

Modification proposal:	<b>Connection and Use of System Code (CUSC) CMP345: Defer the additional COVID-19 BSUoS costs</b>		
Decision:	The Authority <sup>1</sup> directs that WACM2 of this modification be made <sup>2</sup>		
Target audience:	National Grid Electricity System Operator (NGESO), Parties to the CUSC, the CUSC Panel and other interested parties		
Date of publication:	23 June 2020	Implementation date:	25 June 2020

## Background

### *COVID-19 impact on system balancing costs*

COVID-19 presents a serious challenge for the energy industry to tackle, on behalf of the homes and businesses that depend on the sector for gas and electricity. Reduced demand since the start of the lockdown has led to increases in the cost of balancing the electricity transmission system, and forecast costs over the rest of this summer. Balancing Services Use of System ('BSUoS') charges are the means by which National Grid Electricity System Operator ('NGESO') recovers these costs. BSUoS charges are recovered from demand customers and larger generators based on the amount of energy imported or exported onto the transmission network (in £/MWh) within each half-hour period.<sup>3</sup>

Our current thinking on this matter is that market participants are aware that electricity demand and BSUoS charges have been difficult to forecast for a number of years and will have taken this into account in their commercial decision making and setting risk premia to reflect these uncertainties and risks. We recognise that the Covid pandemic has resulted in demand reductions that even prudent market participants may not have foreseen, or incorporated into all of their commercial decisions for summer 2020. We also recognise that this demand reduction has led to forecast increased balancing costs that can be considered 'exceptional' in nature. In deciding whether and to what extent that the payments to recover these costs should be deferred to a later period, the following factors were considered in the context of the legal framework which is described further below:

- The level and materiality of these 'exceptional' costs that a prudent market participant may not have reasonably foreseen;
- The fact that a deferral of charges that were taken into account in commercial decisions before the summer may lead to an increase in charges that consumers eventually pay;

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<sup>1</sup> References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work.

<sup>2</sup> This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

<sup>3</sup> Larger generators are those above 100MW that are connected to either the distribution or the transmission network.

- The potential impact of deferring these charges into a later period, where other pressures may also arise in relation to demand uncertainty and the level of unpredictability of BSUoS charges; and
- Other factors which may have the effect of mitigating these exceptional costs.

On Friday 15 May 2020, NGENSO published a new BSUoS forecast for the rest of 2020/21, which included the additional costs brought about by managing the system during this COVID-19 period with lower demands for the summer months. The May to August system balancing costs were forecast at £826m. This represented an increase in system balancing costs for those months, over previous forecasts published by NGENSO:

- £441m increase, compared to the February forecast of £384m.
- £406m increase, compared to the March forecast of £420m.

CMP345 seeks to defer the additional BSUoS costs arising from COVID-19 that are incurred in 2020/21 (between 1 May and 31 August 2020) to the 2021/22 Charging Year.

The increase in costs expected this summer is driven in part by the increase in balancing services and other actions required to operate the system within its technical parameters in periods of very low demand. System balancing costs in May were ~£163m, £60m higher than the March forecast. This increase includes the impact of COVID-19 lockdown measures, which alongside warmer weather, drove the suppression of demand by 15 – 20% compared to recent levels. The forecast released by NGENSO on May 15 of £826m assumed that this level of demand suppression would continue until the end of August.

Since then, there has been a recovery in demand to between 5 – 10% below normal conditions. This was reflected in the June forecast released by NGENSO, which includes demand sensitivities for June to August. The table below compares the forecasts.

Forecast date	May – August system balancing cost forecast	Assumed demand suppression*
15 May	£826m	15-20%
12 June	£593m	5%
	£655m	10%
	£725m	15%

\* All forecasts include actual demand suppression from May of 15-20%. Data shown reflects assumption from June to August.

There are several longer term reforms to BSUoS charging for storage and Smaller (sub 100MW) Distributed Generation that are either being developed by industry or are currently planned for April 2021 implementation. Alongside these reforms, in our TCR decision, we acknowledged the findings of the first Balancing Services Charges Task Force that it is not “feasible to charge any of the components of BSUoS in a more cost-reflective and forward-looking manner that would effectively influence user behaviour that would help the system and/or lower costs to customers. Therefore, the costs included within BSUoS should all be treated on a cost-recovery basis”. A key conclusion of the Task Force was that “the volatility and inability to forecast BSUoS is adding risk premia costs to all parties exposed to BSUoS”.

