



Making a positive difference
for energy consumers

To all stakeholders

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Dear Stakeholder,

Launch of a second Balancing Services Charges Taskforce

Today we published our direction on the Targeted Charging Review (TCR). We are publishing this letter alongside that decision to launch and explain how a second Balancing Services Charges Taskforce will consider the distortion which we think remains in the current charging regime, because larger generators are liable for balancing services charges and Smaller Distributed Generators are not. This second taskforce will build on the work of the TCR and the first Balancing Services Charges Taskforce to consider the future of balancing services charges, particularly who should pay them and how the charges should be designed.

We asked the Electricity System Operator (ESO) to launch the first Balancing Services Charges Taskforce when the TCR minded-to consultation was published in November 2018. The taskforce was asked to examine the potential for, and feasibility of, improving the cost reflectivity of some elements of balancing services charges and hence for these charges to provide stronger forward-looking signals.

The overall conclusion of the first taskforce was that balancing services charges should be treated as cost-recovery charges. We accept that at present it is not possible to send useful forward-looking signals through balancing services charges. When we launched the TCR, we said that balancing services should be considered for reform if they are to remain cost recovery charges.

We took the taskforce conclusions into account in our TCR decision and direction. The decision document, published alongside this letter, explains how transmission and distribution residual charges will be recovered from final demand consumers through fixed charges, and reform to the remaining non-locational Embedded Benefits will include:

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- setting the Transmission Generation Residual to zero (subject to compliance with EU regulation 383/2010),¹ and
- removing the ability for Smaller Distributed Generators to receive payment for offsetting suppliers' demand, reducing the suppliers' liability for balancing services charges.

However, these changes exclude making Smaller Distributed Generators liable for balancing services charges, an additional proposed change in the minded-to consultation. We said in our decision that we think rather than requiring Smaller Distributed Generation to pay balancing services charges, there should be further work undertaken to consider the implications of treating balancing services charges as cost-recovery charges.

We have now asked National Grid ESO to launch a second Balancing Services Charges Taskforce which will be tasked with applying the TCR principles to balancing services charges as a cost-recovery charge to consider how they should be recovered. This gives rise to two specific questions:

1. Who should be liable for balancing services charges?
2. How should these charges be recovered?

We think that industry, through a taskforce, is best placed to address these questions as they have considerable expertise and information available to make recommendations which we will consider. If necessary reforms emerge from the taskforce, we expect code modifications to be raised by the ESO following the final conclusions of the taskforce.²

We have recently published, on 25 October, our 'RIIO-2 financial methodology and roles framework for the Electricity System Operator' decision.³ In this we explain that we will be publishing a consultation regarding changes to the cashflow risk associated with collection of Transmission Use of Service (TNUoS) charges towards the end of 2019. This is part of our work to consider where it would be most efficient to place risks associated with revenue collection activities. In particular, we are considering the level of price control remuneration that would be needed to account for these risks, as well as the potential unintended consequences created by linking the size of any remuneration to costs that companies can influence.

With this in mind we expect that the design of BSUoS charges will not impose disproportionate risk on the ESO in its role of recovering these charges. Overall, the taskforce should consider what arrangements are most efficient for industry and consumers as whole. This should take into account costs and risks borne by both market participants and network operators, as well as any unintended consequences for energy consumers.

1. The second taskforce

We are launching a second Balancing Services Charges Taskforce to do this work, building on the first taskforce's evidence and conclusions. We expect a second taskforce to consider:

1. Who should be liable for balancing services charges?
2. How should these charges be recovered?

We expect the taskforce to answer these two questions, taking into account the conclusions of the TCR, and place the underlying TCR principles at the heart of their assessment of options. We think that industry is better placed to address these issues because they have the available data and expertise.

¹ This regulation sets the range in which average transmission charges must fall, €0-€2.50 for GB, further information is in the decision document.

² Further details of the taskforce's work and conclusions can be found in Annex 1

³ https://www.ofgem.gov.uk/system/files/docs/2019/10/riio-2_financial_methodology_and_roles_framework_for_the_eso_0.pdf

The aim of the taskforce will be to create a more level playing field across all generation, and use the TCR principles of:

- reducing harmful distortions,
- fairness, and
- proportionality and practical considerations

We expect that any proposed changes to balancing services charges will facilitate better competition across all network users and be a proportionate and practical outcome. We encourage industry to be actively involved in developing options for further balancing services charges reform.

The ESO will publish draft terms or reference for the taskforce at the end of November 2019. Charging Futures members will be able to send comments on the draft terms of reference to the ESO as secretariat.⁴ The ESO will be responsible for providing a final draft of the terms of reference following stakeholder review. We will be responsible for signing off the terms of reference.

The timelines for the taskforce will be:

Deliverable	Date
Terms of reference agreed	Before the first meeting in January 2020
Consideration and assessment based recommendation as to who should pay balancing services charges. This should be carried out using the aims and principles of the TCR, noting any potential differences between residual charges, which are subject to RIIO price controls, and balancing services charges, which are not.	First taskforce meeting in January 2020
Investigation and recommendation for recovering balancing services charges, including collection methodology and frequency. This should also be carried out using the aims and principles of the TCR but also consider the implications for the RIIO-2 price control determinations. In particular, the design of BSUoS charges should take into account any additional costs and risk placed upon the ESO.	First conclusions on who should be liable for balancing services charges in February 2020 Investigation of frequency etc February to March 2020
Interim report This should provide detailed reasoning and any analysis behind the conclusions of the taskforce which will be considered by Ofgem before code modifications are raised	Initial report April 2020
Consultation	Consultation review April 2020

⁴ Charging Futures is a forum hosted by the ESO which provides information and events around the charging reforms and related projects. More information can be found at the website www.chargingfutures.com and the terms of reference at <http://www.chargingfutures.com/media/1278/bsuos-taskforce-tor-eso-jan-19-v22.pdf>

This should provide opportunity for stakeholders to comment on the approach or recommendations	
<p>Final Report</p> <p>This should incorporate and show consideration of any views from stakeholders and provide final recommendations on who should pay, and the design of balancing services charges</p>	Final report June 2020 with the possibility of 2021 being pursued if deemed in the best interests of consumers, to align with the implementation of partial reform but balancing this against the best interests of consumers.

