

APPENDIX 1

Self Governance Decision Appeal Form – Responses

Attached to this Appendix 1 is a paginated bundle of exhibits marked as "Appendix 2 – Exhibits", to which this Appendix will make reference. References to page numbers in the exhibit are in the form **[EX/page number]**.

1. On which ground(s) are you appealing the self-governance decision?

- 1.1 National Grid ESO (the "**National Grid**") wishes to modify relevant sections of the Connection and Use of System Code (the "**CUSC**") to codify the practice that the amount secured by developers for Cancellation Charges should include a security for the VAT which would become payable only if developers terminate a project prior to connection.¹ There is currently no wording to this effect in the CUSC. The National Grid seeks to implement this modification by way of the CMP342 Original Proposal ("**CMP342**"). A copy of the CUSC Panel Decision is exhibited to this response at **[EX/1-11]**.
- 1.2 Muirhall Energy Limited ("**Muirhall Energy**") appeals the National Grid's use of the Self-Governance Procedure to implement CMP342² on the grounds that CMP342 does not meet the self-governance criteria set out in Section 11 of the CUSC.³ Specifically, CMP342 is likely to:
 - 1.2.1 have a material effect on competition in the generation of electricity by disadvantaging small and medium-sized developers; and
 - 1.2.2 discriminate between different classes of CUSC Parties, to the detriment of small and medium-sized developers.
- 1.3 Muirhall Energy's position is that CMP342 should instead be proposed by way of the standard modification route.
- 1.4 Muirhall Energy further appeals the substance of CMP342 on the following grounds:
 - 1.4.1 Muirhall Energy is, or is likely to be, unfairly prejudiced by the implementation of CMP342.
 - 1.4.2 In the case of implementation, CMP342 will not better facilitate the achievement of any of the Applicable CUSC Objectives as detailed below:
 - (a) the efficient discharge by the Licensee of the obligations imposed on it by the Electricity Act 1989 and the Transmission Licence;
 - (b) facilitating effective competition in the generation and supply of electricity and (so far as consistent therewith) facilitating such competition in the sale, distribution and purchase of electricity;
 - (c) compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency; and
 - (d) promoting efficiency in the implementation and administration of the CUSC arrangements.
 - 1.4.3 This Appeal is not raised for reasons that are trivial, vexatious and this Appeal has a reasonable prospect of success.
- 1.5 Further detail in respect of each of these grounds is set out in response to Question 2 below.

¹ Section 8 of CUSC sets out the possible avenues through which the CUSC can be amended, including the standard modification route and the self-governance route. The full text of Section 8 can be found [here](#).

² For clarification, Muirhall Energy submits this Appeal on behalf of itself and its project companies which are owned by Muirhall Energy and its investor partners.

³ The full text of Section 11 of the CUSC can be found [here](#).