We launched a second Balancing Services Charges Task Force, to make recommendations for BSUoS reform based on this assessment.<sup>4</sup> The Task Force is expected to report in September. We anticipate that NGENSO will then raise modifications to implement any resulting reforms. We understand that reform is unlikely to be implemented ahead of the 2021/22 charging year.

### **The modification proposal**

SSE Generation ('the Proposer') raised CMP345 and submitted it to the CUSC Modification Panel (the 'Panel') for its consideration on 19 May 2020. The alleged defect identified by the proposer is that the unprecedented and unexpected increase in BSUoS charges will have significant commercial impacts on generators and suppliers and will adversely impact competition in the generation and supply of electricity. The Proposer requested that CMP345 be treated as an Urgent CUSC Modification Proposal. The Panel's unanimous view was that CMP345 should be treated as an Urgent CUSC Modification Proposal. We granted the request for urgency on 22 May 2020.<sup>5</sup>

CMP345 (the Original Proposal) seeks to defer the additional BSUoS costs arising from COVID-19 that are incurred from 1 May 2020 to 31 August 2020 to the 2021/22 Charging Year. The Workgroup defined the costs that should be deferred as 'Covid Costs'. The largest component of 'Covid Costs' would be the net Balancing Mechanism costs related to forecast demand of less than 18GW.

The proposer considers that the Original Proposal is positive in terms of Applicable Charging Objective (ACO) (a) as it would ensure that BSUoS-paying market participants are not adversely impacted by the costs incurred by NGENSO to manage the transmission system during the COVID-19 pandemic. The proposer's view is that this would facilitate effective competition in the sale, distribution and purchase of electricity, because it would mean that BSUoS-liable parties are not impacted adversely by the COVID-19 related costs incurred by the ESO. The proposer also considers that the Original Proposal is positive in terms of Applicable Objective (c) as it would ensure that the BSUoS methodology properly takes account of the developments in transmission licensees' transmission businesses arising from the unprecedented COVID-19 pandemic.

Fourteen alternative solutions were put forward and debated by the Workgroup. The Workgroup agreed to support eight Workgroup Alternative CUSC Modifications ('WACMs') which proposed a range of approaches to address the defect. These are:

- **WACM1 – Extended Payment Terms (6 months)** - defer the COVID-19 costs within the 2020/21 Charging Year by allowing an option for a Payment Holiday for up to 6 months for any identified COVID-19 costs with no end date for support. Implementation from 1 June 2020, with no an end date for support.
- **WACM2 – Apply a £15/MWh BSUoS price cap** - apply a cap of £15/MWh to the BSUoS price in each settlement period from the implementation date to the 31 August 2020. Any under-recovery of revenue from the application of the cap would be recovered through BSUoS charges equally across all settlement periods in 2021/22. Implementation from 2 working days after Ofgem's decision.
- **WACM3 - Deferral of costs on Optional Downward Flexibility Management (ODFM) and nuclear contract(s)** to October 2020 – January 2021/February

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<sup>4</sup>[https://www.ofgem.gov.uk/system/files/docs/2019/11/open\\_letter\\_on\\_the\\_balancing\\_services\\_charges\\_taskforce.pdf](https://www.ofgem.gov.uk/system/files/docs/2019/11/open_letter_on_the_balancing_services_charges_taskforce.pdf)

<sup>5</sup><https://www.nationalgrideso.com/document/169841/download>

2021, with daily reporting. To take effect from the Implementation Date (proposed to be 2 working days after Ofgem decision), until 31 August 2020.

