

All interested parties,  
stakeholders in GB and beyond,  
and other regulatory bodies

Email: [Alastair.Owen@ofgem.gov.uk](mailto:Alastair.Owen@ofgem.gov.uk)

Date: 8 November 2021

Dear colleagues,

**Decision on Short Term Operating Reserve in relation to an update to the Terms and Conditions related to Balancing**

On 1 October 2021, we<sup>1</sup> received a proposal from the Electricity System Operator ("ESO") to make amendments to the national terms and conditions related to balancing ("T&C") required by Article 18 of Commission Regulation (EU) 2017/2195 establishing a guideline on electricity balancing (the "EBGL Regulation"),<sup>2</sup> as amended by the Electricity Network Codes and Guidelines (Markets and Trading) (Amendment) (EU Exit) Regulations 2019.<sup>3</sup> This proposal relates to an update of the Short Term Operating Reserve ("STOR") Assessment Principles which is part of the suite of documents that make up the STOR service conditions.<sup>4</sup>

This letter sets out our decision to approve that the proposed amendments to the STOR service conditions, as mapped by the ESO, form part of the T&C pursuant to Article 18 of the EBGL Regulation.

---

<sup>1</sup> The terms "we", "us", "our", "Ofgem" and "the Authority" are used interchangeably in this document and refer to the Gas and Electricity Markets Authority. Ofgem is the office of the Authority.

<sup>2</sup> Commission Regulation (EU) 2017/2195 of 23 November 2017 establishing a guideline on electricity balancing. The EBGL came into force on 18 December 2017. Accessible at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017R2195>

<sup>3</sup> The UK SI amendment of the EBGL Regulation is accessible at: [https://assets.publishing.service.gov.uk/media/5c17d6b440f0b60c8d601a2c/ENC\\_Markets\\_and\\_Trading\\_SI.pdf](https://assets.publishing.service.gov.uk/media/5c17d6b440f0b60c8d601a2c/ENC_Markets_and_Trading_SI.pdf)

<sup>4</sup> The STOR service conditions are the following documents: STOR Auction Rules, STOR Assessment Principles, STOR Service Terms, STOR General Terms and Conditions and STOR Participation Guidance Document. These are accessible at: <https://www.nationalgrideso.com/industry-information/balancing-services/Reserve-Services/Short-term-operating-reserve/Document-Archive>

## Background

In accordance with Article 18 of the EBGL Regulation, the ESO was required to develop a proposal regarding the T&C for balancing service providers ("BSPs") and balance responsible parties ("BRPs"). On 8 October 2019,<sup>5</sup> we published our decision to confirm, upon satisfaction of certain conditions, that the T&C proposed by the ESO are the T&C required by Article 18 of the EBGL Regulation. On 25 June 2020, all the necessary conditions were met, and the proposed T&C came into force in GB.

STOR is a product that the ESO already uses within the Great Britain ("GB") electricity system for the purposes of balancing. It provides a reserve of energy which is dispatched by the ESO in response to a fault on the network (e.g. in response to the loss of a generator). It is one of a number of products that contribute to the Operating Reserve Requirement ("ORR")<sup>6</sup> which the ESO holds. STOR had previously been procured on a long-term contract basis, but in accordance with Article 6(9) of Regulation (EU) 2019/943 on the internal market for electricity (recast) (the "Electricity Regulation"),<sup>7</sup> as amended by the Electricity and Gas (Internal Markets and Network Codes) (Amendment etc.) (EU Exit) Regulations 2020<sup>8</sup> the ESO moved its procurement of STOR to the day-ahead timeframe.<sup>9</sup>

The ESO has since established that there were a low number of curtailable bids<sup>10</sup> being submitted in the STOR day ahead auction. As the auction was designed to procure an exact volume of reserve, it led to many auctions paradoxically rejecting bids in order to procure that precise volume.<sup>11</sup> This resulted in an uneconomic outcome from the auction. Therefore, the ESO has submitted proposed changes which will adjust how the auction is assessed at the marginal price.

