



Making a positive difference
for energy consumers

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CC: Transmission Owners, Generators,
Suppliers, Traders, Consumers and Other
Interested Parties

Email: ESOperformance@Ofgem.gov.uk

Date: 4 November 2022

Dear colleagues,

Decision to Direct National Grid Electricity System Operator to make revisions to C16 Statements in relation to the Demand Flexibility Service earlier than set out in the C16 Licence Condition

Background

In accordance with Standard Condition C16 of its Electricity Transmission Licence, the Electricity System Operator ("ESO") is required to conduct an annual review of all statements set out under that condition, proposing changes as necessary. The licence statements are:

- Procurement Guidelines Statement ("PGS");
- Balancing Principles Statement ("BPS");
- Balancing Services Adjustment Data ("BSAD") Methodology Statement;
- System Management Action Flagging ("SMAF") Methodology Statement;
- Applicable Balancing Services Volume Data ("ABSVD") Methodology Statement.

Additionally, the ESO should promptly seek to revise these documents where there are changes to their methodologies or principles, or if new products or services are to be procured, as approved by the Authority.¹

The ESO aims to procure a new product, the Demand Flexibility Service ("DFS"),² to provide an additional option for system security over winter 2022/2023. We understand that the ESO views the introduction of this product as a prudent step in ensuring operational security for the coming winter.

To provide transparency around how this product would be procured and used, the ESO consulted on provisional updates to the standard licence condition ("SLC") C16

¹ 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.

² The Demand Flexibility Service has been developed to allow the ESO to access additional flexibility when national demand is at its highest during peak winter days, which is not currently accessible in real time.

statements earlier this year, in line with the requirements of its Transmission Licence.³ SLC C16 states that the ESO must send us a report on the proposed update of the statements within 7 days of the consultation closing. Following industry feedback from the first consultation, the ESO reported that it was not in a position to propose changes at this time.

On 12 September 2022, the ESO submitted a request to us to allow it to reopen a further two-week consultation window on the DFS for the BPS and BSAD statements. This was intended to provide industry with the opportunity to comment on additional proposed changes in light of feedback from the initial consultation period.

We provided direction to the ESO to allow it to hold a consultation on these additional elements for no less than 14 days, rather than the 28 days specified in the Licence.⁴

Following completion of this second consultation,⁵ the ESO submitted a report to the Authority in line with SLC C16.

The revisions proposed to the statements relate to the following:

- i. Revisions to the PGS to include reference to the DFS;
- ii. Revisions to the BSAD Methodology Statement to explain how volumes related to the DFS will be actioned;
- iii. Revisions to the ABSVD Methodology Statement to explain that DFS volumes will be treated under ABSVD;
- iv. The view that the DFS is already covered in the definition of services in the Balancing Principles Statement.

The Authority's decision

We have decided not to use our power under Standard Licence Condition C16(9)(b)(ii) to veto the changes proposed by the ESO relating to the addition of the DFS to the C16 statements. However, we have decided to use our powers under C16(9)(i) to direct the ESO to make these revisions 1 working day after the date of this decision letter, instead of after 28 days of their submission to the Authority.

We note that the ESO also proposed housekeeping changes to the BSAD and ABSVD Statements. These have already been implemented by the ESO following our decision on the ESO's proposed changes to those documents to accommodate the Winter Contingency Service ("WCS").⁶ The updates to the respective methodologies will reflect the order in which the Authority's decisions were made.

In assessing the proposed revisions submitted by the ESO, we have considered the arguments presented in the ESO's report to the Authority, as well as the responses to both consultations run by the ESO in relation to these revisions.

