

National Grid Electricity Transmission plc

Reactive Power Market Tender Review Detailed Proposals

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Introduction

At the Balancing Services Standing Group (BSSG) meeting on the 26th January 2009, National Grid discussed its initial proposals for the review of the Reactive Power Market Tender process with industry participants. Following this meeting, and having received preliminary feedback from attendees, this document sets out some detailed proposals on the development of the Reactive Power Market Tender process. This document also poses a number of questions that we would like you to consider, providing responses as required.

Please review these proposed changes and send your responses to the questions and/or any general feedback you may wish to provide on the Reactive Power Market Tender to Katharine Clench by emailing katharine.clench@uk.ngrid.com or by telephoning 01926 656036.

Readers may find it useful to read the Initial Proposals Document in conjunction with these detailed proposals which can be found at:

<http://www.nationalgrid.com/uk/Electricity/Balancing/services/ReactivePower/marketender/>

Focus Areas of Review

The key areas of the Reactive Power Market Tender review which have been considered in this document are:

1. Tender frequency and contract length
2. Assessment timescales
3. Assessment principles
4. Introduction of framework agreements
5. Other tender timescales
6. Unit Substitution
7. Market Information
8. Enhanced Service
9. Removal of market tender terms from CUSC

1. Tender Frequency and Contract Length

National Grid's view is that bi-annual tenders as currently exist are sufficient for the Reactive Power Market and feedback from the BSSG was generally supportive of this view. The possibility of more frequent tenders were discussed but it was felt that, for example, monthly tenders would be too much of an administrative burden for both National Grid and providers. Following the BSSG therefore, it is proposed that the timing i.e. contracts commence 1st April/ 1st October, and frequency of tenders remain as they are.

Currently the minimum market contract length for which providers can tender is 12 months and it was proposed that this be reduced to 6 months in order to reduce the risk to both National Grid and providers of fluctuations in the default price. Members of the BSSG did not seem to think that current contract length was a particular issue but that some providers might want the option to contract for a shorter period. It is therefore proposed that the minimum contract length be reduced to 6 months with 6 month increments thereafter.

Question Box: Tender Round Frequency and Contract Length

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| Q1 | Do bi-annual tender rounds give providers sufficient opportunity to tender/ re-tender throughout the year? |
| Q2 | Do you agree that reducing the minimum contract length reduces risk to the provider? |
| Q3 | Do you consider the current minimum contract length of 12 months to be an issue? |

2. Assessment Timescales

At present, as prescribed within the CUSC, National Grid must make 'reasonable endeavours' to complete the assessment of reactive power tenders within 10 weeks (see Appendix 1 for a tender timeline of tender process). It was proposed that this time period be reduced to 5 weeks (see Appendix 2 for proposed timescales) which was successfully trialled for the last tender round (TR23). It was agreed that reducing this time period by half would again serve to reduce risk to the provider of hedging against the default price. The BSSG questioned whether this time period could be reduced further but in the interest of consistency with other services and due to the processes that have to be undertaken during the assessment period, National Grid is still proposing that this be reduced from 10 to 5 weeks.

Question Box: Assessment Timescales

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| Q4 | Do you agree that assessment timescales are currently too long? |
| Q5 | Do you agree that reducing assessment timescales reduces risk for the provider? |

3. Assessment Principles

In the initial proposals document, National Grid questioned whether the reactive market assessment principles were sufficiently transparent to participants. The BSSG believed that the current assessment criteria as set out in CUSC were sufficiently transparent and clear. It is therefore proposed that the assessment criteria are not changed. However, the BSSG discussed the possibility of removing the evaluation criteria from Appendix 6, Schedule 3 of the CUSC and creating a separate Assessment Principles document as we have for other commercial Balancing Services. The document would be subject to appropriate governance to manage any subsequent amendments and would serve to increase future flexibility in the service. (Note - The removal of the Reactive Market Tender Process from CUSC is discussed further in section 9.)