2. Please provide detailed facts and reason(s) in support of your appeal:

Appeal of the Self-Governance Procedure

- 2.1 In respect of Muirhall Energy's appeal of the use of the Self-Governance Procedure, CMP342 does not meet the self-governance criteria for the reasons set out below.
- (i) CMP342 will have a material impact on competition in generation, distribution or supply of electricity*
- 2.2 The implementation of CMP342 will have a material impact on competition in generation of electricity because it will directly disadvantage small and medium-sized developers who will not be able to absorb the additional costs imposed by CMP342 and who will therefore struggle to compete in the market.
- 2.3 As small and medium-sized developers seek to grow the number and size of projects in which they are involved, the requirement to pay VAT on their security will quickly become a hindrance to the continued participation of these developers in the market.
- 2.4 **[EX/12]** contains an example of the security payable on a project in the renewables market including and excluding VAT. As demonstrated in the example, if a project takes 7 years between the signing of the connection and the connection coming into place, developers must provide security equalling 100% the Cancellation Charges for the first 4 years. A trigger point then comes into effect 3 years prior to the connection coming into place. After the trigger point, depending on when the developer obtains the necessary planning consents and demonstrates that they can meet their contracted capacity, they must then either provide a security equalling 10% or 42% of the Cancellation Charges for each period.
- 2.5 The amount of security payable by developers is set out on a cumulative basis. In year 1, the developer will be required to provide £23.5 million as security (excluding VAT). In year 2, the developer will be required to add £5.6 million (excluding VAT) to top up the security held to £29.1 million. The developer will continue to top up the security in each subsequent year to secure the sums set out in the table.
- 2.6 Should the developer be required to secure VAT, in year 1 the developer would pay a total of £28.2 million (being £23.5 million plus £4.7 million in VAT). In year 2, the developer would be required to top up an additional £6.72 million (being the £5.6 million difference referred to above plus £1.12 million in VAT). Therefore by year 2, the cumulative VAT secured will have reached £5.82 million (being £4.7 million paid in year 1, plus £1.12 paid in year 2). On this basis, by year 6, the total amount secured will have reached £135.2 million (excluding VAT) and the developer will have provided a cumulative amount of £27 million for security of the VAT.
- 2.7 If termination does not occur and the project successfully connects at the end of 7 years, the security funds (including VAT) will be released to the developer. However for the duration of those 7 years, the developer will have been, for no discernible purpose, deprived of millions of pounds in funds which they would have otherwise invested in future projects. In the example, over the course of 6 years, a developer will have lost the ability to use £27 million to invest in even more projects or upscale the size of the projects in which they can invest.
- 2.8 This is further exacerbated in circumstances where project timelines extend beyond the control of developers, requiring developers to secure previously unforeseen funds for the security, in addition to the VAT as proposed by CMP342. It is clear that should small or medium-sized developers be involved in multiple projects simultaneously, the additional 20% of the value of the security for each project for each year until connection will accumulate in such a way that it will create a significant barrier to developers' ability to compete in the generation of electricity. They will simply not have enough capital to continue to invest in new projects.

- 2.9 Additionally, as the Cancellation Charge will only come into effect should a project terminate early and not complete to connection, the VAT on the Cancellation Charge will only be invoiced at the point of termination. In practice this means that small and medium-sized developers will be forced to pay VAT on the security upfront on a bi-annual basis, but will then not be able to claim back the VAT from HMRC unless and until termination occurs years later. This is supported by the advice given by the HMRC to the National Grid, confirming that the security on the Cancellation Charge falls outside the scope of VAT, and that VAT should be levied on the Cancellation Charge at the point of termination, see **[EX/13]**.
- 2.10 If termination does not occur, these developers will have been deprived of the benefit of their capital for many years, hindering their ability to compete in the market against larger developers who have more resources at their disposal and who are able to absorb the additional 20% proposed by CMP342.
- (ii) CMP342 will lead to discrimination between different classes of CUSC parties*
- 2.11 Indeed CMP342 will lead to discrimination which is directly detrimental to small and medium-sized developers.
- 2.12 As explained above, the 20% VAT payment will have a negative effect on the ability of small and medium-sized developers to secure the necessary funds to continue investing in more projects. In contrast, larger companies and established utilities will be able to better absorb the additional costs and continue investing and participating the market.
- 2.13 Additionally, CMP342 will favour certain classes of CUSC parties as those developers who do not have parent companies with the requisite credit rating will need to provide higher cash deposits or letters of credit, imposing a real cash cost on those developers and putting them at a disadvantage to those developers with suitably credit-rated parent companies.⁴
- 2.14 For instance, if small and medium-sized developers seek a letter of credit from a funder, they will have to pay the costs of obtaining this letter and provide security to the funder. At this stage the relevant project will not be ready for securitisation so the developer will have to provide alternative forms of security. Compounded across many projects, this will stifle small and medium-sized developers' ability to give securities to additional projects. In contrast, large developers will benefit from parent companies with the appropriate credit rating and will not face the same difficulties in securing funding to provide the security and VAT required.
- 2.15 The discrimination between classes of CUSC parties is further exacerbated by the fact that renewables developers no longer have the benefit of subsidies. Previously, subsidies allowed developers to free up needed equity for future investment in larger projects. In light of the removal of these subsidies, small and medium-sized developers need to maximise access to their funds in order to help them invest in future projects. CMP342 would solidify the (incorrect) practice of requiring developers to secure VAT at a time when they are seeking to increase their participation in the market in the absence of subsidies.
- 2.16 The CMP342 therefore discriminates between different classes of developers, creating barriers to entry and participation in the market for small and medium-sized developers.