The ESO will chair the taskforce and ensure that the timelines are followed and outputs achieved. We will participate in the taskforce as an observer. Following the taskforce's final report, we will review the conclusions of the taskforce and decide on the next steps to be taken. If necessary reforms emerge from the taskforce, we expect a code modification to be raised by the ESO. We expect that the code modification should be implemented in a timely manner which reflects the best interests of all industry participants.

How to get involved

We encourage industry participants to be actively involved in developing options for balancing services charges reform. There will be a representative group created if there are too many stakeholders who want to be involved for the group to be effective. The ESO will be publishing the Terms of Reference for this taskforce at the end of November and providing details of how to get involved at the next Charging Future Forum.

We will be responsible for signing off the terms of reference before the taskforce meets for the first time in January 2020. Stakeholders will have the opportunity to respond to the taskforce findings. Both the taskforce and the Access and forward looking charges project will continue to use the Charging Futures Forum website and forum to engage with stakeholders.

Annex 1 - The First Balancing Services Charges Taskforce

The ESO recovers its costs in operating the transmission system through balancing services charges. Currently half of the total of balancing services charges is levied on generation and half on demand. In November 2018 when we published the TCR minded-to consultation, we also launched the first Balancing Services Charges Taskforce who were asked to provide "analysis to support decisions on the future direction of balancing services charges".⁵

The scope of the work that the first taskforce undertook was to:

- a) assess the extent to which elements of balancing services charges currently provide a forward-looking signal that influences the behaviour of system users,
- b) assess whether or not existing elements of the balancing services charges have the potential to be made more cost-reflective,
- c) based on the assessment at b), above, assess the feasibility of charging any identified potentially cost-reflective elements of balancing services charges on a forward-looking basis.
- d) the analysis should include a reasonable qualitative and, to the extent possible, quantitative assessment, and
- e) agree a set of conclusions.

Once the taskforce was established they determined that there were four deliverables within their scope, which were:

- a) whether balancing services charges currently provide a useful forward looking signal,
- b) whether there were potential options for charging these charges differently, to be cost-reflective and therefore provide a forward-looking signal,
- c) what the feasibility of charging potentially cost-reflective elements of balancing services charges to provide a forward-looking signal are, and
- d) to use this information to form a set of conclusions regarding how cost-reflective balancing services charges are, and how this differs across different components within the charge.

The taskforce worked through these tasks systematically, finding first, that the existing elements which make up balancing services charges do not currently provide any forward-looking signal influencing users to use the networks more economically or efficiently. It also suggested that risk premia are adding to costs of all parties paying balancing services charges because of the volatility and the difficulty in forecasting charges correctly. It did however, consider four options within the charge for further investigation to determine whether they could be charged in a cost-reflective manner but were unable to find a way for this to work in practice.

Their overall conclusion was that 'It is not feasible to charge any of the components of balancing services charges in a more cost-reflective and forward-looking manner that would effectively influence user behaviour. Therefore the costs within balancing services charges should all be treated on a cost-recovery basis'.⁶

The draft report was published on 2 May 2019 before a consultation period to provide opportunity for stakeholders to comment on their findings, before the final report was published on 31 May 2019. Of the 24 responses only one disagreed with their findings and two others only partially agreed with them on two of their findings.

⁵https://www.ofgem.gov.uk/system/files/docs/2019/02/decision_to_launch_a_balancing_services_charges_taskforce.pdf

⁶ <http://www.chargingfutures.com/media/1348/balancing-services-charges-task-force-final-report.pdf>

Links with the TCR

2. We have published our final decision on the TCR reforms. We have decided to implement 'partial' reform to the remaining non-locational Embedded Benefits. This means:
 - setting the Transmission Generation Residual to zero, subject to maintaining compliance with a European regulation (reg. 838/2010) which requires average generator charges to fall within the limits of €0 and €2.50 per MWh,⁷ and
 - removing the ability for Smaller Distributed Generators to receive payment for offsetting suppliers' demand, reducing the suppliers' liability for balancing services charges.
3. This option excludes:
 - charging Small Distributed Generation balancing services charges.
4. We said in our minded to consultation that we would take account of the Balancing Services Charges Taskforce findings when reaching our final decision. We also consulted to provide stakeholders the opportunity to comment on the findings and their use within the context of the TCR significant code review. We have included the findings in our decision making and explain how we reached our final decision in the documents published alongside this letter today.
5. We have, through the TCR process, determined that only final demand consumers should pay residual charges. This is partly because residual charges are cost-recovery charges, and as such, we do not think that they should send signals to influence users to change their behaviours on the network. Given this, and the taskforce conclusion that balancing services charges should also be treated as cost-recovery charges, we think that further consideration should be given to who should pay them and how these charges should be structured and recovered in future.