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Dear Donald,

**Re: Consultation on CUSC modification proposal 224**

Thank you for the opportunity to respond to this consultation. We address the three consultation questions in turn below:

1. The interpretation of Paragraph 2(1) Annex Part B of the Regulation

We agree with Ofgem that this paragraph of the Regulation is ambiguous. For the purpose of complying with the Regulation it is not clear, with reference to the GB charging methodology, what constitutes "charges paid by producers for physical assets required for connection to the system or the upgrade of the connection".

Although paid for through use of system charges under the GB charging methodology, the onshore local circuit charge, offshore circuit charge, offshore substation charge and the recovery of the cost of certain assets located at the onshore substation of an offshore generator are asset specific charges. These are paid for solely by the generator requiring those assets in order to connect to the wider onshore transmission system. In this regard it is possible to conceive an argument that may be no less persuasive compared to the strict interpretation.

Notwithstanding this we recognise that on balance the strict interpretation would reduce regulatory risk. This is because it is consistent with the current GB charging methodology in that, it assumes that unless a charge is categorised as a connection charge under the GB charging methodology, it is not a charge paid by a producer for physical assets it requires for connection to the system.

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## 2. The impact on consumers of transferring costs from generation to demand under the different proposals submitted

Taking the analysis provided by National Grid, compared to WACM2 and 3, where a much lower amount of transmission cost would be passed through at a much later date; both the Original proposal and WACM1 will result in a greater amount of transmission cost being passed through directly to customers earlier. According to the analysis undertaken by National Grid, a lower amount is recovered directly from customers under the Original proposal than compared with WACM1, due to the larger margin of error that is a feature of the 12 month notice period of a change to the G:D split under WACM1.

We expect that network users would react to the redistribution of transmission cost and that there would be an adjustment factored in to costs that generators seek to recover in part through the wholesale price. This may not happen as quickly as the pass through of the cost to customers, as it depends on the extent of forward contracted positions taken by generators and traders.

We would therefore concur that there could be a shorter term increase in cost to consumers, which may be diluted in longer timescales as the redistribution of cost feeds through to the wholesale price. Additionally as the capacity market is introduced this will provide a separate revenue stream to enable the recovery of certain fixed costs, such as Transmission Network Use of System (TNUoS) charges, which could also have a bearing on the wholesale price and in turn overall cost to customers. In both examples in theory the overall cost is essentially the same, it is just recovered through different mechanisms.

## 3. The impact on consumers of any additional risk that suppliers and/or generators face for options with a shorter lead time for setting the G:D split as compared to options with a longer lead time

The most significant challenge is managing the level of certainty over whether the G:D split will change and how much notice market participants will have to factor this in to pricing. More notice is always preferable as it allows for costs to be more accurately factored in to pricing decisions.

For suppliers, a shorter lead time creates a risk of suboptimal pricing. If there is not sufficient certainty of the costs far enough in advance suppliers have to make assumptions in their longer term contracts. These assumptions might be wrong and consequently a risk premium might need to be added. Depending on the extent of the percentage change in the G:D split this is not an insignificant risk and exposure that suppliers have to manage.



In the case of generators, longer notice periods of a change to the G:D split enable a change in its cost base to filter through to the wholesale price in a more predictable manner. In the context of the capacity market, longer notice periods will enable a generator to reflect any change in its cost base more appropriately in its bidding strategy, given that the auctions take place four years ahead of delivery.

Whilst CMP224 provides a mechanism to reflect any change to the G:D split in TNUoS charges, the largest uncertainty at present is whether the European Commission will revise the €2.5/MWh limit for the period from 1 January 2015 and to what extent this has already been factored in by parties. In this regard the opinion provided by ACER in April 2014<sup>1</sup> suggests that the limit could be removed in a GB context. We note that there was no reference to ACER's opinion in Ofgem's consultation and query whether this has a bearing on its decision on CMP224? We would also observe that CMP227, currently at the working group stage, may provide longer term certainty on the G:D split.

We hope that you find our response of help and would be happy to discuss any aspect of it with you further.

Yours sincerely

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<sup>1</sup>[http://www.acer.europa.eu/official\\_documents/acts\\_of\\_the\\_agency/opinions/opinions/acer%20opinion%2009-2014.pdf](http://www.acer.europa.eu/official_documents/acts_of_the_agency/opinions/opinions/acer%20opinion%2009-2014.pdf)