Appeal of the CMP342

- 2.17 Muirhall Energy appeals the substance of CMP342 on the following grounds:
- (i) Muirhall Energy is, or is likely to be, unfairly prejudiced by the implementation of CMP 342*
- 2.18 Muirhall Energy is, or is likely to be, unfairly prejudiced by the implementation of the CMP342 for the reasons set out at paragraphs 2.2 to 2.16.

⁴ According to Section 15, Part 3, paragraphs 2 and 4 of CUSC, whilst developers can provide an appropriate company credit rating from Standard and Poor's or Moody's, the developer does not have to provide a security for the Cancellation Charges. The full text of Section15 can be found [here](#).

(ii) If implemented CMP342 will not better facilitate the achievement of any of the Applicable CUSC Objectives

- 2.19 Primarily, CMP342 will not assist in the efficient discharge by the Licensee of the obligations imposed on it by the Electricity Act 1989 and the Transmission Licence. Although National Grid has always sought to secure VAT, this practice was not codified in the CUSC or any relevant legislation. Indeed the proforma Exhibit MM2 (Cancellation Charge Secured Amount Statement) in CUSC does not provide an addition of VAT to the security.⁵ The same is true of the User Commitment Methodology introduced to section 15 of the CUSC by way of CMP192 in 2013.⁶ The purpose of CMP192 was to update existing charging arrangements to ensure that developers provide security for works undertaken by the National Grid, but that this security did not present a barrier to entry to small-sized developers.⁷
- 2.20 On the contrary, the codification of the VAT element of the security will increase the barriers to entry for small and medium-sized developers, distorting competition and discriminating against certain classes of CUSC parties. This will clearly not assist in the efficient discharge of obligations in the CUSC or any relevant legislation.
- 2.21 Secondly, CMP342 will not facilitate effective competition in the generation and supply of electricity or facilitate competition in the sale, distribution and purchase of electricity. As explained in paragraphs 2.2 to 2.16, in practice CMP342 works to the detriment of small and medium-sized developers' ability to compete in the market by imposing an unnecessary financial burden on these developers which prevents them from investing in future projects.
- 2.22 Thirdly, CMP342 will not assist in compliance with the Electricity Regulation and any relevant legally binding decisions of the European Commission and/or the Agency. The Panel Decision recognised that the CMP342 has no impact on this Regulation or any relevant legally binding decisions of the European Commission and/or the Agency, see [EX/7-10].
- 2.23 Fourthly, CMP342 will not promote efficiency in the implementation and administration of the CUSC arrangements. As explained, previous CUSC arrangements such as CMP 192 and the User Commitment Methodology did not require developers to pay VAT on their security. Therefore the measures introduced by CMP342 are additional to, and have no positive impact on, the existing arrangements. On the contrary, one of the measures initially introduced by the User Commitment Methodology was to reduce the amount of security required because the previous amount was viewed as a barrier to entry. Therefore the CMP342 reverses previous CUSC arrangements in so far as they made the market more accessible to all classes of CUSC parties.

(iii) This appeal is not brought for vexatious or trivial reasons and the appeal has a reasonable prospect of success

- 2.24 Primarily, as set out in Muirhall Energy's response to Question 2, the potential impact of CMP342 on the ability of small and medium-sized developers to compete in the market is substantial. CMP342 essentially reinforces a measure that results in a positive cash flow advantage to the National Grid by levying amounts for VAT which may never become due, while unfairly subjecting developers to unnecessary financial burdens. In particular, CMP342 has a disproportionate and material impact on small and medium-sized developers in the renewables market, who are ultimately contributing to the UK's net zero targets, without achieving the commensurate improvements in efficiency or compliance with CUSC and relevant legislation.

⁵ The proforma Exhibit MM2 can be found [here](#).

⁶ Indeed CMP192 was proposed through the standard modification route (i.e referred to Ofgem for approval) rather than through the self-modification route adopted by the National Grid for CMP342. If VAT had been a relevant criteria, this would have featured in part of this modification process and due consideration could have been given to it by Ofgem. The Guidance and Implementation Document for CMP192 can be found [here](#).

⁷ It is interesting to note that the Wider Cancellation Charge Statement which is based on the User Commitment Methodology contained within Section 15 of CUSC also does not mention that developers are required to provide security for VAT levied on wider cancellation charges. The Wider Cancellation Charge Statement can be found [here](#).