- **WACM4 - Deferral of costs on ODFM and nuclear contract(s)**, same as WACM3, with weekly reporting.
- **WACM5 - Cost Deferral of £250m to 2022/23** - defer a set £62.5m per month of BSUoS costs, as a proxy for COVID-19 related costs, from 1 June 2020 to 30 September 2020 to offer an overall level of support of an absolute £250m. Charges recovered in 2022/23.
- **WACM6 – Extended Payment Terms (5 months) for 30% BSUoS Charges** – extend payment terms 30% of BSUoS charges on opt in basis, from 3 days to 150 days (remaining 70% costs paid as usual). Support capped at £300m. The implementation date for this proposal is three working days after an application, to cover charges from 1 June 2020 to 30 September 2020.
- **WACM7 – Within Year Cost Deferral of £250m** – same deferral amount and timing as WACM5, with recovery from October 2020 to January 2021, spread over all settlement periods.
- **WACM8 – Cost Deferral of up to £500m to 2022/23** – same deferral amount and timing as Original Proposal but defer the recovery to 2022/23 Charging Year rather than 2021/22 Charging Year.

The Workgroup assessed the Original Proposal, eight WACMs and existing arrangements (the 'Baseline'), against the Applicable CUSC Charging Objectives to propose the best option. The votes for the best option were:

- Baseline (no change): Seven votes
- Original Proposal: Four votes
- WACM2: Two votes
- WACM5: Three votes
- WACM6: One vote

The Workgroup's detailed discussions are described in the Final Modification Report (FMR).<sup>6</sup>

### CUSC Panel<sup>7</sup> recommendation

The CUSC Panel considered CMP345 at a meeting on 15 June 2020 and recommended that none of the proposed solutions better facilitated the ACOs than the Baseline. The Baseline received three votes for best option, more than the Original Proposal or any WACM. The table below summarises the Panel votes.

<b>Proposed Solution</b>	<b>Of the 9 Panel Members, how many considered this option to be better than the Baseline?</b>	<b>Of the 9 Panel Members, how many considered this option to best meet the ACOs?</b>
Baseline (no change)	N/A	3
Original Proposal	3	0
WACM1	3	1
WACM2	4	1
WACM3	0	0

<sup>6</sup> <https://www.nationalgrideso.com/industry-information/codes/connection-and-use-system-code-cusc-old/modifications/cmp345-defer>

<sup>7</sup> The CUSC Panel is established and constituted from time to time pursuant to and in accordance with the section 8 of the CUSC.

WACM4	0	0
WACM5	3	1
WACM6	4	1
WACM7	1	0
WACM8	3	2

### *The CUSC Panel's assessment*

The table below summarises the Panel Members' assessment of the options against the ACOs. As shown in the table, the assessments varied significantly for several ACOs.

Panel Members took a range of views on whether various options supported ACO (a), the impact on competition. Panel Members who positively assessed proposals to defer charges agreed with the proposer's comments that if parties are unable to recover unforeseen costs related to COVID-19 this may be detrimental to competition.

Panel Members who positively assessed proposals that extend payment terms, believed these measures would address cash flow challenges that market participants may be facing due to higher charges.

Some of the WACMs proposed that deferral of charges to be retrospective and others proposed that only charges from the modification implementation date would be deferred.<sup>8</sup> Some Panel Members expressed concern that solutions applied retrospectively would undermine commercial decisions that had already been taken (for short term trading and other balancing actions) and undermine market confidence more generally (due to perception of increased market risk). A full definition of each ACO is provided below under 'Our Assessment'.

Proposed Solution	Applicable Charging Objective									
	A		B		C		D		E	
	+ve	-ve	+ve	-ve	+ve	-ve	+ve	-ve	+ve	-ve
Original Proposal	3	5	0	4	3	3	0	1	0	6
WACM1	3	4	1	1	1	4	0	1	1	3
WACM2	4	3	0	4	2	2	0	1	0	5
WACM3	0	7	0	3	0	4	0	1	0	3
WACM4	0	7	0	3	0	4	0	1	0	3
WACM5	3	5	0	4	3	3	0	1	0	5
WACM6	4	4	1	1	2	2	0	1	1	2
WACM7	0	7	0	3	1	2	0	1	0	4
WACM8	3	5	0	4	3	3	0	1	0	6

*Summary of Panel Member votes. Neutral assessments not shown.*

### **Our decision**

We have considered the issues raised by the Original Proposal, WACMs 1-8 and the FMR. We have considered and taken into account the responses to the Workgroup Consultation