³ This first consultation ran from 8 August to 5 September 2022, covering proposed revisions to the PGS, BPS, and SMAF and ABSVD methodology statements. Details of this consultation are available at: <https://www.nationalgrideso.com/industry-information/codes/balancing-settlement-code-bsc/c16-statements-and-consultations>

⁴ Our decision to provide direction to the ESO to hold a consultation of not less than 14 days for changes relating to this service can be accessed at: <https://www.ofgem.gov.uk/publications/decision-provide-direction-national-grid-electricity-system-operator-limited-pursuant-standard-licence-condition-c169aii>

⁵ This second consultation ran from 22 September to 6 October 2022, covering proposed revisions to the PGS and BSAD methodology statements. Details of this consultation are available at: <https://www.nationalgrideso.com/industry-information/codes/balancing-settlement-code-bsc/c16-statements-and-consultations>

⁶ <https://www.ofgem.gov.uk/publications/direction-national-grid-electricity-system-operator-revision-revisions-its-c16-statements-required-due-introduction-winter-contingency-service>

We have summarised our conclusions below:

i. Revisions to the PGS to include reference to the DFS

The purpose of the PGS is to set out the kind of balancing services which the ESO may be interested in purchasing, together with the mechanism by which it envisages purchasing such balancing services.

We consider the ESO's proposed text in relation to the DFS provides details as to the intended purpose of the service.

We also accept the ESO's proposal not to reference within the PGS how this service is settled, as this is in keeping with the level of detail included for other products in that document. For clarity, we have also issued a decision approving the proposed changes to the Article 18 terms and conditions related to balancing.⁷ In its consultation on those changes,⁸ the ESO provided further detail on the settlement mechanism for the service. Having initially proposed to settle the DFS product as 'pay-as-clear' in the PGS in its first C16 consultation, it later proposed to settle as 'pay-as-bid' in the Article 18 consultation.

Respondents to the initial consultation further expressed concerns around the lack of clarity as to the life of the service, as well as when it would be used. We consider that these concerns fall outside of the scope of these changes to the PGS. The ESO should make clear if it intends to procure the service beyond the end of this regulatory year⁹ in its annual review of the SLC C16 statements. We note that the ESO provided additional clarity on the use of this service at its Markets Forum event in September 2022.¹⁰

Additional to the inclusion of DFS in the PGS, the ESO also proposed some minor housekeeping changes to this statement. The Authority considers that the proposed housekeeping changes keep the statement current and relevant. They also support the economic and efficient operation of the system, and therefore serve the interests of the consumer. We are pleased that the ESO took this opportunity to update some outdated sections of text and encourage continuous review and, where appropriate, revision of the text by the ESO.

ii. Revisions to the BSAD Methodology Statement to explain how volumes related to the DFS will be actioned

The BSAD Methodology Statement sets out the information on balancing services that will be taken into account for the purpose of determining imbalance prices in the balancing market ("BM").

Industry feedback during the first consultation period highlighted the need to include the DFS in the BSAD Methodology Statement to provide clarity on the impact of the service on imbalance pricing and cash-out arrangements. This was the focus of revisions to these statements consulted on during the follow-up period.

The System Operator Flagging process identifies Bid Offer Acceptances taken for system reasons, such as binding network or operational constraint, as opposed to energy

⁷ The terms and conditions related to balancing are required under Article 18 of Commission Regulation (EU) 2017/2195 establishing a guideline on electricity balancing ("EBGL"), as amended into UK law by UK SI 2019 No 532.

⁸ This consultation ran from 1 September to 3 October 2022. Details are available at: <https://www.nationalgrideso.com/calendar/eb-article-18-demand-flexibility-terms-and-conditions>

⁹ The regulatory year runs annually from 1 April to 31 March.

¹⁰ The ESO held a Markets Forum event on 28 September 2022, details of which can be accessed here: <https://www.nationalgrideso.com/research-publications/markets-roadmap/markets-forum-events>

balancing reasons, to minimise the extent of non-energy actions influencing or setting the price for energy balancing actions and imbalances.

The DFS service design includes a number of test runs, distinguished from real events. During test runs there is a possibility that the Guaranteed Acceptance Price ("GAP") will be above the marginal BM price and therefore set cash-out prices at an artificially high level. To provide clarity as to the treatment of real events and test runs under BSAD for the purpose of calculating imbalance prices, the ESO has proposed that real events will be energy flagged and fed into cash-out calculations, while test runs will be system flagged (minimising their impact on cash-out prices).

