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Re: Money For Nothing? A Review of National Grid's Contracting Criteria

Dear Greig

Many thanks for taking the opportunity to meet with National Grid on Tuesday 8th November 2011 to discuss the publication of the aforementioned paper by the Canterbury Club. The continued development of the Aggregation model will be fundamental to facilitating growth in the provision of Operating Reserve from demand-side service providers and we therefore welcome the interest shown in this area.

As the level of service provision has grown over the past couple of years, it has been necessary for National Grid to adopt an evolutionary approach in the development of the Aggregator terms and conditions. I have therefore responded to each of the major issues raised in the paper, providing an update on the developments in each of these areas to date in addition to our intended next steps where applicable. The key points to be noted are:

- it is the intention that Aggregator terms will continue to be developed in a transparent manner to facilitate competition in the procurement of Operating Reserve;
- Aggregators are not (and have never been) remunerated on the basis of Phantom MW;
- the inability of Aggregators to deliver on contracted volumes does not result in the procurement of additional Operating Reserve within shorter timescales, when it is less economic to do so;
- we no longer offer the functionality of Phantom MW to new Aggregators and it is the intention that this concept will disappear in its entirety as existing Aggregators transition to the new contract form; and
- a revised auditing process will give us additional comfort that Aggregators consistently deliver on their contracted volumes.

Given that the paper was originally distributed to a wide audience within the energy industry and has no doubt been subsequently forwarded, my proposal is to publish this response (alongside the paper) on the Balancing Services area of the National Grid website, concurrent to further circulation by the Canterbury Club to the original distribution list.

Background

As National Electricity Transmission System Operator (NETSO), National Grid procures Balancing Services in order to balance demand and supply and to ensure the security and quality of electricity supply across the Great Britain Transmission System. These Balancing Services include Short Term Operating Reserve (STOR).

STOR is a service for the provision of additional flexible active power from generation and/or demand reduction, used to deal with supply shortfalls close to real time due to unforeseen circumstances such as generation plant failure or actual demand being greater than forecast. National Grid procures part of the overall requirement for Operating Reserve through STOR, where it is economic to do so via a competitive tender process.

Reserve Providers with a minimum capability of 3MW are invited to tender for the provision of STOR directly, whilst Aggregators can provide STOR through the provision of steady demand reduction from multiple sites, subject to the aggregated volume being 3MW or greater.

The paper notes that STOR Aggregators have added a new dimension to the STOR market, but that expansion in this area may have come at the cost of transparency and the risk that National Grid is not securing the best terms available in STOR Aggregator contracts. It is true that the growth in the level of service provision from Aggregators has contributed to increased levels of competition in the STOR market. Given this, we are keen that the terms of the Aggregation service continue to be developed in a transparent manner, such that further growth in this area can be facilitated. Below, I have highlighted some of the developments already undertaken, in addition to how this might be progressed further over the course of the next year or so.

Transparency of Terms and Conditions

The Aggregator model was originally developed and facilitated by the use of Special Conditions in an Aggregator's Framework Agreement. Whilst these broadly achieved the same thing for all Aggregators, there were subtle differences in the way that some of the contracts operated in practice due to the differing requirements of each Aggregator.

In the interests of providing consistency and transparency of Aggregator terms and conditions, a "Standard" set of terms were published in December 2010. These were offered to incumbent Aggregators that wished to transition from their existing terms at the time, and became the standard set of terms made available to new Aggregators. Following informal consultation with all relevant parties, these terms were subsequently developed further to incorporate some of the feedback received and were re-published in October 2011.¹

It is the intention that all Aggregators will be signed up to these terms prior to Tender Round 16 in January 2012, to become effective from the first contract start date of 1st April 2012. This will provide the platform for further development of the terms as part of an evolutionary process that will involve continued consultation with both existing and prospective STOR market participants. Whilst the terms and conditions are not yet captured as part of the STOR Standard Contract Terms, it is the intention that this will be the case in the longer term.