<sup>8</sup> The Original and WACM8 would have retrospectively deferred COVID-19 related BSUoS charges from the 1 May.

and the Code Administrator consultation on the modification proposal which are attached to the FMR.<sup>9</sup> We have concluded that:

- WACM2 would best facilitate the achievement of the applicable objectives of the CUSC;<sup>10</sup> and
- Directing that WACM2 be made is consistent with our Principal Objective and Statutory Duties.<sup>11</sup>

## Reasons for our decision

There was significant interest in the Workgroup Consultation for CMP345, with 45 responses received. In particular, the responses reflected a diversity of views regarding the level of charges that may be considered 'exceptional' and what their impact on market participants may be. The section below outlines our views on the forecasts for system balancing costs and the potential level of charges that market participants could face this summer.

As described in the Background section, NGENSO's forecasts of summer 2020 BSUoS charges changed significantly between February and June.<sup>12</sup> There was a significant drop in the forecast charges from May to June, reflecting changes to expected demand suppression that would accompany an easing of lockdown conditions.

If the current level of demand suppression (5% - 10%) continues, NGENSO's June forecast of system balancing costs for May to August is £593m - £656m.<sup>13</sup> This would represent an increase of £173m - £303m compared to the March forecast.<sup>14</sup> This is significantly lower than the £500m increase referenced in the FMR (as the expected increase in costs compared to previous forecasts).

Without taking COVID-19 into account, there was also underlying uncertainty in the pre-summer forecasts for Summer 2020 as the forecasts increased by over £70million between the December 2019 and March 2020 forecasts. Moreover, the ESO reported that its baseline model<sup>15</sup> in this period did not capture demands below 18GW. Given that such levels of demand have been experienced in 2019 and were forecast in the Summer Outlook report,<sup>16</sup> this raises the risk that the pre-summer forecasts could underestimate the expected summer balancing costs.

As described above, market participants' exposure to volatile BSUoS charges may be reduced in the future through enduring reforms. However, under current arrangements

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<sup>9</sup> CUSC modification proposals, modification reports and representations can be viewed on NGENSO's website at <https://www.nationalgrideso.com/industry-information/codes/connection-and-use-system-code-cusc/modifications>

<sup>10</sup> As set out in Standard Condition C5(5) of the Electricity Transmission Licence, see: <https://epr.ofgem.gov.uk/Content/Documents/Electricity%20transmission%20full%20set%20of%20consolidated%20standard%20licence%20conditions%20-%20Current%20Version.pdf>

<sup>11</sup> The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Electricity Act 1989 as amended.

<sup>12</sup> <https://data.nationalgrideso.com/backend/dataset/c0376ed7-3205-4fe2-9496-28496f1f287a/resource/e5997b05-8432-486b-94db-819a4be7c2db/download/summary-of-feb-june-BSUoS-forecasts-18.06.20.pdf>

<sup>13</sup> This forecast includes initial estimates of actual May outturn, of £163m

<sup>14</sup> <https://data.nationalgrideso.com/backend/dataset/c0376ed7-3205-4fe2-9496-28496f1f287a/resource/e5997b05-8432-486b-94db-819a4be7c2db/download/summary-of-feb-june-BSUoS-forecasts-18.06.20.pdf>

<sup>15</sup> <https://data.nationalgrideso.com/backend/dataset/c0376ed7-3205-4fe2-9496-28496f1f287a/resource/1234299c-49a4-4a92-ba33-358c25357620/download/BSUoS-forecast-explained-update.pdf>

<sup>16</sup> <https://www.nationalgrideso.com/document/167541/download>

market participants bear this risk and we expect that they have undertaken appropriate actions to mitigate this risk, such as adding risk premia to their commercial agreements.

Based on the factors described above, we expect that prudent market participants would have accounted for the possibility that summer costs may exceed the NGESO’s forecasts or other baseline estimates, by some degree. As a result, we do not agree that all increases in BSUoS charges attributable to COVID-19 in some way should be considered exceptional, or as costs that prudent market participants could not have foreseen and taken account of in commercial planning for the summer.

