

Open Letter to the UK Electricity Market Participants, Industry Stakeholders and Large Energy Consumers seeking views on the possible treatment of pricing new Balancing Services into cash-out14th July 2014

Dear Colleague

This letter seeks industry views on the treatment of the new Balancing Services in the imbalance price for winters 2014/15 and 2015/16 and in particular on proposals that they be priced at the Value of Lost Load (VoLL) as specified in the Electricity Balancing Significant Code Review (EBSCR)¹ Final Policy Decision (£3000/MWh).

Background

In December 2013 Ofgem published its decision² to approve the application by National Grid Electricity Transmission (NGET) to introduce two new balancing services: Supplementary Balancing Reserve (SBR) and Demand Side Balancing Reserve (DSBR).

In an open letter to industry³ published on 10th June 2014, we provided our maximum de-rated volume requirements for the next four years along with details of the procurement process. Tenders are invited for DSBR contracts only for 2014/15, whilst invitations to tender for the 2015/16 requirement will be open to both SBR and DSBR service providers.

The existing arrangements under the Balancing and Settlement Code (BSC) and Standard Condition C16 Statements⁴ of NGET's Transmission Licence prevent prices associated with either accepted SBR or DSBR services from feeding into the calculation of the cash-out price.

We recognise that a means of factoring SBR and DSBR accepted actions into imbalance prices is necessary. This is required in order to ensure accurate signalling to the market of actions required to balance their positions and to be consistent with the intent of the EBSCR which seeks to remove distortions in the existing imbalance pricing arrangements.

¹ EBSCR: <https://www.ofgem.gov.uk/electricity/wholesale-market/market-efficiency-review-and-reform/electricity-balancing-significant-code-review>

² Ofgem decision letter on new balancing services: <https://www.ofgem.gov.uk/ofgem-publications/85278/decisiontoacceptngetapplicationtointroducetwonewbalancingervicesandsubsequentconsultationonfundingarrangements.pdf>

³ National Grid letter to industry on Volume and Procurement of new Balancing Services <http://www.nationalgrid.com/NR/rdonlyres/D63DC28A-ACC9-496E-A39C-1682CF25EE08/63428/VolumeRequirementOpenLetter.pdf>

⁴ Links to all the C16 Methodology Statements (including the System Management Action Flagging and Balancing Services Adjustment Data Methodology Statement) can be downloaded from the following site: <http://www2.nationalgrid.com/UK/Industry-information/Electricity-codes/Balancing-framework/Transmission-license-C16-statements/>

Discussions so far

Several options are feasible for ensuring the provision of an appropriate price signal when SBR and DSBR actions are taken, which have the potential to result in a significant range of impacts on the resultant System Buy Price (SBP). Consequently, the question of how to treat the new balancing services in the cash-out calculations was raised as an Issue under the BSC Change process to invite industry views (Issue 56⁵). The conclusion of the Issue Group meeting discussions was to progress a modification to the BSC to feed SBR and DSBR services into cash-out at the Value of Lost Load (VoLL) price applied to demand control actions specified in the EBSCR Final Policy Decision of £3000/MWh. However it was recognised by the Issue Group attendees that applying this price signal for actions taken in winter 2014/15 is likely to have mixed support from the industry due to the short lead time. Therefore the importance of the consultation process in taking forward the modification was emphasised. Following this meeting, since no changes to the BSC were identified to progress the recommended solution (amendments are instead required to the C16 Statements), no modification was deemed necessary to the BSC⁶.

Next Steps

Recognising that taking forward the recommended solution of the Issue Group assumed that a full consultation with industry would take place through the BSC Modification process, ahead of consulting on specific changes to the C16 Statements, we welcome industry views on this issue and in particular the questions contained in Annex 2 of this letter. Questions are asked with respect to the potential DSBR services that may be taken for winter 2014/15 and to the potential SBR and DSBR services that may be taken for winter 2015/16.

Please send any comments you may have to BalancingServices@nationalgrid.com by Monday 11th August 2014. Pending these responses we will determine the next steps. For the avoidance of doubt, any changes proposed to the C16 Methodology Statements would be subject to a separate consultation.

If you have any comments or questions on the content of this letter, please contact Sally Lewis in the first instance at Sally.Lewis@nationalgrid.com or by calling 01926 6656984.

Yours sincerely

Ian Pashley

Markets & Balancing Development Manager, National Grid

⁵ <http://www.elexon.co.uk/smg-issue/issue-56/>

⁶ References to the treatment of SBR and DSBR services are currently only contained in the BSAD and SMAF Methodology Statements. If the submitted price of an energy action is provided to BSC systems at a given level (e.g. £3000/MWh), this is the price that will feed into the imbalance calculation (detailed in Section T of the BSC).

Annex 1 – Further Information

Supplementary Balancing Reserve (SBR) and Demand Side Balancing Reserve (DSBR) are new balancing services available to the System Operator. SBR provides a means for plant held outside the wholesale market to contribute to balancing the system in winter periods of high demand (as a last resort prior to initiating Demand Control measures). DSBR provides a new facility for the demand side to participate in the balancing services by shifting or shedding demand.

