



Making a positive difference
for energy consumers

All those with an interest in
balancing services charges

Direct Dial: 020 3263 9721
Email: tim.aldridge@ofgem.gov.uk

Date: 28 November 2018

Review of balancing services charges

National Grid Electricity System Operator (ESO)¹ recovers its costs of operating the transmission system through Balancing Services Use of System (BSUoS) charges. There are questions about how these charges work and, in our July consultation on a review of electricity access and forward-looking charges (our "Electricity network access project")², we sought views on launching a Balancing Services Charges Task Force to examine these questions.

Following consideration of responses on this issue, we have decided to ask the ESO to launch a task force under the Charging Futures arrangements.³ This will be led by the ESO as part of its role to ensure these arrangements reflect the changing energy system. The objective of the Task Force will be to provide analysis to support decisions on the future direction of balancing services charges. In particular, it will examine the potential for and feasibility of some elements of balancing services charges being made more cost-reflective and hence provide stronger forward-looking signals.

The Task Force will inform the direction of balancing services charges based on assessing whether: (i) there is value in seeking to improve cost-reflective signals through BSUoS, or (ii) BSUoS should be treated as a cost recovery charge. In the latter case, it may be suitable to apply the same approach that we are proposing for transmission and distribution residual use of system charges through our Targeted Charging Review (TCR). We have published our consultation on the TCR proposals alongside this letter.⁴

We have decided to ask the ESO to launch a Balancing Services Charges Task Force alongside our TCR consultation as we think this work needs to be taken forward as a priority. We therefore do not see it as necessary to delay launching it until we publish our decision on next steps on the Electricity network access project later this year.

This letter explains the current issues with balancing services charges and the role of the Task Force in assessing those issues. There may be other issues which arise during the review.

¹ ESO is currently part of National Grid Electricity Transmission plc but will become a legally separate company, within the National Grid Group, from April 2019.

² <https://www.ofgem.gov.uk/publications-and-updates/getting-more-out-our-electricity-networks-through-reforming-access-and-forward-looking-charging-arrangements>

³ These are arrangements to help people understand and engage in electricity network charging issues: <http://www.chargingfutures.com/>.

⁴ <https://www.ofgem.gov.uk/publications-and-updates/targeted-charging-review-minded-decision-and-draft-impact-assessment>

1. Issues with balancing services charges

Balancing services charges recover the cost associated with the ESO operating the existing transmission system, including costs for constraints, procurement of system balancing services and operations costs. Balancing services charges are recovered from suppliers and generators, based on the amount of energy imported or exported onto the network (£/MWh) within a given half-hourly period. Balancing services charges do not reflect the location of the services provided.

We note that currently there is a limit to the extent to which charges to individual parties reflect the costs they impose on the system. This is because the relevant costs are recovered across all applicable generators and demand users in each half hour period in a homogeneous manner. As such, balancing services charges primarily function as a cost recovery charge presently.

We note that a number of code modification proposals have suggested changes that might be merited if it were clear that balancing services should remain primarily a cost recovery charge. These have highlighted concerns with increasing volatility and unpredictability with the changing generation mix, potentially adding a risk premium which is ultimately passed onto consumers. Other parties have highlighted specific concerns about the signal that balancing services charges send to users. For example, on windy nights, there can be high balancing services constraint costs from constraining wind generation (which is not needed to meet low demand). Additional overnight demand would help reduce these costs, but the current balancing services charges methodology actually discourages this as half of the charges would be recovered from suppliers based on their customers' demand during that period.

One proposal, CMP250⁵, proposed to fix charges on an annual basis rather than varying on a half-hourly basis. We rejected that modification as we were not convinced there was clear evidence that it would, amongst other things, facilitate the code objective of supporting cost-reflectivity better. This is because it did not demonstrate adequately the extent to which different elements of balancing services currently provide any useful cost-reflective signals.

We continue to consider that there would be benefit from examining the extent to which BSUoS is currently cost-reflective to some degree, or could be made more so in future. This could include whether constraint signals are more effectively sent through balancing services charges (as they are currently) or transmission use of system charges.⁶

Interaction with the TCR

Most small (less than 100MW) generators connected to the distribution network (DG) do not pay balancing services charges, in contrast with larger DG and transmission connected generation. This represents one of the 'embedded benefits' where changes are being considered by the TCR. We will consider the report from the Task Force carefully in the context of the TCR and the responses to the TCR consultation we are publishing today. This will include consideration of the relationship with any potential changes to the balancing services embedded benefits. We expect the conclusions of the Task Force to be available ahead of our final decision on the TCR.

2. Proposal for reviewing balancing services charges

In our Electricity network access project consultation, we invited views on whether there should be a task force under the Charging Futures arrangements to conduct further

⁵ Connection and Use of System Code (CUSC) CMP250: 'Stabilising BSUoS with at least a twelve month notification period.'