Question Box: Assessment Principles

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| Q6 | Do you think that the CUSC assessment criteria are sufficiently transparent? |
| Q7 | Should the assessment criteria remain within the CUSC or could they be removed in order to make the service more flexible in the future? |

4. Introduction of Framework Agreements

National Grid proposed that framework agreements be introduced to the reactive power service which would lead to a further reduction in timescales between Market Day and Contract Start Day of 4 weeks (see timeline in Appendix 2). At present, this 4 week period is spent drafting and arranging signature of market agreements with successful tender participants. The framework agreement would be similar to the current market agreement but could also contain some tender information such as the reactive breakpoints which do not often change. The Reactive Attachment document which sets out reactive capability at Nominated Registered Capacity could also be incorporated into either the framework agreement or the tender documentation although the ability to amend this data for each tender round will need to be addressed.

Framework agreements would mean that tenders become binding upon acceptance which in turn means that the option to withdraw from a market agreement following tender acceptance is removed. Due to the ensuing reduction in timescales that framework agreements could bring, it is felt that having the option to withdraw from the process is no longer required as the exposure to fluctuations in the default price is also reduced.

Question Box: Introduction of Framework Agreements

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| Q8 | Are providers willing to accept the introduction of framework agreements in turn for reduced tender timescales? |
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5. Other Tender Timescales

Aside from reducing the assessment and post tender timescale as discussed earlier, the possibility of reducing the tender preparation time period i.e. the time between publication of the Invitation to Tender Pack and Market Day, was also discussed with the BSSG. Currently providers have 8 weeks in which to prepare their tenders and it was agreed that this could be shortened particularly given that the reactive market Invitation to Tender documentation does not change significantly from one tender to the next. It is therefore proposed that this be reduced to 4 weeks which is more in line with other services. National Grid also proposes that the time between tender acceptance/contract signature and contract start day be cut down from 4 weeks to 2 weeks (see Appendix 2 for an overview of all the proposed timescales).

Question Box: Other Tender Timescales

Q9 Do you agree that the time in which providers have to prepare their tenders could be reduced from 8 weeks to 4 weeks?

6. Unit Substitution

Members of the BSSG generally supported the proposed introduction of a unit substitution option to the reactive power service, meaning that providers can ensure even wear and tear across units at a station during the contracted period. The capability of the substitutable unit(s) would need to be the same or greater than the accepted tendered parameters and would be listed within the proposed framework agreements.

It is appreciated that the ability to substitute units may only be of benefit to certain types of generator particularly given the locational nature of the reactive power service (the substitutable units would also be required to be at the same Grid Supply Point). The addition of this option would also have an impact upon National Grid's operational systems which would require development if unit substitution were to be implemented.

Question Box: Unit Substitution

Q10 Would the introduction of unit substitution encourage more providers to tender for the reactive service?

7. Market Information

National Grid's initial view was that the reactive power market report contained a lot of detailed information which could be rationalised and consolidated. However, the BSSG felt that the current market report contained a satisfactory level of information and that the format was useful, particularly given the complexity of the service. Following this feedback it is proposed that the market report be kept largely as it is but to reduce some of the duplicated information. In addition, reactive utilisation data

for the previous 6 months will be taken out of the report as this is now published for each month on the National Grid website – see the following link: http://www.nationalgrid.com/uk/Electricity/Balancing/services/ReactivePower/Reactive_Utilisation/). The market report section of the website will be updated to include this separate utilisation data.

Some providers have commented in the past that the market report information is published too close to each market day which doesn't allow enough time for tender preparation. This issue should be addressed by the above proposed reduction in tender timescales as the time between market report publication and market day is subsequently lengthened to approximately 3 months. The timescales in which the market report is currently published will not change.

Question Box: Market Information

- Q11 Do you agree that the current market report provides sufficient information on the previous 6 month period?
- Q12 Would you want to see any of the market report information in a different format?

