Making a positive difference for energy consumers

Modification proposal:	**Connection and Use of System Code (CUSC) CMP275: Transmission Generator Benefits in the provision of ancillary and balancing services – levelling the playing field**		
Decision:	The Authority[1] has decided to reject[2] this modification proposal		
Target audience:	National Grid Electricity Transmission PLC (NGET), Parties to the CUSC, the CUSC Panel and other interested parties		
Date of publication:	15 August 2018	Implementation date:	n/a

Background

The Electricity System Operator (ESO) develops and procures a number of ancillary and balancing services, such as Short Term Operating Reserve (STOR) and Fast Reserve, to balance demand and supply and to maintain grid stability and security. The ESO's approach to procuring ancillary and balancing services must follow the high level framework set out in the Transmission Licence C16 statements. Some of these services are mutually exclusive and cannot be provided at the same time. However, for services that aren't mutually exclusive, the current charging arrangements allow Balancing Mechanism (BM) units to use the same asset to provide multiple ancillary services. As a result, BM units can subsequently access and "stack" multiple revenue streams.

In the past, stakeholders have expressed concerns that certain ancillary and balancing services may include unnecessary restrictions or requirements (such as exclusivity clauses or minimum delivery requirements) which may prevent market participants or providers of these services from being able to efficiently 'stack' revenue streams. Others are concerned that potential overlaps between different services could lead to inefficient procurement outcomes. Stakeholders have also raised concerns about the extent to which ancillary and balancing services are procured by the ESO through bilateral contracts rather than market based mechanisms.

The ESO is currently looking into reforming its ancillary and balancing services, with the goal of increasing transparency, increasing competition, reducing complexity and delivering greater value for the end consumer.[3] The new ESO regulatory and incentives framework (implemented in April 2018) also incentivises the ESO to ensure its procurement of balancing services is competitive, market-based, simple, fair and transparent.[4]

The modification proposal

<u>Details of proposal</u>

CMP275 was proposed by UK Power Reserve (UKPR) and was submitted to the CUSC Modifications Panel (CUSC Panel) for its consideration on 27 January 2017.

The Proposer maintains that providers receiving multiple revenue streams from the same asset have an unfair competitive advantage which they can use to cross-subsidise their

[1] 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. This decision is made by or on behalf of GEMA.
[2] This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.
[3] More details about the ESO's work to reform balancing services can be found here: https://www.nationalgrid.com/uk/electricity/balancing-services/future-balancing-services
[4] The ESO's Roles and Principles can be found here: https://www.ofgem.gov.uk/system/files/docs/2018/02/eso_roles_and_principles.pdf

tender strategies and undercut other BM and non-BM units that don't receive multiple revenue streams. The Proposer considers that this introduces a distortion in the market and creates a non-level playing field. Ultimately, they consider it adds an expense to the end consumer as they pay for a service twice. Therefore the Proposer seeks to introduce a principle of financial mutual exclusivity under Section 4.4 of the CUSC which would prevent BM units from accessing multiple sources of duplicate and overlapping revenue from ancillary services on the same asset.

The Proposer considers this distortion is most pronounced where units are able to enter and/or tender into multiple ancillary services from National Grid such as Black Start and Fast Start which do not exclude participants from taking part in other services such as STOR. Although the Proposer considers that the defect only exists within the availability payments, they propose that the principle would apply to both the availability and utilisation streams of revenue for ancillary services for completeness.[5]

The principle of financial mutual exclusivity would introduce a netting process which would be used when a BM unit is providing more than one ancillary service in any settlement period and would ensure that providers do not receive, in total, more than the revenue earned from highest paying ancillary services in any settlement period. As an example, if a site is receiving £100,000 in availability on an annual basis from a Black Start contract and it also tendered into the STOR market and received £130,000 in availability payments over the same settlement period then they would only receive £130,000 in availability from both products under CMP275 (£100,000 of its revenue from STOR availability would be netted against its Black Start revenue). The Proposer considers this would be a removal of duplicate revenue and a direct saving to the consumer from paying for the availability of a generation asset twice over.