⁶ We note that the government may need to amend the Public Service Obligation in relation to any change to the socialisation of constraint management costs through balancing service charges.

analysis of whether the different cost elements balancing services charges recover could be charged in a way which provides more effective signals to users. We also sought views on such a task force being led by the ESO given its role in ensuring the transmission charging arrangements are fit for purpose, with input from wider industry.

Decision to launch a Balancing Services Charges Task Force

We have decided to ask the ESO to lead a focussed review of balancing services charges by launching a task force under the Charging Futures arrangements. We think the Task Force should provide a more comprehensive, coordinated, inclusive and less resource-intensive review of balancing services charges than a series of piecemeal modification proposals.⁷

We expect the Balancing Services Charges Task Force to assess three main issues:

1. The extent to which elements of balancing services charges **currently** provide a forward-looking signal that influences the behaviour of system users.
2. Whether or not existing elements of balancing services charges have the **potential** to be made more cost-reflective and hence provide better forward-looking signals.
3. The **feasibility** of charging any identified potentially cost-reflective elements of balancing services charges on a forward-looking basis. It should also consequently identify the extent to which the different elements of balancing services charges should be considered cost-recovery charges.

Building on the analysis conducted to date by the ESO, we expect the Task Force to begin in January 2019 and to publish its final conclusions by May 2019. Depending on the outcome of the work, we expect that the ESO or other parties could take forward appropriate modification proposals to effect the changes identified following the conclusion of the work, under the usual code governance process.

We have asked the ESO to lead and chair the review given its central role in electricity balancing. The ESO is also best-placed to be the secretariat for the Balancing Services Charges Task Force, as part of its role in 'Facilitating Competitive Markets.' The ESO is responsible for managing the balancing services for which BSUoS recovers the cost. Using its existing expertise and access to data, the ESO has already begun investigating these issues and held a series of stakeholder workshops in October. This Task Force will be an opportunity to take this work forward but on a more inclusive basis, under the Charging Futures arrangements.

While we expect the ESO to lead the Balancing Services Charges Task Force, we will attend meetings to support its effective functioning. We will also manage the interaction of the Task Force with the ongoing Ofgem-led charging reviews, and in particular with any proposed changes to balancing services embedded benefits from the TCR. Below we set out more about the role of the Task Force and the opportunities for stakeholders to get involved.

Our response to issues raised in the consultation responses⁸

The majority of respondents to our consultation on the Electricity network access project supported further work on balancing services charges and that it should be ESO-led. We

⁷ Alongside this letter, we have also written to the CUSC Panel regarding proposed modification CMP308: 'Removal of BSUoS charges from Generation.' In that letter, we encourage the proposer and the Panel to not progress the modification at least until the publication of the conclusions of the Balancing Services Charges Task Force. We also encourage other parties considering raising BSUoS modification proposals to first engage with the Task Force. We have published the letter on our website: <https://www.ofgem.gov.uk/publications-and-updates/interaction-between-cusc-proposed-modification-cmp308-removal-bsuos-charges-generation-and-balancing-services-charges-task-force-under-charging-futures-arrangements>.

⁸ The Annex summarises the responses to the BSUoS-related questions in our Electricity network access project consultation. We will publish a summary of responses to all consultation questions in our next steps publication on the Electricity network access project later this year.

welcome the support for the review and encourage respondents to engage with it to highlight their concerns.

We acknowledge the concern expressed about the amount of change going on at the moment. We are also aware that launching a review could in itself introduce some uncertainty around the future of balancing services charges. However, by seeking to ensure the outputs of the review are delivered in a timely manner, we hope to limit the period of uncertainty. We are keen to progress this review on an accelerated timeline relative to the remainder of the Electricity network access project.

We are concerned that, in the absence of a review, parties may raise a series of proposed modifications to balancing services charges. A coordinated review will provide a single focus and be less resource intensive for those wishing to contribute to the review and has the potential to limit uncertainty relative to a potential series of uncoordinated proposed modifications. Stakeholders involved in the review will have the opportunity to highlight potential issues with any proposed changes.

We acknowledge that some parties would prefer an Ofgem-led review to help join up with ongoing wider charging reviews. We anticipate a need for Ofgem involvement to coordinate the Balancing Services Charges Task Force with the other reviews, ensuring a joined-up approach.

We disagree with some consultation respondents who asserted that the ESO leading the review would introduce a conflict of interest. The ESO’s management of Balancing Services means it has the requisite expertise to take this work forward. Under the new regulatory and incentives framework for the ESO, we clarified our expectations related to how the ESO should identify proactively how it can maximise consumer benefits across the full range of its activities. Leading a Balancing Services Charges Task Force fits well within the ESO’s ‘Facilitating Competitive Markets’ role in our framework.

Task Force outputs and timings

Informed by analysis that the ESO is undertaking, the Task Force will address the three questions posed and report back with its conclusions to the Charging Futures Forum.