Details of these changes can be found in the ESO's STOR Assessment Principles document<sup>12</sup> and via slides from a recent ESO webinar.<sup>13</sup> In summary though, the ESO now proposes to

---

<sup>5</sup> Our 8 October 2019 decision is accessible at: <https://www.ofgem.gov.uk/publications-and-updates/decision-transmission-system-operators-proposal-terms-and-conditions-related-balancing>

<sup>6</sup> The ESO holds the ORR to take account of demand forecast errors, plant losses and market imbalance. It mainly consists of actions taken by the ESO in the balancing market and contracted reserve (such as STOR)

<sup>7</sup> Regulation (EU) 2019/943 on the internal market for electricity (recast) can be accessed here: <https://eurlex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0943&from=EN>

<sup>8</sup> The UK SI amendment of the Electricity Regulation is accessible at: <https://www.legislation.gov.uk/uksi/2020/1006/contents/made>

<sup>9</sup> On 23 March 2021, we published a decision approving further changes to the STOR service conditions in order to ensure compliance with Article 6(9) of the Electricity Regulation for procurement of STOR. The decision is accessible at: <https://www.ofgem.gov.uk/publications/decision-stor-relation-update-terms-and-conditions-related-balancing>

<sup>10</sup> Curtailable bids are those which can be accepted at a volume (in single units of MW) from their maximum output to a level specified by the bidder. Curtailable bids were introduced to the STOR auction as part of the auction changes to become compliant with Article 6(9) of the Electricity Regulation.

<sup>11</sup> Paradoxically rejected bid – bid that is in 'merit order' (i.e. below or at the marginal price) but is rejected.

<sup>12</sup> ESO STOR Assessment Principles document will be accessible at the following landing page: <https://www.nationalgrideso.com/industry-information/balancing-services/Reserve-Services/Short-term-operating-reserve/assessment-principles>

<sup>13</sup> ESO Webinar slides are accessible at: <https://www.nationalgrideso.com/document/205851/download>

compare the curtailable cost (existing auction algorithm) with an overholding cost and an underholding cost. The ESO will then select lowest cost method from these three auction outcomes.

As a consequence, the ESO has submitted a proposal to amend the T&C in order to include relevant provisions from the STOR service conditions. To aid with the visibility of the T&C, the ESO has also provided a mapping document, linking specific provisions of the STOR service conditions to the requirements of Article 18 of the EBGL Regulation.

The proposal for amending the T&C to update the STOR service conditions was consulted on between 12 August 2021 and 13 September 2021<sup>14</sup> in accordance with Article 10 of the EBGL Regulation.

## **Decision**

We have reviewed the STOR service conditions proposed by the ESO to be recognised as part of the T&C submitted to us in line with the requirements of the EBGL Regulation, the wider objectives of the Electricity Regulation and our statutory duties and obligations. We have also engaged with the ESO to better understand its proposals.

In making our decision, we took into consideration the responses to the consultation from industry stakeholders. Responses were generally favourable toward the updates proposed to the T&C. Many respondents acknowledged that the new algorithm would allow for the true lowest cost option which will lead to lower costs to consumers. However, one respondent raised concerns about the timing of this change, the underholding method, and the variation of procurement volumes for STOR. We note these concerns but believe that these changes and savings should be made at the earliest opportunity and understand that the method for underholding is consistent with the ESO's current approach (where STOR auctions do not provide the full volume). We also understand that the target for procurement of STOR will not change.

We welcome these changes that the ESO has proposed for STOR and believe that allowing the auction to compare the costs of overholding, underholding and the original curtailable cost will lead to lower costs to consumers and reduce volatility in STOR availability prices.

---

<sup>14</sup> The ESO consultation is accessible at: <https://www.nationalgrideso.com/events-calendar/ebgl-article-18-mapping-dynamic-containment-and-short-term-operating-reserve>

In light of the above, we believe that the ESO's proposal meets the requirements of Article 18 of the EBGL Regulation. We therefore approve the STOR service conditions to form part of the T&C.

## **Next Steps**

We expect the ESO to publish the updated STOR Assessment Principles and implement the change to the STOR day ahead auction algorithm as soon as possible, and to communicate clearly to industry the date from which the auction change will be effective, which we currently expect to be before the end of 2021.

Going forward, we expect the ESO to continue to work to improve their balancing products to ensure that they can be procured as efficiently and economically as possible. We also expect the ESO to take the lessons learned from STOR, apply them to its development of new products,<sup>15</sup> and ensure that legacy inefficiencies are not carried forward into future product design. Finally, we expect the ESO to continue to monitor results of the STOR auctions to identify any further amendments that could be made to improve future products.

If you have any queries regarding the information contained in this letter, please contact James Hill ([James.Hill@Ofgem.gov.uk](mailto:James.Hill@Ofgem.gov.uk)) or Luke McCartney ([Luke.McCartney@Ofgem.gov.uk](mailto:Luke.McCartney@Ofgem.gov.uk)).

Yours faithfully,

**Alastair Owen**

Senior Policy Manager- Systems & Networks

---

<sup>15</sup> Updates on the ESO's Response Reform and Reserve Reform are accessible here:  
<https://www.nationalgrideso.com/industry-information/balancing-services/future-balancing-services>