

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

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

Date: 10 March 2022

Dear colleagues,

### **Decision on Dynamic Regulation in relation to an update to the Terms and Conditions related to Balancing**

On 10 January 2022, 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<sup>2</sup> (the “EBGL Regulation”), 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 to include service documentation for the new Frequency Containment Reserve (“FCR”) product, Dynamic Regulation (“DR”). The ESO later provided an updated version to the proposal sent to us on 10 January 2022 with minor corrections, the inclusion of ‘looped blocks’<sup>4</sup> and information relating to disarming / rearming protocols.<sup>5</sup>

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<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 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> We understood from previous industry engagement that one of the key elements of DR is ability for providers to use looped blocks. We noted that the ESO had not included any text on looped blocks and following a discussion with the ESO, they provided us with an amended submission to include reference to “looped blocks”. More information on looped blocks can be found at: <https://www.nationalgrideso.com/document/223486/download>

<sup>5</sup> The ESO had expressed a need to have the ability to disarm (and rearm) providers as DR is a new product, needing operational learning to fully understand its system impacts. The ESO provided information about the disarming / rearming protocol in a webinar after the close of the consultation. We determined that this information formed part of the T&C mapping, and as such the ESO updated their service documentation and Article 18 mapping document to reflect this. The webinar held by the ESO can be found at: <https://www.nationalgrideso.com/document/233071/download>

DR is a service procured by the ESO based on the DR Service Terms, DR Service Glossary, DR Auction Rules, and DR Participation Guidance Document.<sup>6</sup> The ESO has proposed these documents to allow implementation of the DR balancing product. As a result, the ESO has requested an amendment to the T&C required by Article 18 of the EBGL Regulation, based on the proposed updates. Included in their mapping of DR documentation to the T&C, the ESO refers to our decision to provide a derogation from Article 6(2) of the Electricity Regulation<sup>7</sup>, allowing this product to be procured with a pre-determined price of balancing energy.

This letter sets out our decision to approve the proposed amendment of the T&C.

## **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>8</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 Great Britain (“GB”).

DR is an opt-in service for BSPs to receive payments from the ESO to provide balancing capacity, and to deliver balancing energy, acting quickly to help maintain system frequency. DR is classed as a FCR product for provision of balancing capacity and balancing energy, and consequently the terms and conditions for the provision of DR services by BSPs must be incorporated into the T&C. We recognise that the ESO’s plan is to go live with DR delivering from April 2022.

DR is a product that operates pre-fault to maintain system frequency around the target value of 50Hz. It works through providers making automatic adjustments in generation (or demand) in the range of  $\pm 0.2$ Hz of the target frequency.<sup>9</sup> DR is part of a suite of dynamic FCR products planned by the ESO, including the already approved<sup>10</sup> Dynamic Containment (“DC”) post-fault service, and another pre-fault service, Dynamic Moderation (“DM”).

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<sup>6</sup> The DR documents will be accessible at: <https://www.nationalgrideso.com/industry-information/balancing-services/Frequency-Response-Services/Dynamic-Regulation/How-to-participate>

<sup>7</sup> Regulation (EU) 2019/943 of the European Parliament and of the Council of 5 June 2019 on the internal market for electricity, available here: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32019R0943>, was amended by UK SI 2020 No. 1006 which can be found at:

<https://www.legislation.gov.uk/ukSI/2020/1006/introduction/made>

<sup>8</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>9</sup> More information on DR is accessible at: <https://www.nationalgrideso.com/industry-information/balancing-services/Frequency-Response-Services/Dynamic-Regulation>

<sup>10</sup> Our approval of the most recent DC T&C documents can be found at:

<https://www.ofgem.gov.uk/publications/decision-dynamic-containment-relation-update-terms-and-conditions-related-balancing-1>

We understand that DR will be important in ensuring system operability and brings efficiency savings in procurement as it is designed to be a more effective product than existing similar services such as Firm Frequency Response (“FFR”) and Mandatory Frequency Response (“MFR”).