The existing arrangements under the Balancing and Settlement Code (BSC) and Standard Condition C16 Statements⁷ of NGET's Transmission Licence prevent both SBR and DSBR from feeding into the calculation of the cash-out price. The System Management Action Flagging (SMAF) Methodology Statement classes SBR actions as being 'System Management' preventing those actions from setting the imbalance price. An SO-flag will be applied to the action so that the volume will be classified as a First Stage Flagged balancing action. The action will then become unpriced if it has a more expensive price than the most expensive energy balancing action. The Balancing Services Adjustment Data (BSAD) Methodology Statement explicitly excludes the volumes and prices associated with accepted DSBR services from the price stack.

Since the value that utilisation of these services provides in balancing the system, for a given delivery period, is not reflected in the imbalance price calculations, these arrangements represent potential inefficiencies in the pricing signals provided to market participants.

NGET has determined its requirements for the upcoming winters and has invited tenders for DSBR services for winter 2014/15 (but not SBR services) and will invite tenders for both SBR and DSBR services for winter 2015/16 later this year. Since there is a longer lead time for implementation of a winter 2015/16 solution and the timing of this would coincide with the targeted delivery of the package EBSCR policy reforms⁸, we seek separate views on preferred solutions for DSBR for winter 2014/15 and both services for 2015/16.

Potential solutions identified by the Issue 56 group for applying prices to SBR and DSBR

1. Continue with existing arrangements (SBR is unpriced, DSBR does not feed into the calculation)
2. Treat as a balancing action based on the instructed volume⁹ priced at the utilisation price
Signal in the price stack:
SBR: ~£50-£500 / MWh; DSBR ~£250-£15,000 / MWh
Considerations:

⁷ Links to all the C16 Methodology Statements (including the System Management Action Flagging and Balancing Services Adjustment Data Methodology Statement) can be downloaded from the following site: <http://www2.nationalgrid.com/UK/Industry-information/Electricity-codes/Balancing-framework/Transmission-license-C16-statements/>

⁸ See BSC Modification P305 <http://www.elexon.co.uk/mod-proposal/p305/>

⁹ It is proposed that the associated volume for DSBR services will be based on the de-rated volume required from the despatch instruction, e.g. if the de-rated requirement is 75MW which translates to a 100MW request received by the DSBR provider, 75MW will feed into the volume component of the price calculation

SBR services would have associated availability costs which would not be captured in the utilisation price, therefore this solution is unlikely to be fully cost reflective. In the case of DSBR services there is the possibility that the DSBR price exceeds the VoLL for demand control actions specified in the final EBSCR policy decision.

3. Treat as a balancing action based on the instructed volume priced at the Value of Lost Load (VoLL), initially £3000/MWh in line with the EBSCR policy decision.

Considerations:

Priced equivalent to emergency measures and treated as a proxy for demand control, ensuring that the price of the action would not exceed that for demand control (that is targeted to come into effect from winter 2015/16 through the BSC Modification P305 EBSCR package).

4. Treat as a balancing action based on the instructed volume with an associated price determined by a scarcity based pricing method (e.g. the Reserve Scarcity Pricing (RSP) function detailed in the EBSCR policy package)

Considerations:

Given the timescales and complexities of determining such a method, this is not feasible for winter 2014/15. Under current understanding of the EBSCR RSP function, the RSP price for either service (which should be used only as a last resort) is likely to be set to VoLL. However as the EBSCR RSP policy states that a reserve action is priced at the maximum RSP price for that Settlement Period and the action's utilisation price, there is potential for the associated price to exceed that for demand control (particularly in the case of DSBR services).

The solution recommended by the Issue 56 Group was to price accepted new balancing services actions at the VoLL specified in the EBSCR policy (solution 3, £3000/MWh). Both the new services are only to be used as a last resort to balance the system in the unlikely event that there is not sufficient generating capacity available in the market. As such SBR and DSBR can be considered as 'proxy' measures for demand control actions that would otherwise be required. Therefore the Issue Group concluded that in principle the new services should be priced at VoLL. However there was recognition amongst the Issue Group members that the lead time for implementation this winter 2014/15 may be too short to send the appropriate price signals to market participants to influence behaviour (i.e. supplier positions may already be hedged for the forthcoming winter).

Based on the recommendations of the Issue 56 Group our proposed approach would be to implement changes to the C16 Methodology Statements (changes to the BSAD and SMAF Methodologies would be required) to price DSBR at VoLL (£3000/MWh) from winter 2014/15 and SBR at VoLL from winter 2015/16.

Annex 2 - Questions

This letter invites views from all interested stakeholders on our proposed approach to incorporate the new balancing services into imbalance prices. In particular, we are interested in your views on the following questions:

Treatment of the new balancing services from winter 2015/16

- 1. Do you support the proposal to price accepted DSBR actions at VoLL (£3000/MWh) from winter 2015/16 and any future years for which the service is procured?**
 - If not, please provide reasoning and your preferred alternative solution.
- 2. Do you support the proposal to price accepted SBR actions at VoLL (£3000/MWh) from winter 2015/16¹⁰ and any future years for which the service is procured?**
 - If not, please provide reasoning and your preferred alternative solution.

Treatment of DSBR for winter 2014/15

- 3. Do you agree that accepted DSBR actions should feed into the cash-out price calculations for winter 2014/15?**
 - If not, please provide reasoning.
- 4. Do you support the proposal to price accepted DSBR actions at VoLL (£3000/MWh) from winter 2014/15?**
 - If not, please provide reasoning and your preferred alternative solution.
- 5. Do you have any other comments on these proposals that you would like us to consider?**

¹⁰ SBR services will not be procured earlier than winter 2015/16