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ESO response to call for input on options to address high balancing costs

Dear Robin,

Thank you for the opportunity to respond to the call for input on options to address high balancing costs.

As the Electricity System Operator (ESO) for Great Britain, we are in a privileged position at the heart of the energy system, balancing electricity supply and demand second by second. As the UK moves towards its 2050 net zero target, our mission is to drive the transformation to a fully decarbonised electricity system by 2035, which is reliable, affordable and fair for all.

We play a central role in driving Great Britain's path to net zero and use our unique perspective and independent position to facilitate market-based solutions to the trilemma of affordability, sustainability and security. We fully support well-designed markets which work effectively. Clearly an important part of this is the ability for participants to price in scarcity when it occurs. However, we do not support excessive pricing which takes advantage of that situation.

Last year in response to record high-cost days in the balancing mechanism we launched a review of the balancing market¹. Carried out by external consultants, we sought to ensure that, at a time when household budgets are under increasing strain, we do all we can to minimise the costs passed through to consumer bills. Amongst other recommendations put forward was the option to introduce a code or licence obligation to determine how participants can bid into the market and we are pleased to see this being taken forward by Ofgem for consideration by the industry.

In summary, our views on the six options presented in Ofgem's call for input are:

- Option 1 Price Cap on BM Offers - We agree with Ofgem that this is not an option to pursue currently.
- Option 2 Changes to BM offer structures – We agree with Ofgem that this is not an option to pursue as a near time solution. However, there is not sufficient evidence to rule it out as a potential longer-term reform.
- Option 3 ESO Balancing Service – We are currently consulting on a new service to procure firm reserve which will move procurement from the balancing market to day ahead. We are looking to implement this as soon as possible as we believe that it will reduce operational costs significantly. This will reduce our operational spend by moving scarcity into the more transparent, liquid, and competitive market timeframes as well as providing clearer investment signals for industry.
- Option 4 New licence condition – We agree with Ofgem's proposal to introduce a new licence condition and outline our thinking on this in more detail in our response to the call for input questions in Appendix 1. We agree that it will help reduce a source of potentially high balancing costs but as

¹ [ESO Balancing Market Review 2022 | National Grid ESO](#)

there are many other drivers of cost, such as the accuracy of forecasts including demand and wind forecasting, and the setting and procurement of reserve levels, it is unlikely to completely eradicate high balancing costs overall.

- Option 5 Restrict intraday changes to PN – We agree with Ofgem's position in the call for input that this is not an option to pursue
- Option 6 Clarifying the Grid Code – We agree with Ofgem's position in the call for input that the success would depend on the clarity of the guidance and note that any changes would need to be managed through the code modification process.

We agree with Ofgem's comment that the options are not mutually exclusive. Alongside any actions taken to prevent undesirable behaviours within the existing market regulations, we are also keen to proactively work with Ofgem to find and close loopholes ahead of need. To deliver on our net zero commitments we need to have well-functioning markets, delivering clear signals leading to efficient dispatch. Any changes or reforms to address gaps in market design should include not only Generator BMUs but also BMUs without any physical assets which participate in these markets.

We very much welcome the opportunity to discuss any of the points raised within this response. Should you require further information or clarity please contact Claire Thorpe-Morris, Market Monitoring Manager at claire.thorpe-morris@nationalgrideso.com in the first instance.

Yours sincerely

Craig Dyke

Head of National Control

Appendix 1 – Call for Input Question Responses

Question 1 Do you agree that our preferred option will effectively prevent the behaviour that caused last winter's high balancing costs? Please provide reasons for your answer.

We agree that the preferred option will go some way to addressing behaviours which can contribute to high balancing costs. It can be implemented in a relatively timely manner and does not impact on existing market design. However, the consultation only refers to BM units changing their PN to 0MWs and then the ESO having to offer them up at an excessive price. It is possible that a unit could reduce its PN from 500MW to 250MW, price its offer volume excessively and gain benefits from significantly reducing its PN without reducing to 0MW.

Question 2 Is the proposed licence condition drafting in Annex 1 sufficiently clear? Are there any drafting edits or additions that you would encourage us to consider?

We think that the proposed licence condition drafting could be refined to make it clearer. The wording of 'submitted a Physical Notification' introduces some ambiguities as there may be some generating units which re-submit their Physical Notifications (PNs) several times within day even if unchanged. It might be better to use the wording 'submitted a revised Physical Notification' to make it clear that it is only concerned with PNs changing from non-zero to zero within day. As noted above, the drafting should also address that a significant step change between PNs within day at short notice prior to Gate Closure could also lead to excessive benefits. The drafting could refer to a PN of 0MW or a defined term around significantly reduced capacity.

The wording of the licence text (and the guidance) also needs to make sure that it does not penalise legitimate behaviours or technologies. It is feasible that there are circumstances where a generator could have a technical issue to resolve and to expedite its return there is a premium to pay to cover the risk they would be taking for the few hours over the peak, so that they can fix properly overnight.

One option would be to draft the licence condition so that if you submit a revised PN, whether to 0MW or within a significant % step change, that the price should remain within a range of the prices, (x% for example), which were submitted before the PN was changed. This would help to negate the need to define 'excessive' which would be subjective.

Lastly, paragraph 3b of the proposed drafting seems unclear and we suggest that it might be more appropriate to word it as 'an increase in generation of electricity by a particular generating plant, regardless of whether there is an overall increase in electricity generation'.

Question 3 Do you agree with the initial list of factors to consider when assessing excessive behaviour? Are there any other factors that would encourage us to consider?

For a) clear criteria in this area will be important, as will a definition of which warnings – if an assessment is made on public data and Capacity Market Notices (CMNs) then this could be a different view to a control room assessment which may be considering future trades (for example).

For b) – as above does the PN need to be zero (or just reduced and excessive offer price on the upwards volume).

For c) Need clear criteria of what 'materially affecting system margin' means? This may become simpler if reserve is procured ahead of time?

Another thing to consider, although it may not be entirely straightforward to unravel, is whether the unit is pricing against providing energy/margin only or if it is pricing against providing flexibility and fast ramp rates. For example, a Fast Reserve provider with a non-negative PN, which is then revised to 0MWs, could reasonably expect to price a premium on its dynamics when compared to a conventional unit.

Another scenario where 'excessive benefits' may result is where a generator submits very high prices to start with, but the ESO doesn't need to take these high offers. Then the generator withdraws the PN and we need to accept the unchanged but still very high offer prices.

The part that inflexibility and long Minimum Non Zero Times (MNZTs) have to play in overall costs should also be considered. A price may not be viewed as excessive over the Darkness Peak due to scarcity of supply, however the same price taken at 14:00 would be excessive as the system isn't tight until later. This factor was found to be a major contributor of high cost in the Balancing Market Review². It is implicit in points a, c and d on the list of factors, but we believe it should be called out more explicitly.

Question 4 Is there any specific information you would like to see in the accompanying guidance related to interpretation and enforcement of the new licence condition?

There needs to be a clear definition of what 'price change significantly' and 'materially affect system margin' mean. As outlined above it would also be beneficial to include commentary on pricing for providing energy/margin vs pricing to provide flexibility/ fast reserve etc.

² <https://www.nationalgrideso.com/document/263916/download>