The ESO has now submitted a proposal to amend the T&C in order to include relevant provisions from the DR Service Terms, DR Service Glossary, DR Auction Rules, and DR Participation Guidance Document. To aid with the visibility of the T&C, the ESO has provided an updated mapping document.

The proposal for amending the T&C to include those provisions was consulted on between 15 November 2021 and 15 December 2021<sup>11</sup> in accordance with Article 10 of the EBGL Regulation.

## **Decision**

We have reviewed the provisions related to DR proposed by the ESO to be recognised as 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 industry consultation. Responses were generally favourable toward the updates proposed to the T&C. However, several consultation responses requested clarifications on the performance monitoring and the auction rules. The ESO responded to these questions appropriately and made changes to the T&C to reflect stakeholder comments.

Key aspects of the documentation which were updated following consultation are:

- Inclusion of details regarding disarming and rearming, including expectations of compliance with arming signals and confirmation that only Balancing Mechanism Units (“BMU”) are to be disarmed / rearmed for the day 1 product launch.
- Inclusion of looped blocks, an anticipated product feature which allows providers to link bids of upward and downward capacity together.
- Changes to the proposed performance tolerance bands in line with provider feedback.

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<sup>11</sup> The ESO consultation is accessible at: <https://www.nationalgrideso.com/industry-information/codes/european-network-codes-old/meetings/abr-article-18-dynamic-moderation-dm>

Many respondents to the consultation also questioned the efficacy of running DR, DC and DM auctions separately at the same time. Respondents queried whether better results for providers, the ESO and the customer could be achieved through co-optimised auctions or by staggering auctions. We understand that co-optimisation of auctions for the suite of dynamic FCR products is the ESO's longer-term aim. The ESO explained to us that holding auctions in a staggered manner is not appropriate: timing restrictions<sup>12</sup> mean that there would be little change in market bidding behaviour by holding auctions in a staggered fashion, leading to little-to-no efficiency benefits.

Several parties queried the performance tolerance band (3% - 7%) used for DR. The ESO has set a new band (5% - 25%) for DR, and we understand that this is in line with provider expectations. The ESO recognised that the initial proposal could have excluded certain providers from this product that would otherwise meet the technical parameters for delivery.

We also acknowledge the concerns that stakeholders have raised with regards to performance baselines and applicable balancing services volume data ("ABSVD"). We understand that the ESO has a plan in place to address these areas and will continue to engage with stakeholders in order to prevent barriers to parties who wish to enter the DR market as well as for other dynamic FCR products.

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 proposed amendments to the provisions that form part of the T&C.

## **Next Steps**

We welcome the introduction of this new FCR product by the ESO and believe that procuring frequency response through DR and phasing out similar existing products will be more beneficial to market participants and the ESO. However, we request that the ESO continuously review the economic efficiency of the DR auction to ensure that it is being procured at the lowest possible cost to consumers. We understand that the ESO is already progressing some efficiency improvements to this effect.

Further, the ESO should ensure that market participants receive the best possible information to support involvement in this market, including progression of improvements

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<sup>12</sup> We understand that auctions for these products can only take place after the completion of the day-ahead interconnector capacity nominations (known as of 13:30 day-ahead), but that further delays beyond the current auction timings would lead to operational challenges as the auction outcomes inform further ESO control room decision making.

in communication of volume requirements, such as 4 day-ahead forecasts. The ESO should also remain cognisant of additional monitoring expectations we have set out in our decision to approve a derogation for DR from the requirements of Article 6(2) of the Electricity Regulation. These measures are necessary to ensure that the DR product is being procured in an efficient, economic and transparent fashion.

We expect the ESO to publish the DR Service Terms, DR Service Glossary, DR Auction Rules, and DR Participation Guidance Document as well as an updated mapping of the T&C as soon as possible.

Finally, the ESO should take learnings from the Article 18 consultation process undertaken for DR to improve the clarity of information provision in future consultations. We also expect the ESO to take on board industry feedback requesting more time between consultation close and product launch, providing sufficient time for onboarding and provider readiness for future product introduction / updates.

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)).

Yours faithfully,

**Grendon Thompson**

Head of ESO Regulation