Options considered

Two options were put forward for consideration: the Original Proposal, raised by UKPR (also referred to in this document as CMP275), and one Workgroup Alternative CUSC Modification (WACM1), raised by NGET. The Original Proposal, would apply the proposed netting process to all existing and future ancillary service agreements after it is implemented. In contrast, WACM1 would allow all existing ancillary service agreements to continue, without change, until the contracted end date. WACM1 would apply the proposed netting process to new ancillary service agreements entered into after it is implemented.

Proposers' views of CMP275 against Applicable CUSC Objectives

The Original Proposal and WACM1 were assessed against the Applicable CUSC Objectives[6], referred to as Objectives in this document.

It is the view of the Proposer that the Original Proposal better facilitates Objective (a) as it seeks to address an alleged defect that impacts the ESO's procurement of balancing services which subsequently affects market behaviour. The Proposer also views that the

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[5] It was noted that services that only receive a utilisation payment would not be covered by the scope of this CMP275 modification proposal as this payment is made when a service is instructed and so is distinct. It is physically not possible for a unit to provide two services at the same time.

[6] The proposal must be evaluated to consider whether it better facilitates achievement of the Applicable CUSC Objectives. These can be summarised as follows:

(a) The efficient discharge by the Licensee of the obligations imposed on it by the Act 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.

Original Proposal better facilitates Objective (b) as it will level the playing field by removing any duplicate revenue streams BM Units currently receive. The Proposer considers this will improve competition in the market and reduce cost to the end consumer. The Proposer views the Original Proposal to be neutral against Objectives (c) and (d).

NGET views that WACM1 would not better facilitate Objectives (a) and (b) compared to the baseline and would be neutral against Objectives (c) and (d). However, in comparison to the Original Proposal, NGET considers that WACM1 would better facilitate achievement of the Objectives as it would allow existing bilateral agreements to continue to their contracted end date, which would lead to fewer negative implications.

CUSC Panel[7] recommendation

At the CUSC Panel meeting on 29 June 2018, the CUSC Panel unanimously agreed that neither the Original Proposal nor WACM1 were better than the baseline and hence neither would better facilitate the Objectives. Therefore, the Panel did not recommend approval of the Original Proposal or WACM1.

The majority of the CUSC Panel considered that the Original Proposal did not better facilitate Objectives (a) and (b) and it was neutral against Objectives (c) and (d). The majority of the CUSC Panel also considered that WACM1 did not better facilitate Objectives (a) and (b) was neutral against Objectives (c) and (d).

Our decision

We have considered the issues raised in the Final Modification Report (FMR)[8] dated 12 July 2018. We have considered and taken into account the responses to the industry consultation on the modification proposal which are attached to the FMR. We have concluded that implementation of the Original Proposal or WACM1 will not better facilitate the achievement of the Applicable CUSC Objectives.[9]

Reasons for our decision

We consider that the Original Proposal will not better facilitate the Objectives (a) and (b), and has a neutral impact on Objectives (c) and (d). Similarly, we consider that WACM1 will not better facilitate the Objectives (a) and (b), and has a neutral impact on Objectives (c) and (d).

(a) the efficient discharge by the licensee of the obligations imposed upon it under the Act and by this licence

Overall, the majority of Workgroup members and respondents to the Workgroup consultation and code administrator consultation were in agreement that neither the Original Proposal nor WACM1 better facilitates Objective (a). We agree that neither the Original Proposal nor WACM1 will better facilitate Objective (a) for the following reasons. The Original Proposal and WACM1 would net the revenue market participants receive for providing multiple ancillary services. This may incentivise service providers to avoid tendering in for more than one service and instead focus on markets that produce the most value, which would in turn limit the availability and provision of services to the ESO.

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[7] The CUSC Panel is established and constituted from time to time pursuant to and in accordance with section 8 of the CUSC.
[8] CUSC modification proposals, modification reports and representations can be viewed on NGET's website at: http://www2.nationalgrid.com/UK/Industry-information/Electricity-codes/CUSC/Modifications/
[9] As set out in Standard Condition C10(1) 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

With any decrease in supply it can be reasonably expected that costs to the consumer will rise. In addition, a reduction in availability and provision of services could lead to the ESO being unable to procure it's minimum system requirement for certain ancillary services and could potentially result in system security issues, impacting the ESO's ability to safely and efficiently manage the electricity network.