Phantom MW

In recognition of the uncertainty that Aggregators have with regards to the level of service that they can provide due to the uncertain nature of demand, the contractual framework adopted originally, afforded Aggregators the ability to tender multiple sites on a flexible basis with actual availability declared at week-ahead stage.

For example, an Aggregator could tender four individual STOR Sites of 3MW, 4MW, 5MW and 6MW respectively, and then (subject to acceptance in the tender process) subsequently declare any combination of these available at week-ahead stage, when they have more certainty of availability of their sub-sites. Using this example, the potential level of service provision from an

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http://www.nationalgrid.com/NR/rdonlyres/EF35E0EC-D7EC-4169-94FB-B09B484C21DF/49612/Generic_Aggregation_STOR_Framework_Agreement.pdf

Aggregator could be anything between 3MW and 18MW. This differential in the actual level of service provision and the upper capacity limit is referred to as “Phantom MW”.

It should be noted that Aggregators are not (and have never been) remunerated on the basis of Phantom MW, but on the basis of the capacity declared available at the week-ahead notification stage. The assertion that National Grid, through its Aggregator contracts has been providing “*Money for nothing?*” is therefore incorrect. Additionally, the existence of Phantom MW has always been factored into each STOR assessment when ascertaining the overall requirement for Operating Reserve. The inability of Aggregators to deliver on contracted volumes therefore does not result in the requirement to procure additional Operating Reserve within shorter timescales, where it would potentially be less economic to do so.

The concept of Phantom MW suited the Aggregator model whilst in its infancy, when capacity levels tendered were relatively low. As significant growth has been experienced in Aggregation over the past couple of years however, we have recognised that it is necessary to move away from this approach.

It is therefore our intention that the concept of Phantom MW will be removed from the Aggregator model in their entirety, as existing Aggregators migrate to the newly published Aggregator terms. This reduction in flexibility for the Aggregator will be offset by affording greater flexibility in the sub-site allocation process which should better facilitate the provision of a committed service from Aggregators, rather than flexible which has in the main, been the case to date.

Auditing of sub-sites

As noted previously, the role of the Aggregator was introduced such that multiple sub-sites of less than 3MW in capacity could be developed and operated by an Aggregator acting on behalf of third parties, without the requirement of National Grid to manage them directly.

In the early stages of development of the Aggregator terms, it has never been the intention for National Grid to undertake a full audit of all sub-sites on the basis that this would be a disproportionate use of resource. Account Managers have however, been very proactive in visiting Aggregators and a selection of their sub-sites to gain an appreciation of the technology being deployed for both metering and aggregation methodology purposes. At no point during these visits or in the ongoing management of Aggregator accounts, has there been any reason to suspect that Aggregators are not delivering on their contracted volumes.

Nevertheless, under the recently published Aggregator Terms, a more robust auditing process is being put in place whereby not only is relevant site information provided by the Aggregator, but this is also verified by the owner/operator of each sub-site. Following receipt of this information we will then have full audit and inspection rights, subject to providing the asset owner/operator a period of notice of 5 Business Days.

We welcome your recommendation regarding the introduction of an independent auditing system and will give due consideration to this when assessing the relative merits of all options in developing a proportionate approach towards resolving any issues should they exist.

In summary, through the transparent development of Aggregator terms and conditions, the concept of Phantom MW will disappear, whilst a revised auditing process will give us comfort that Aggregators consistently deliver on their contracted volumes and continue to play an important role in the facilitation of competition in the procurement of STOR which ultimately, results in a better deal for the end consumer.

Your continued engagement in the ongoing developments of the Aggregator model is very welcome. Should the Canterbury Club consider any future publications in this area or any other area directly relevant to National Grid, we would be more than willing to meet and discuss the content of these with the membership. If you have any questions relating to either the content of this letter or that of the publication which you feel I have not addressed, please feel free to contact either myself, or Craig Maloney on (01926) 655896.

Yours sincerely

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