8. The Enhanced Reactive Service

The enhanced service was discussed at the BSSG and it was felt that it provides a suitable route to market for providers who either have a greater reactive capability than the obligatory Grid Code requirements or are not subject to such requirements. It was felt that the potential market for such a service was small but that the service should remain available for this market in the future. It is therefore proposed that the enhanced service remains as it is.

Question Box: The Enhanced Reactive Service

- Q13 Do you agree that the Enhanced Reactive Power Service should remain as it is?
- Q14 Do you think that the complexity of the current Enhanced Reactive Power Service deters potential participants?

9. Removal of Market Tender Terms from CUSC

The removal of the assessment criteria from CUSC has already been mentioned in Section 3 above, but BSSG discussions also touched upon whether the entire reactive market tender process should sit within the CUSC at all, particularly given that it is the commercial element of the mandatory service. If the proposals set out in this document are taken forward, the CUSC will require modification via the usual process. In the interest of increasing future flexibility of the reactive service, National Grid propose that the market tender terms be removed entirely from the CUSC thereby taking the same form as other balancing services i.e. with standard contract terms. Again, these documents would be subject to governance provisions which

have also been introduced to STOR and other services to ensure full consultation with industry participants prior to implementing any amendments.

Question Box: Removal of Market Tender Terms from CUSC

Q15 Do you agree that the reactive market terms could be removed from the CUSC?

Q16 Do you agree that removing the terms from CUSC will increase future flexibility and aid development of the service?

Other considerations

Following publication of the initial proposals document we received some further feedback from providers as to how the service could be developed. These areas are discussed below:

Tendered Price Indexation

The feedback we received was that although reducing tender timescales was beneficial in terms of reducing exposure to risk against fluctuations in the default price, that the risk still remained. It was suggested that to reduce this risk further, price indexation be introduced for tendered market prices. However, National Grid's view is that for contracts of 12 months or less, indexation is not required due to the ability to forecast power price movement across that time period and that the risk of doing this can be priced into the tender. This view was also shared by providers participating in the STOR service review when discussing indexation for the longer term service.

The reactive power service does already allow for indexation for contracts above 12 months and this is consistent with other balancing services. Therefore we do not propose to introduce indexation for prices for contracts of 12 months or less.

Simplification of Capability Prices

The second suggestion received was that the two capability prices (synchronised capability and available capability prices) be replaced with a single capability payment which would simplify the payment structure. Although simplification of the service is welcomed, National Grid feels that the two elements of the capability price are important because it gives providers the opportunity to spread relative value across the two aspects of capability. In turn, National Grid value these two capabilities differently depending upon the forecast running time of the unit against times of system requirement (this is explained in more detail in the Market Report). We therefore think that the pricing structure should remain with the two capability payments.

Summary of Views Sought

National Grid welcomes views on any aspect of this document. In particular, National Grid is keen to receive views on the specific questions raised, as summarised below. Responses are requested by **5pm on 20th March 2009**. Responses should be emailed to katharine.clench@uk.ngrid.com.

- Q1 Do bi-annual tender rounds give providers sufficient opportunity to tender/ re-tender throughout the year?
- Q2 Do you agree that reducing the minimum contract length reduces risk to the provider?
- Q3 Do you consider the current minimum contract length of 12 months to be an issue?
- Q4 Do you agree that assessment timescales are currently too long?
- Q5 Do you agree that reducing assessment timescales reduces risk for the provider?
- Q6 Do you think that the CUSC assessment criteria are sufficiently transparent?
- Q7 Should the assessment criteria remain within the CUSC or could they be removed in order to make the service more flexible in the future?
- Q8 Are providers willing to accept the introduction of framework agreements in turn for reduced tender timescales?
- Q9 Do you agree that the time in which providers have to prepare their tenders could be reduced from 8 weeks to 4 weeks?
- Q10 Would the introduction of unit substitution encourage more providers to tender for the reactive service?
- Q11 Do you agree that the current market report provides sufficient information on the previous 6 month period?
- Q12 Would you want to see any of the market report information in a different format?
- Q13 Do you agree that the enhanced service should remain as it is?
- Q14 Do you think that the complexity of the current enhanced service deters potential participants?
- Q15 Do you agree that the reactive market terms could be removed from the CUSC?
- Q16 Do you agree that removing the terms from CUSC will increase future flexibility and aid development of the service?