There is an additional risk that as the value proposition for providing multiple services changes, suppliers' bidding strategy will change to reflect this, leading to further price increases in the tendered bids. As a result, the ESO would have to procure more expensive services. We note the analysis produced by the ESO which suggests that the costs of procuring STOR and Black Start would increase if the netting process described under the Original Proposal or WACM1 were implemented[10].

The netting process that would be introduced with either the Original Proposal or WACM1 would also add complexity and cost to how these services are procured as the ESO would have to assess tenders and take into account the netting of revenues across multiple products. This would potentially reduce the ability of the ESO to efficiently discharge its licence obligations and could lead to an increase in cost to the consumer.

(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

Overall, the majority of Workgroup members and respondents to the Workgroup consultation and code administrator consultation were in agreement that neither the Original Proposal nor WACM1 better facilitates Objective (b). We agree that neither the Original proposal nor WACM1 will better facilitate Objective (b) for the following reasons.

We agree with the majority of stakeholders that it is economically efficient for providers of ancillary and balancing services to be able to provide more than one product if they are capable of doing so. Any provider who is providing more than one ancillary and balancing service should be subject to the true costs and benefits of their actions and consequently should be able to stack revenue accordingly.[11]

We agree with the stakeholders that commented that the Original Proposal and WACM1 could discourage investment in technologies which can provide multiple ancillary and balancing services and would rely on multiple service revenue streams (e.g. flexible generation). This would further reduce competition by stifling competitive behaviour and lead to increased costs to consumers.

Other considerations

Overall, we note that CMP275 touches on fundamental issues within the ancillary and balancing services market. In particular, the complexity and overlap of services and the concern around lack of transparency behind the ESO's procurement decisions. However we do not think the Original Proposal or WACM1 are the correct solutions to address these concerns.

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[10] For more information on the analysis, please refer to the FMR: https://www.nationalgrid.com/sites/default/files/documents/CMP275%20FMR%20final%2012%20July%202018.pdf

[11] Page 17: Smart Systems and Flexibility Plan (2017): https://www.ofgem.gov.uk/system/files/docs/2017/07/upgrading_our_energy_system_-_smart_systems_and_flexibility_plan.pdf

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Separately, we note that the new ESO regulatory and incentives framework (implemented in April 2018) incentivises the ESO to ensure its procurement of balancing services is competitive and market-based, simple, fair and transparent. In particular, the ESO should limit, wherever possible, exclusivity requirements to enable providers of ancillary and balancing services to stack revenue streams and should procure services in a way that facilitates existing and new providers to compete on a level playing field, regardless of size or type.[12] We look to the ESO's Future of Balancing Services workstream to further simplify the ancillary and balancing services market, increase transparency and competition in the market by standardising products and removing barriers to entry to create a more level playing field.

We also note the CUSC governs mandatory ancillary services and that the proposal sought to cover all ancillary services, which are governed under the C16 Procurement guidelines. The ESO is responsible for consulting on the C16 Procurement guidelines on an annual basis and we encourage the ESO to ensure industry participants can propose, and feed into, any modifications to the C16 Procurement guidelines.

Decision notice

In accordance with Standard Condition C10 of NGET's Transmission Licence, the Authority has decided that modification proposal CMP275: *Transmission Generator Benefits in the provision of ancillary and balancing services – levelling the playing field* should not be made.

Kind regards,

Louise Van Rensburg

Interim Deputy Director – SO and Whole Systems
Signed on behalf of the Authority and authorised for that purpose

[12] Principle 3 under the ESO Roles and Principles requires the ESO to ensure the rules and processes for procuring balancing services maximise competition where possible and are simple, fair and transparent. https://www.ofgem.gov.uk/system/files/docs/2018/02/eso_roles_and_principles.pdf