- 2.25 From the chronology of events set out below, it is clear that the whole consultation and process was not carried out in a fair and open manner. [REDACTED]
[REDACTED] Therefore it is clear that an appeal of CMP342 is not trivial or vexatious, but is a viable avenue through which CUSC parties can raise their concerns in respect of the material impact of CMP342.
- 2.26 Secondly, Muirhall Energy has been denied an opportunity to be fairly represented in the process of approving CMP342. Should the full information provided by Muirhall Energy be considered, it is Muirhall Energy's position that this appeal would have a reasonable prospect of success.
- 2.27 For example, Muirhall Energy requested to attend the CUSC Modification Panel meeting held on 29 May 2020, but the CUSC team responded that Muirhall Energy may attend but not speak unless invited to do so by the Chair. [REDACTED]
[REDACTED]
- 2.28 Whereas Muirhall Energy is the only developer who has raised an objection to CMP342, this modification clearly impacts all developers. Nevertheless, [REDACTED]
[REDACTED] It is clear from [REDACTED] the accompanying slides that the Panel was only presented with evidence supporting the implementation of CMP342, [REDACTED]
[REDACTED]. Muirhall Energy was not given an opportunity to speak at this meeting.
- 2.29 Muirhall Energy participated in the consultation process which closed on 10 July 2020, see [EX/23-26] for Muirhall Energy's consultation response.
- 2.30 On 17 July 2020 Muirhall Energy contacted the CUSC team to ask if there was a further opportunity for engagement in this process. The CUSC team replied that Muirhall Energy will only have an opportunity to ensure that its position in the consultation has been correctly recorded in the Draft Code Modification Self-Governance Report, see [EX/38-43].
- 2.31 Nevertheless, Muirhall Energy's amended summary was then rejected by the CUSC team on the basis that Muirhall Energy included additional comments not originally set out in its consultation response, see [EX/38-43]. One of the amendments rejected by the CUSC related to the advice received from HMRC that the security for the Cancellation Charge was not within the scope of VAT. [REDACTED]
[REDACTED].
- 2.32 However, the HMRC advice was not obtained for this purpose, but was requested by the National Grid after discussion with Muirhall Energy in respect of whether the security was within the scope of VAT and would therefore require VAT to be paid by developers prior to the termination point, see [EX/45-53]. Muirhall Energy was not permitted to include this clarification in its summary in the Draft Code Modification Self-Governance Report, see [EX/38-43].
- 2.33 As the process unfolded it became increasingly apparent that the National Grid had not presented the full factual position to the Panel. Muirhall Energy attended the CUSC Modification Panel meeting held on 31 July 2020 and was given a brief opportunity to explain its position following which the Panel decided to delay its decision on CMP342 and requested further information from the National Grid in respect of the VAT mechanism, [REDACTED]
[REDACTED]
-
- [REDACTED]