Next Steps

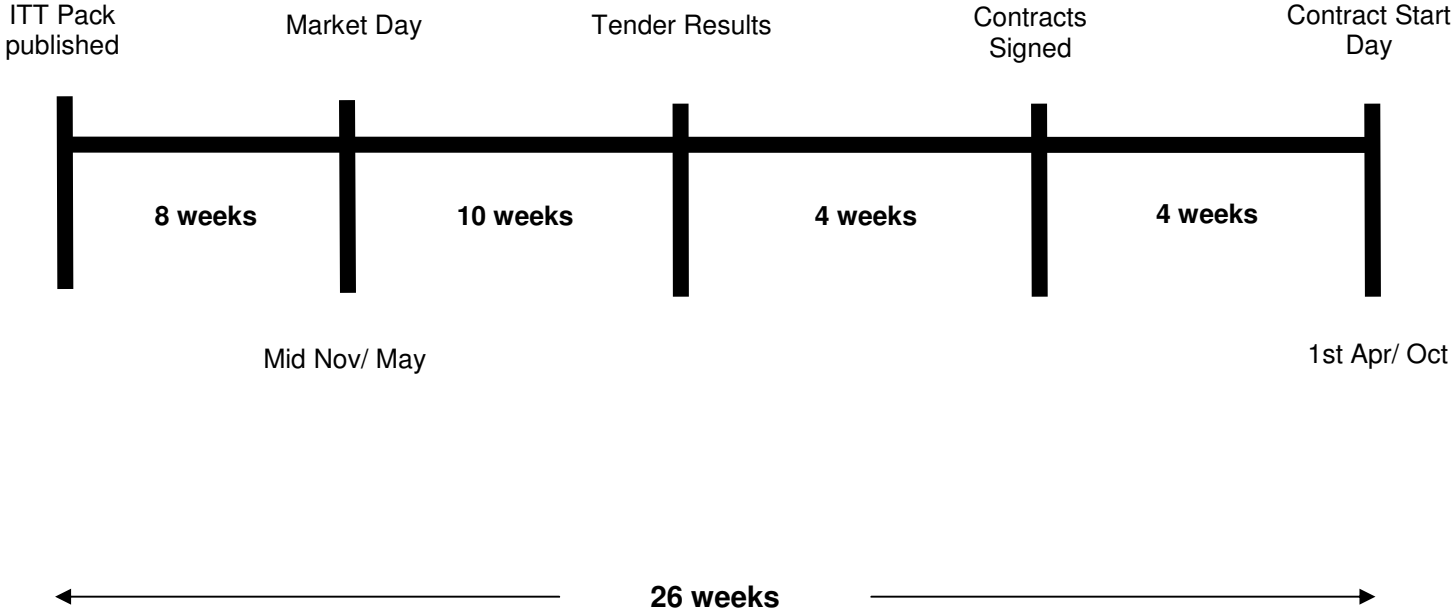
- Feedback to be received from Providers on the above proposed changes by Wednesday 20th March 2009
- Publication of final proposals by mid April 2009
- Propose necessary CUSC modifications by the end of April 2009
- New service format to be implemented (subject to review of feedback received/ CUSC modifications timescales) for Tender Round 26

Responses to this document will be published on the Reactive Power web page and should be sent to:

katharine.clench@uk.ngrid.com

by 5pm on 20th March 2009

Appendix 1 – Current Reactive Power Market Tender Timescales



Appendix 2: Proposed Reactive Power Market Tender Timescales