We have taken this context into consideration in our assessment of the options below, particularly those options that would defer charges to future years, enabling market participants to pass through more of these costs to consumers.

**Our assessment**

We consider that WACM2 would better facilitate ACO (a) and has a neutral impact on ACOs (b), (c), (d) and (e).

Our assessment of each option against the ACOs is summarised in the table below.

Proposed Solution	Does the proposal better facilitate the ACO?				
	ACO (a)	ACO (b)	ACO (c)	ACO (d)	ACO (e)
Original Proposal	No	Neutral	No	Neutral	No
WACM1	Neutral	Neutral	Neutral	Neutral	Neutral
WACM2	Yes	Neutral	Neutral	Neutral	Neutral
WACM3	No	Neutral	No	Neutral	No
WACM4	No	Neutral	No	Neutral	No
WACM5	No	Neutral	Neutral	Neutral	Neutral
WACM6	Neutral	Neutral	Neutral	Neutral	Neutral
WACM7	No	Neutral	Neutral	Neutral	Neutral
WACM8	No	Neutral	No	Neutral	No

***(a) that compliance with the use of system charging methodology facilitates effective competition in the generation and supply of electricity and (so far as is consistent therewith) facilitates competition in the sale, distribution and purchase of electricity;***

Original Proposal, WACM2, WACM5 and WACM8

These options would all reduce BSUoS charges this summer to some degree and defer them until 2021/22 or 2022/23. This would enable increased pass through of those charges to consumers, because market participants would be able to incorporate the resulting increases to 2021/22 or 2022/23 charges into some of their future commercial decisions. The options would also reduce payments from suppliers to Smaller Distributed Generators.<sup>17</sup> The implications of these changes for competition are assessed below.

*Potential impacts of unexpected, high BSUoS charges on competition*

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<sup>17</sup> Smaller Distributed Generators are those less than 100MW that are connected to the distribution network which receive two Embedded Benefits related to BSUoS.

Market participants pass system balancing costs through to end consumers via the wholesale market and supply agreements. There are existing mechanisms whereby suppliers and generators will be able to pass through some of the increased summer BSUoS charges to participants, regardless of whether the charges exceed previous expectations. These include adjustments to the Default Tariff Cap to reflect the cost increases which can be incorporated by suppliers into future Standard Variable Tariffs. Generators can also incorporate the increases to expected system balancing costs into some of their trading decisions in various markets.

Some of the increased charges will not be able to be passed through to end consumers. For example, suppliers with fixed price contracts that were in place before COVID-19 may not be able to pass through unexpected charges to those customers or some may not deem it efficient to re-open such contracts even where they have the right to do so.

Where these increased costs cannot be passed through, they will be borne as losses. Combining our views on the likely level of unexpected costs and the mechanisms that will allow some pass-through of those costs, our assessment of the extent of windfall losses related to system balancing costs this summer, is that they are likely to be significantly less than the full difference between actual costs, and NGESO's forecasts from earlier this year. Furthermore, they are likely to be less than the full costs attributed to COVID-19. The workgroup discussed the need to define these costs and developed their own definition of 'Covid Costs' as noted in the FMR. The full definition is set out in the legal text within the FMR, but was based on the definition set out in the proposal as costs related to demand below 18GW.

Should losses associated with exceptional system balancing costs this summer lead directly to (otherwise financially sound) participants exiting the market, we believe this would have a negative impact on competition and consumers. Nonetheless, our view is that there is a low likelihood that under the baseline, that these exceptional costs will on their own, lead to the exit of companies whose business model is otherwise viable.

#### *Amount of deferred charges and impact on competition*

The Original Proposal and WACM8 would defer the 'full' costs attributable by these modifications to COVID-19 to 2021/22 or 2022/23, respectively. As described above, we do not believe that a deferral of this amount would reflect costs that a prudent market participant could not have foreseen.

WACM5 would defer a fixed amount of £250m to 2022/23. Based on the June forecast and sensitivities, we consider this amount to be high relative to current forecasts and what a prudent market participant could have anticipated.

We believe that these deferrals would negatively impact competition, because consumers could finance a likely windfall gain to some suppliers and generators. The distribution of such gains may disproportionately benefit some market participants over others.

