modification proposal in how the Fund will be managed. For example, the Legal text for modification options with a Fund does not

⁶ [Balancing Services Use of System \(BSUoS\) charges | National Grid ESO](#)

⁷ [National Grid ESO- CMP361 & CMP362 Final Modification Report Annexes- Legal Text for WACM5](#) a) Clause 14.30.8. b) Clause 14.30.9

currently provide for the returning of surplus Fund money that is no longer required by the ESO to manage BSUoS risk within a year. We expect there to be arrangements in place to return this surplus to consumers through the Tariff setting process at the earliest opportunity.

2.15. Similarly, should circumstances change, resulting in the ESO no longer requiring or being able to hold such a Fund, we would expect the Fund to be returned to consumers at the earliest opportunity.

2.16. If a modification with a BSUoS fund were to be approved, we will work with the ESO to ensure that any ambiguity is clarified. Including by the introduction of further regulatory mechanisms where appropriate.

Benefits of CMP361

2.17. Whilst we believe the underlying potential benefits of CMP361 remain relevant as presented in the Frontier/ LCP analysis, the value of those benefits has changed. The Frontier/ LCP analysis estimated overall benefits of CMP361 on the basis of moving risk and therefore the cost of capital to manage BSUoS from suppliers to the ESO.

2.18. As the Fund would be comprised of money that has been collected from consumers, this would be considered at the Social Time Preference Rate⁸ which would be higher than the ESO's borrowing costs⁹. Therefore, the benefits associated with our minded-to option would likely be marginal and may prove to be negative in light of the current scale and volatility of BSUoS.

2.19. We recognise that lower P-levels, and therefore smaller Fund sizes, are more likely to result in overall consumer benefits associated with the transition to ex-ante BSUoS.

⁸ Social Time Preference Rate of consumers money in HMT's '[Green Book](#)' is 3.5%. While estimates vary widely, literature indicates that there is evidence to suggest personal discount rates would be considerably above market rates. For example, the NIC used 10% real in their [evaluation of the nuclear regulated asset base](#).

⁹ Frontier Economics Report (Annex 4 of the [CMP361 FMR Annexes](#)) 4.1.5 states ESO's short term borrowing cost at 1.8%

2.20. A final Impact Assessment will accompany our decision on an ex-ante BSUoS modification, including updated benefits associated with any difference in cost of capital assumptions.

Our considerations

2.21. We would like to stress that we continue to support the principles of the conclusions of the two BSUoS Task Forces. We have made our support public in an open letter¹⁰, where we also stated that any decision from the Authority would need to be accompanied by analytical evidence of the benefits. In deciding the appropriate risk level at which to set the BSUoS Fund calculation, we will consider a number of factors, including:

2.21.1. The level of the Fund should provide certainty and stability through avoiding the resetting of tariffs throughout the fixed period as a result of reasonable fluctuations in BSUoS costs.

2.21.2. Exceptional circumstances should be reflected into the BSUoS regime, to a similar degree as they are reflected in other parts of the system.

2.21.3. The costs of the Fund should also not significantly detract from the benefits of achieving the objectives of CMP361. Fund levels that result in overall consumer net benefits will be preferred.

2.21.4. Further, as detailed in our draft impact assessment, we consider there to be a series of non-quantifiable benefits associated with the implementation of ex-ante fixed BSUoS, such as improved system management, savings on BSUoS prediction costs and significant reductions in system complexity.

2.21.5. However, the size of the Fund should not be excessive and disproportionate to the overall level of BSUoS costs. Additional costs for

¹⁰ [Reform to Balancing Services Use of System \(BSUoS\) charges - analysis of proposal to remove BSUoS from generation \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/reform-to-balancing-services-use-of-system-bsuos-charges-analysis-of-proposal-to-remove-bsuos-from-generation)

consumers should be minimised, particularly during this period of unprecedented high energy prices.

- 2.22. Balancing our considerations and the new information available to us, we recognise our minded-to position of a fund at P99 unlikely to be appropriate given the increase in cost to consumers, and a Fund level that includes a lower level of certainty at a lower cost may be more appropriate. We are seeking views from industry on the appropriate level of certainty and cost.

3. Next steps

- 3.1. The supplementary information available and our considerations cause us to reconsider the viability of our minded to position, WACM5 and options with a P99 risk level. This was a concern shared by respondents but otherwise there was support for other elements of WACM5, and we continue to support options with shorter notice periods and longer fixed, in particular those with a fixed period of 12 months and a notice period of 3 months.
- 3.2. We recognise that a modification option that includes this fixed period and notice period, with a lower Fund level, is not available through CMP361. We are reviewing other options under CMP361 however we recognise there are other potentially workable options available that may have been developed by the CMP361 Workgroup.
- 3.3. We are therefore requesting ESO to bring forward an alternative modification proposal, which continues to work towards implementation from 1 April 2023 where possible¹¹. We would like modification options available that allow for a decision on the basis set out above and encourage industry to work together to develop alternatives that reflect these considerations.
- 3.4. We have been in discussion with ESO and wish for a set of different proposals to be brought forward, which would have a different effect to those which are currently available under CMP361. Our expectation is that all options will include a fixed period of 12 months and a notice period of 3 months, with varying Fund risk levels from P70 to 90.
- 3.5. We would also expect any unresolved matters that allow for the functioning of the Fund, such as provisions for the returning of unnecessary money within the Fund to consumers, to be included in this alternative modification proposal.

¹¹ We recognise there are risks to implementation on 1 April 2023 given the notice period required. We will review this as appropriate to prioritise a workable solution being in place for 1 April 2023 to the extent possible.