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# FINAL ADE Response | Ofgem Call for Input on addressing high balancing costs | 5 December 2022

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## Context

The ADE welcomes the opportunity to respond to Ofgem's Call for Input on addressing high balancing costs.

The ADE is the UK's leading decentralised energy advocate, focused on creating a more cost effective, low-carbon and user-led energy system. The ADE has more than 150 members active across a range of technologies, including both the providers and the users of energy equipment and services. Our members have particular expertise in demand side energy services including demand response and storage, combined heat and power, heat networks and energy efficiency.

## Overall Evaluation

The ADE strongly supports this Call for Input and appreciate the difficulties faced by all those involved in the energy industry both this winter and last, and the consequent effects on balancing costs. Therefore, as an industry wide issue, we believe that Ofgem is the best placed body to address the underlying causes of these cost increases and to assess the extent of any immoderate behaviour.

We can see the advantages of the proposed licence condition option in principle but we have concerns about potential unintended consequences (detailed below).

Therefore, we consider that further clarification of what constitutes good practice is the best option in the short term; it can be implemented quickest and in place for this Winter.

In the medium to long term, this review raises significant questions about reforms to the Balancing Mechanism as it transitions with the broader electricity market towards a net zero carbon market. Options such as Option 1: A price cap have clear interactions with some of the proposals being put forward through REMA such as the reliability incentive and should be explored further by both Ofgem and BEIS. In developing this work, it is important that in exploring these new market designs, the need for prices across the day-ahead, intraday and Balancing Mechanism to reflect scarcity is also given its full weight.

While we have answered the provided questions below, we would like to first provide further detail on our concerns regarding the ESO's proposed Balancing Reserve Service.

### Option 3 - A new Balancing Reserve service

We fully concur with Ofgem that this is not a desirable option but would perhaps take the argument a step further in the non-immediate risks, including non-monetary, such a service would incur.

Further, whilst we understand that it is the ESO's position that any action by Ofgem in this regard would be complementary, not a substitute for, the new Balancing Reserve service, we do not consider that this case has been shown conclusively. The ESO has not released any assessments publicly that include the measures outlined here and that shows that the Balancing Reserve service is required and saves significant costs. Given that the service design directly undermines the ESO's and Ofgem's strategic objectives for RIIO-2, we do not think an unsubstantiated view that it is in the consumer interest is sufficient to progress with such a service.

### **Reputational Risk**

We agree that there is uncertainty regarding the volume of capacity that the service may attract. However, it is both the signal it sends to the consumer and wider industry that poses a greater risk since the service adds further technology specific signals in the BM rather than removing them. It, therefore, starkly and directly contradicts ESO's own RIIO-2 objectives for removing barriers to market entry for smaller flexible assets and Ofgem's Forward Work Programme priorities for Full Chain Flexibility. This can affect investment decisions in the short, medium, and long term and therefore have an implicit unintended impact on reaching net zero.

Early conversations around this service have also highlighted the lack of clarity on how a prima facie discriminatory product may be judged to be a proportionate measure by Ofgem and the ESO. Given this, we are concerned that the ESO felt confident in Ofgem's likely supportive decision to develop it at the pace at which it has.

### **Stagnation Risk**

The ESO have indicated in various, if not always consistent, ways that the progression of this service will, and undoubtedly already has, delayed the remaining ancillary service reform products, namely quick and slow reserve. These services have already been repeatedly delayed which contributes to a level of uncertainty within industry, especially with regard to what products and assets to launch at what time, given the lack of clarity on phase out timelines of retiring products with different technical requirements. Since ancillary service reform is a key tenet of both the Smart Systems and Flexibility Plan and ESO's RIIO-2 license conditions it does not appear prudent to delay the progress of market-wide products in favour of an uncertain and unjustified service.

At a broader level, this service has confirmed what many in industry have been flagging for a long time, that ESO control room have difficulty efficiently dispatching small MW assets.

**The technical requirements** for the service, mandating a minimum 50MW threshold, are explained by the ESO as necessary "to ensure that the full quantity of the service can be instructed in a reasonable time within current control systems" since it "will require multiple BOAs to be sent manually". Therefore, ESO are acknowledging that manually dispatching sub-50MW assets in tight timeframes, as is the norm in the balancing mechanism, is too difficult under their current systems. While we know ESO have such IT upgrades within their BP-2 business plan to be completed by 2025, we also know that delays to these upgrades were the primary reason for Ofgem imposing a £0.8m penalty on ESO at their mid scheme review. Were this service allowed to proceed it would afford ESO even less incentive to address these delays.

With respect to Ofgem's consideration of the Balancing Reserve service, this service's parameters clearly contradict statements by the ESO to industry, including through its Dispatch Transparency Tool, that the vast majority (more than 95%) of dispatches are efficient. This should further reinforce Ofgem's focus on the ESO's poor performance in this area.

Finally, owing to this confirmation by ESO, any proposals to amend the service to remove discriminatory barriers or set forth a plan to incorporate smaller assets in the future (e.g., Day 2 improvements) should be rejected outright. The reason for the design has been made explicit and simply removing it from service terms will not change the fundamental underlying problem; it would only advance a guise of equality. Likewise, a plan to phase out barriers should be treated with the utmost scepticism given the ESO's track record with implementing Day 2 improvements and IT upgrades in a timely way to date.

### **Call for Input Questions**

#### **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 appreciate the enduring benefits that could be seen through a new license condition but have concerns of possible overreach. For example, batteries very often have OMW PNs at day ahead for reasons far removed than those motivating the introduction of this license condition. It may be possible to design the licence condition to avoid these unintended consequences but we are concerned about the potential for them.

#### **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?**

The ADE does not have a view on this.

#### **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?**

The ADE fully supports the list of factors, noting the additional unintended consequences to consider as set out in Question 1.

#### **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?**

The ADE does not have a view on this.

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#### **For further information please contact:**

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