WACM2 caps BSUoS charges for a settlement period at £15/MWh. Periods with charges over £15/MWh are rare. Had the cap been in place in May, when the COVID-19 lockdown and weather conditions drove extremely low demand on several weekends, the deferred charges would have been £8.5m, from 112 settlement periods. From February to April 2020, the cap would have taken effect in 30 settlement periods in April, leading to the deferral of £1.3m.



Our current view is that we would not expect the total amount of charges that are likely to be deferred under the WACM2 proposal to exceed 5% of total BSUoS charges from 25 June until 31 August.

We believe that there would be benefits to competition from this option, because it would enable deferral of exceptional BSUoS charges which prudent market participants could not have likely foreseen, without a significant risk of windfall gains to some participants.

#### *Impact of reducing payments to Smaller Distributed Generators on competition*

If BSUoS charges are deferred from this summer to 2021/22 or 2022/23, it would lead to reductions in payments made by suppliers to Smaller Distributed Generators for offsetting their BSUoS charges this summer. These payments are known as 'Embedded Benefits'.

The scale of these impacts would be directly related to the amount of BSUoS charges deferred to later years. The Original Proposal, WACM5 and WACM8 would have a significant impact due to the large amount of charges deferred. WACM2 would have a smaller effect because of the relatively lower amount of charges likely to be deferred.

#### *Overall assessment of Original Proposal, WACM2, WACM5 and WACM8*

In our overall assessment of whether these options better facilitate competition, we must weigh the factors outlined above. Given our view on the low likelihood that unexpected system balancing costs in the Baseline scenario (no change in BSUoS charges calculations) will, on their own, lead to market exits that would not otherwise occur, we believe that the potential for negative impacts from windfall gains associated with the Original Proposal, WACM5 and WACM8, outweighs any potential benefits for competition, so they would not better facilitate ACO (a).

Given the low likelihood that WACM2 would lead to windfall gains and the potential to promote long-term market confidence by protecting market participants from exceptionally high BSUoS charges, we believe (in these specific circumstances) it would better facilitate ACO (a).

#### WACM1, WACM3, WACM4, WACM6 and WACM7

To the extent that these solutions would facilitate competition it is by addressing near-term cashflow issues arising from higher BSUoS charges linked to COVID-19 demand reduction. They would not enable market participants to pass through significantly more of the BSUoS charges from this summer to end consumers, than they would under the Baseline.

On 2 June, we noted the wider risks to suppliers' cashflow as a result of COVID-19, which could have negative impacts for consumers including through risks to competition. We welcomed the progress that network companies had made towards enabling the temporary relaxation of network charge payment terms for suppliers and shippers.<sup>18</sup> The electricity network charge scheme is now in place for suppliers, and we are today publishing our decision on the Uniform Network Code modification proposal that aims to put in place a scheme for gas shippers.

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<sup>18</sup>[https://www.ofgem.gov.uk/system/files/docs/2020/06/open\\_letter\\_on\\_relaxing\\_network\\_charge\\_payment\\_terms\\_1.pdf](https://www.ofgem.gov.uk/system/files/docs/2020/06/open_letter_on_relaxing_network_charge_payment_terms_1.pdf)

The extended payment terms solutions, WACM1 and WACM6, do not change market participants' liability for BSUoS charges for the summer. They would further increase the liquidity available to suppliers, however on a different basis to the scheme described above. We do not consider that the scale of additional liquidity that could be available to suppliers through changes to BSUoS charges would make a substantive additional contribution to tackling cash-flow challenges beyond existing plans for network charge deferrals. As a result we believe WACM1 and WACM6 would have a neutral impact on competition.

WACM3 and WACM4 defer costs of ODFM and nuclear contract(s) to winter 2020/21. WACM7 would defer a set £62.5m per month of system balancing costs, as a proxy for COVID-19 related costs, to be recouped from October 2020 to January 2021. The potential for these options to increase market participants' ability to pass additional costs through to consumers is limited, because the charges would only be deferred for a few months. We would expect uneven impacts across market participants, depending on the arrangements they have in place and their ability to pass costs through. As a result we believe these options would have a negative impact on competition.