- 2.34 On 31 July 2020 Muirhall Energy wrote to the CUSC team expressing its disappointment that the National Grid did not set out the complete factual position at the beginning of this process, see **[EX/35-36]**. The information provided by Muirhall Energy in its consultation document was provided on the basis that the National Grid would take into account, and present to the Panel, all related information previously obtained by the National Grid.
- 2.35 Nevertheless, as set out in this email, Muirhall Energy was concerned that HMRC's advice, that the security for the Cancellation Charge falls outside the scope of VAT, was portrayed by the National Grid as supporting the levying of VAT on the security. Additionally, the Panel was not presented with evidence that the proforma exhibit MM2, and CMP192 which implemented the User Commitment Methodology did not provide for the increase of the financial security to provide for VAT.
- 2.36 Further to the Panel's request following the CUSC Modification Panel meeting, the National Grid submitted a diagram which purports to demonstrate that should generators default on their Cancellation Charges and VAT at point of termination, then these costs would have to be recouped by National Grid from other users, and therefore generators should be required to secure the VAT charges as well, see **[EX/56]**.
- 2.37 However, the National Grid omitted to explain in this diagram that in a situation of generator default, the National Grid can apply to HMRC for bad debt relief in respect of VAT owed by the National Grid, but not collected from the generator. Moreover, at lines 8 and 9 of the explanatory table below the diagram it is clear that the National Grid is uncertain as to whether VAT would be applicable at all to TNUoS charges passed on to the users as a result of generator default, and if so at what rate said VAT would apply. On its own face, it appears that the National Grid provided a diagram that demonstrates uncertainty as to whether the VAT it seeks to secure from developers is chargeable and at what rate.
- 2.38 Following the provision of the National Grid's diagram, the CUSC team requested Muirhall Energy's response, but again with the proviso that Muirhall Energy could not provide new information not previously raised in the consultation document.
- 2.39 The CUSC team additionally acknowledged Muirhall Energy's feedback that the whole modification and consultation process was unclear and that developers were not informed of when they could provide information and what information they could provide in the process, see **[EX/31]**.
- 2.40 Muirhall Energy's response to the National Grid's diagram was shared with the Panel, following which the Panel decided on 28 August 2020 to accept CMP342.
- 2.41 It is clear that the process of approval of CMP342 did not provide developers with sufficient opportunity to put their concerns directly before the Panel. The initial proposal for CMP342 was presented by the National Grid and portrayed the modification as a minor issue of re-wording the CUSC and which affects a single user in the entire market. Muirhall Energy was also not allowed to ensure that the summary of its position was expressed as comprehensively and effectively as possible neither at the Panel meetings nor in the reports which were presented to the Panel. Meanwhile the National Grid was permitted to introduce information to the Panel at will and put forward its position, unchallenged by the parties to whom the proposed modification is to apply.
- 2.42 During the process Muirhall Energy made repeated requests from the CUSC team to attend Panel Meetings and to be able to provide input in the process. Had Muirhall Energy not been proactive in its pursuits, developers would not have known when their input could have been provided outside the consultation process. Even so, Muirhall Energy was only permitted to restate points made in the consultation process despite the National Grid not being subject to the same limitation. Additionally when Muirhall Energy was finally given an opportunity to address the Panel directly, it was told to be brief because the Panel had a lot of business that day, see **[EX/54]**.
- 2.43 The CUSC team itself acknowledged the shortcomings of the process and the lack of clarity afforded to developers in respect of the timing and content of their interventions. The CUSC team said they will "act on it", but it is clearly too late for CMP342.

2.44 These are clearly not the hallmarks of due process. It is Muirhall Energy's position that had the Panel been afforded the opportunity to consider the information set out in this Appeal, alongside the position of the National Grid, the Panel would not have approved CMP342. Muirhall Energy believes that against the background explained above and in light of the additional information it has provided in this Appeal, this Appeal has a reasonable prospect of success.

3. Please explain the impact on you of this decision and how a successful appeal would resolve this matter. Please indicate if you consider there to be any other persons affected by this decision.

3.1 The impact of CMP342 on Muirhall Energy is as set out above in paragraphs 2.2 to 2.16.

3.2 If we return to the example of a project which requires 7 years to reach connection, as mentioned [EX/12] shows that should VAT be applied to the security for this project, the amount of cumulative VAT security payable by a developer such as Muirhall Energy in year 6 of the project could reach £27 million. This is a substantial financial burden to impose on any size developer, let alone small and medium sized developers.

3.3 Unlike the National Grid's diagram which demonstrates the financial burden to developers to be akin to £20 [EX/56], this is clearly a significant financial burden to impose on any size developer for a contingency which may never occur. Even if a developer can afford to meet these financial obligations at the time, these funds will remain tied up for 7 years in a best case scenario with developers unable to invest it in the market. It is difficult to understand the commercial rationale behind requiring such large amounts of capital to remain locked up for years instead of being invested into electricity generation.

3.4 By way of another example, Muirhall Energy currently owns the [REDACTED] project, the connection for which was signed in [REDACTED]. [REDACTED]

3.5 It is clear that the cumulative effect of the VAT for one project, and as amalgamated across all projects in which a developer such as Muirhall Energy participates, is crippling for small and medium-sized enterprises.

3.6 Muirhall Energy currently has over [REDACTED] and has [REDACTED] and will therefore be required to secure significantly more securities over the next few years.

3.7 A successful appeal of the CMP342 would, reverse the potential negative impact on small and medium-sized developers such as Muirhall Energy and reinject certainty into the market. Muirhall Energy will be able to benefit from substantial amounts of equity that would have otherwise been used to pay additional VAT to invest in larger renewables projects and compete in the market alongside other market players. Muirhall Energy and other developers will also benefit from certainty in their financial planning.