We note that during the C16 consultation period which included the proposed changes to the BSAD Methodology Statement, the ESO did not expressly reference test runs and real uses of the DFS, and thus did not receive feedback from industry on its final position, as submitted to the Authority. However, we understand the driver behind the ESO now proposing to include the treatment of tests and real uses separately within the document. Further, we note industry feedback received through the ESO's consultation on proposed changes to the terms and conditions relating to balancing under Article 18 of the EGBL, which sought clarification as to the impact of DFS on imbalance price calculations. In line with this feedback, we agree that it is appropriate for the ESO to include the proposed BSAD specification to provide clarity and transparency to industry around the impact of the service on market signals.

iii. Revisions to the ABSVD Methodology Statement to explain that DFS volumes will be treated under ABSVD

The ABSVD Methodology Statement sets out the information on Applicable Balancing Services that will be taken into account for the purposes of determining imbalance volumes.

We agree that it is appropriate for the ESO to include the DFS in the ABSVD and thus it was required to include these changes in the Methodology Statement.

The Authority considers that the proposed amendments and choice of wording clarifies the ESO's treatment of volume data relating to the DFS, including its intention to submit half-hourly settled volume data — but not non-half-hourly settled data — under ABSVD to Elexon. Industry feedback suggests that this is an appropriate approach.

iv. The view that the DFS is already covered in the definition of services in the BPS

The BPS is intended to define the broad framework against which the ESO will make balancing action decisions.

We note that in response to the ESO's initial consultation on these changes, one market participant suggested that the DFS should be included in the BPS to clarify when the service would be used in relation to the WCS. The ESO consulted on this question in its follow-up consultation but did not receive any further comments. We are comfortable that Part C of the BPS provides coverage for the DFS, accordant with the level of detail for other balancing services, with no further amendments required.

We expect the ESO to continue reviewing and updating the C16 statements as required under its licence obligations to ensure clarity and transparency for market participants, taking into account stakeholder feedback, and continuing to engage with industry around the procurement and use of its balancing services on an ongoing basis.

Yours sincerely,

Eleanor Warburton

Deputy Director – Institutions for Net Zero

Annex – Direction on Condition C16 in relation to the ESO’s C16 statements

For and on behalf of the Gas and Electricity Markets Authority

DIRECTION PURSUANT TO SUB-PARAGRAPH 9(b)(i) OF CONDITION C16 OF NATIONAL GRID ELECTRICITY SYSTEM OPERATOR LIMITED’S ELECTRICITY TRANSMISSION LICENCE IN RELATION TO THE PROCUREMENT AND USE OF BALANCING SERVICES

Whereas:

1. National Grid Electricity System Operator Limited (“NGESO”) is the holder of an electricity transmission licence (“the Licence”) granted or treated as granted under section 6(1)(b) of the Electricity Act 1989 (“the Act”).
2. Standard Licence Condition (“SLC”) C16 (Procurement and use of balancing services), subparagraph 9(b)(i) allows the Authority to direct NGESO to make revisions on a date earlier than 28 days of submission of its report to the Authority (prepared in accordance with sub-paragraph 9(a)(iii)).
3. For the reasons set out in the letter to which this Direction is attached, the Authority has decided to direct that NGESO should make its revisions 1 working day after the date of this Direction.

Therefore:

In accordance with sub-paragraph 9(b)(i) of SLC C16, the Authority hereby directs NGESO to make revisions to its SLC C16 statements earlier than 28 days from the submission of their report, instead making them 1 working day after the date of this Direction.

This Direction and the letter to which it is attached constitutes notice of the reasons for the decision pursuant to section 49A of the Act.

Eleanor Warburton – Deputy Director
For and on behalf of the Gas and Electricity Markets Authority
4 November 2022