***(b) that compliance with the use of system charging methodology results in charges which reflect, as far as is reasonably practicable, the costs (excluding any payments between transmission licensees which are made under and in accordance with the STC) incurred by transmission licensees in their transmission businesses and which are compatible with standard condition C26 (Requirements of a connect and manage connection);***

Original Proposal, WACM2, WACM3, WACM4, WACM5, WACM7 and WACM8

These options would all reduce BSUoS charges by some degree. WACM2 would reduce charges in high cost periods. WACM5 and WACM7 would reduce charges in all periods by some amount. The Original Proposal, WACM3, WACM4 and WACM8 would have a combination of these two effects.

Overall, we believe these options would have a neutral impact on ACO (b).

WACM1 and WACM6

These proposals do not change how charges are incurred so are neutral against ACO (b).

***(c) that, so far as is consistent with sub-paragraphs (a) and (b), the use of system charging methodology, as far as is reasonably practicable, properly takes account of the developments in transmission licensees' transmission businesses;***

We acknowledge that COVID-19 had led to an unexpected reduction in demand and the potential for exceptional BSUoS charges, and the Original Proposal and all WACMs seek to take this into account. However, the different options are not equally practicable in the way they seek to do this.

WACM1, WACM2, WACM5, WACM6 and WACM7

These options would all require NGESO to finance some extension of payment terms or deferral of charges. NGESO has stated that financing some of these options would have a significant impact on its reported profit and loss.

We believe that the expected amount of charges that would be deferred through WACM2 would be low relative to the other options, and that the impact on NGESO can be managed without a breach of licence conditions. This is discussed in our assessment against our statutory duties below.

We have not taken a view on the materiality of these objections regarding the other options, or whether alternative financing mechanisms which reduce these risks are available.

Our overall assessment is that these WACMs are neutral against ACO (c).

#### Original Proposal, WACM3, WACM4 and WACM8

For the defect identified to be addressed in a practicable manner, any solution should be implementable within the required timescales outlined. NGESO set out its concerns about implementation for several options in its Workgroup Consultation response. We have examined these concerns, and assessed the potential impact of the issues raised. As a result, we do not believe that any of the Original Proposal, WACM3, WACM4 nor WACM8 can be implemented within the required timescale. Therefore, we believe that the Original Proposal, WACM3, WACM4 and WACM8 would not better facilitate ACO (c).

#### ***(d) compliance with the Electricity Regulation and any relevant legally binding decisions of the European Commission and/or the Agency;***

We believe that ACO (d) is not relevant for the modification and our decision.

#### ***(e) promoting efficiency in the implementation and administration of the system charging methodology.***

#### WACM1, WACM2, WACM5, WACM6 and WACM7

These options all introduce new processes which require additional processing by NGESO. Given the temporary nature of each of these proposals in response to the Covid-19 pandemic, we believe that temporary arrangements are appropriate. Our view is that they would have a neutral impact on ACO (e).

#### Original Proposal, WACM3, WACM4 and WACM8

As for our assessment under ACO (c), we do not believe that any of the Original Proposal, WACM3, WACM4 nor WACM8 can be implemented within the required timescale. We consider any option that cannot be implemented to be manifestly inefficient. Therefore, we believe that the Original Proposal WACM3, WACM4 and WACM8 would not better facilitate ACO (e).

#### **Assessment against the Authority's principal objective and statutory duties**

In making a decision on this modification proposal, we have to act in accordance with our Principal Objective and Statutory Duties. Key considerations are described below.

### *Protecting the interests of existing and future electricity consumers*

In regard to our Principal Objective, we have considered whether this arrangement would be consistent with our overall response to the COVID-19 pandemic. We consider that WACM 2 takes a prudent approach to the recovery of exceptional costs reducing the potential adverse impacts on competition of significant losses related to balancing costs that could not have reasonably anticipated.

### *NGESO financing of deferred charges*

We have a duty to have regard to the need to ensure the financeability of the regulated companies. The modification we have approved will lead to a loss of revenue to NGESO this year, to be recovered in the following year. Our view is that the level of costs that are likely to be deferred under WACM2 can be managed within the current financing arrangements for NGESO.