There are specific outputs that the Task Force needs to meet within specified timescales:

| Deliverable | Date |
|--|---------------------------|
| <p>Task Force document assessing the extent to which elements of balancing services charges currently provide a forward-looking signal that influences the behaviour of system users.</p> <p>This should build on the ESO’s analysis of different elements of balancing services charges which the ESO will present at the January 2019 meeting of the Charging Futures Forum (with slides also published on the Charging Futures website).</p> | February 2019 |
| <p>Task Force document assessing the potential for existing elements of balancing services charges to be charged more cost-reflectively and hence provide better forward-looking signals.</p> <p>The analysis should explore each of the existing components of balancing services charges and to what extent they have the potential to influence the behaviour of different parties.</p> | March 2019 |
| <p>Task Force document assessing the feasibility of charging any identified potentially cost-reflective elements of balancing services charges on a forward-looking basis.</p> | April 2019 (draft report) |

| | |
|---|--------------------------------|
| <p>Based on the candidate elements of balancing services charges from the previous stage, assess the feasibility of charging these elements to influence user behaviour. This could include consideration of whether constraint signals are more effectively sent through balancing services charges or transmission use of system charges.</p> <p>It should consequently identify the extent to which the different elements of balancing services charges should be considered cost-recovery charges and therefore have potential for the TCR approach for cost-recovery charges to be applied.</p> | <p>May 2019 (final report)</p> |
|---|--------------------------------|

The ESO will chair the Task Force meetings to ensure that it delivers the outputs within the specified timescales. We will also participate as a member of the Task Force.

How to get involved

We encourage industry to be actively involved in developing options for balancing services charges reform.

Alongside this letter, the ESO has published an announcement explaining how stakeholders can get involved in the Task Force.⁹

The ESO has also published a draft terms of reference for the Task Force. A draft version will be discussed at the next Charging Delivery Body meeting (in December 2018). Charging Futures members can also send comments on the draft terms of reference to the ESO as secretariat. The ESO will be responsible for providing a final draft following stakeholder review. We will be responsible for signing off the terms of reference before the Task Force meets for the first time in January 2019.

Beyond the Balancing Services Charges Task Force, stakeholders will have the opportunity to respond to our consultation on TCR proposals (published alongside this letter) and to engage in taking forward our next steps on electricity network access and forward looking charging reform. Both projects will continue to use the Charging Futures website and forum to engage with stakeholders.

Yours faithfully,

Andy Burgess
Deputy Director, Charging & Access

⁹ <http://www.chargingfutures.com/whats-happening/access-reform-task-forces/balancing-services-charges-task-force/>

Annex – Consultation responses

This section summarises the responses to the BSUoS-related responses to our Electricity network access project consultation. We will publish a question-by-question summary of consultation responses in our next steps for the project later this year.

Further work

Our consultation on electricity network access and forward-looking charging reform sought views on further work to assess options to make balancing services charges more cost-reflective. Of the 49 respondents directly addressing this question, around two-thirds supported further work. Those in support represent a variety of organisations including network companies, suppliers, generators and consumer groups. Some of them highlighted particular issues that they thought should be considered by any review. These included: the interaction of BSUoS with transmission owner investment and network constraints; how to split BSUoS into forward-looking and residual elements; the opportunity to increase the emphasis on flexibility and ancillary services; and the inclusion of interconnectors.

A minority of these respondents supported a review in principle, but felt that it should be delayed pending the outcome of the ongoing charging reviews (and other changes in the sector).

Several respondents considered that we should conduct a focussed review of the socialisation of Connect and Manage costs through balancing services charges. Others considered that this should be done as part of a comprehensive review of balancing services charges. Some respondents considered that consequential wider reform of balancing services charges may be required to implement other areas of charging reform.

Seventeen respondents disagreed with the need for further work. Those against a review were principally renewable generators and vertically-integrated generators/suppliers. The main reasons were either from a practicality or policy perspective. In terms of practicality some were concerned that, with the amount of change already happening, they lacked the resource to be able to input adequately into another review and/or another review would increase uncertainty. From a policy perspective, some asserted that balancing services charges are not supposed to be cost-reflective. Others were concerned that a review could lead to unintended consequences and/or introduce unnecessary complexity.

Who should lead any review?

Of the 23 respondents expressing a view, around two-thirds of them supported an ESO-led industry task force. Two respondents felt an ESO-led approach could lead to a conflict of interest given its management of Balancing Services. Six felt any review should be Ofgem-led, potentially as part of the electricity network access project Significant Code Review to ensure the work remains joined up, two of whom felt the ESO would be best-placed were it not to be led by Ofgem. One respondent suggested Elexon as a potential lead body while another would rather the current open governance process be used to reform balancing services charges, through a series of modifications to the CUSC.

Those supporting an ESO or Ofgem-led review emphasised the need for independence of the lead body, inclusiveness of input and the importance of joining up with the related work. A number of respondents were concerned with the possibility of a series of individual modifications being raised in the absence of a coordinated approach.