Nonetheless, we recognise that there is a limit to the amount of liquidity that can be provided by NGESO, under current arrangements. With this in mind, we think it would be efficient and appropriate, should the level of BSUoS costs being deferred approach £100m, to consider further how to mitigate the NGESO's exposure.

The legal text for WACM2 enables NGESO to recover of the costs of financing and administering this modification, subject to the Authority's approval. We will consider the recovery of these costs at the appropriate time.

Separate to this decision, we also recognise that currently, NGESO does not have a formal mechanism within the CUSC or License to recover bad debt associated with unpaid BSUoS bills. We are planning to introduce a formal mechanism to allow the ESO to recover bad debt costs, as part of the RIIO-2 price control. Any bad debt costs efficiently incurred in RIIO-1 would be recoverable in RIIO-2.

### *Impact assessment*

In the our letter regarding urgency on 22 May 2020, we decided that the modification should be treated as an Urgent CUSC Modification Proposal.<sup>19</sup> In the reasons, it was noted that '[w]e are satisfied that the progression of this modification proposal is related to "a current issue that if not urgently addressed may cause a significant commercial impact on parties, consumers, or other stakeholders(s)", noting that the actual extent of that impact is still uncertain.'

Section 5A of the Utilities Act 2000 imposes a duty on the Authority (its "Section 5A duty") to undertake an impact assessment in certain circumstances. In particular, that applies where it appears to the Authority that a proposal is important. A proposal is important for these purposes if its implementation would be likely to, among other things, "have a significant impact on persons engaged in commercial activities connected with the ... generation, transmission, distribution or supply of electricity." Where this applies, the Authority is obliged to carry out an impact assessment.

The Authority has not found it necessary to reach a decision on the implications of the reasons set out in our letter for the application of its Section 5A duty. This is because of

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<sup>19</sup> <https://www.ofgem.gov.uk/publications-and-updates/decision-cusc-modification-panel-s-recommendation-cmp345-defer-additional-covid-19-bsuos-costs-be-treated-urgent-cusc-modification-proposal>

the exceptions to this duty. These apply if it appears to the Authority that the urgency of the matter makes it impracticable or inappropriate for the Authority to comply with the Section 5A duty.

The Authority considers it is both impracticable and inappropriate to comply with the Section 5A duty for this decision. The timeline for decision proposed in the FMR does not allow for a full impact assessment.<sup>20</sup> The proposals put forward seek to mitigate the impacts of the high BSUoS charges that have been incurred since May and those that have been forecast for the rest of the summer. Our decision will provide market participants with increased certainty, with respect to charges incurred and forecast from May to August. With the time available, we did consider the potential impacts of the proposed options on suppliers, generators and NGESO. Recognising the limitations of the analysis undertaken, we have taken account of those potential impacts in this decision.

## **Implementation**

We consider that 25 June 2020 is an appropriate implementation date for CMP345.

## **Observations**

### *BSUoS volatility and forecasting issues*

COVID-19, combined with other underlying drivers of low demand and high system balancing costs, has led to unprecedented levels of BSUoS volatility this summer. We acknowledge that this volatility has been both difficult for NGESO to forecast and difficult for market participants to manage.

We encourage NGESO to be as transparent as possible with the assumptions that go in to the forecast and provide clear guidance to market participants regarding published forecasts, and the uncertainty around their interpretation.

WACM2 will reduce market participants' exposure to volatility in BSUoS until 31 August 2020. In the long term, we expect the volatility in BSUoS charges to be significantly reduced as a result of changes that will follow the conclusion of the second Balancing Services Charges Task Force. This modification has highlighted the importance of the work that the second BSUoS Task Force is undertaking. We encourage market participants to actively engage in the upcoming Task Force consultation.

## **Decision notice**

In accordance with Standard Condition C10 of the Transmission Licence, the Authority, hereby directs that WACM2 of modification proposal CMP345: *Defer the additional COVID-19 BSUoS costs* be made.

## **Frances Warburton**

### **Director, Energy Systems Transition, Systems and Networks**

Signed on behalf of the Authority and authorised for that purpose

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<sup>20</sup> <https://www.ofgem.gov.uk/publications-and-updates/impact-assessment-guidance>