

To: All interested stakeholders

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

Date: 13 October 2023

Dear colleagues,

**Decision on Enduring Auction Capability in relation to an amendment to the Terms and Conditions related to Balancing**

On 14 August 2023, we<sup>1</sup> received a proposal from the Electricity System Operator ("ESO") to make amendments to the terms and conditions related to balancing ("T&C") required by Article 18 of Commission Regulation (EU) 2017/2195 establishing a guideline on electricity balancing ("EBGL")<sup>2</sup>, as amended by the Electricity Network Codes and Guidelines (Markets and Trading) (Amendment) (EU Exit) Regulations 2019.<sup>3</sup>

The ESOs proposal facilitates the launch of their Enduring Auction Capability ("EAC"), a new auction platform for the procurement of Dynamic Containment, Dynamic Regulation and Dynamic Moderation ("Response Services"). This may be expanded to include the procurement of other services in due course.

The ESO's proposal:

- introduces a new set of rules for procuring Response Services on the EAC platform, the "Response Services Procurement Rules" version 1.0, which will replace the existing procurement rules for Response Services;
- updates the existing "New Response Services Procurement Rules" to version 2.0;

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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 (EBGL). EBGL came into force on 18 December 2018. Accessible at: <https://eur-lex.europa.eu/eli/reg/2017/2195/oj>

<sup>3</sup> The UK SI amendment of the EBGL: [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)

- updates the “New Response Services Service Terms” to version 2.0.

This document sets out our decision to approve that these documents form part of the T&C required by Article 18 of EBGL, replacing any previous versions of these documents that formed part of the T&C for each service effective immediately.

## **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>4</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”).

EAC<sup>5</sup> has been designed to deliver co-optimised procurement of day-ahead balancing services. With an optimisation function that aims to maximise market welfare, EAC should allow the ESO to procure balancing services in a more efficient way, whilst allowing providers to offer availability into multiple markets at the same time. The design aims to improve access across multiple markets by enabling the ESO to connect and co-optimize auctions for ancillary services where they see this as providing additional value.

Underpinning these benefits is the ability for EAC to scale for future services, such as new Quick and Slow Reserve products which are expected to be brought forward by the ESO in the future.<sup>6</sup>

At launch, the EAC will be used to procure capacity for Response Services using a uniform clearing price per product for each service window. For each of these services, EAC facilitates two product directions, High and Low.<sup>7</sup>

The ESO reached out to industry through a formal consultation process between 14 June 2023 and 14 July 2023. The ESO consulted on several documents. The first was a new set of “Response Services Procurement Rules”, which outlined the eligibility rules and processes by which the ESO will procure Response Services from service providers. Alongside this was

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<sup>4</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>5</sup> More information on the EAC can be found on the ESO’s website: <https://www.nationalgrideso.com/industry-information/balancing-services/enduring-auction-capability-eac>

<sup>6</sup> You can find the ESOs markets roadmap here: <https://www.nationalgrideso.com/research-and-publications/markets-roadmap>

<sup>7</sup> High frequency response aims to balance the system when frequency gets too high above the 50Hz target. Low frequency response aims to balance the system when frequency gets too low.

the "New Response Services Service Terms",<sup>8</sup> outlining the requirements for provision of Response Services procured by the ESO. This document also describes the basis upon which the ESO shall make payments to service providers. The final document consulted on was an update to the existing "New Response Services Procurement Rules".<sup>9</sup> To aid with visibility of the T&C, the ESO has also provided an Article 18 mapping document.

## **Decision rationale**

We have reviewed the service documents (consisting of the "New Response Services Service Terms", the "New Response Services Procurement Rules" and the "Response Services Procurement Rules") proposed by the ESO to be recognised as part of the consolidated T&C and submitted to us in line with the requirements of the EBGL, the wider objectives of the Electricity Regulation, and our statutory duties and obligations. We have engaged with the ESO to better understand its proposals in some areas.

In reaching our decision, we have considered the responses to the ESO's consultation from industry stakeholders. Stakeholders support both the overall aims of EAC, and the eligibility criteria and rules on participation outlined in the documents the ESO has proposed in their consultation. We conclude from this consultation that the end consumer will benefit from this new platform, whilst allowing more efficient service procurement for the ESO and participation for market parties.

Between consultation and submission, the "Response Services Procurement Rules" have been amended. The update removed reference to reserve services at this time, recognising that, while under development earlier this year, the introduction of those services has since been delayed. We agree that this change is appropriate, noting that the delay in producing documents such as the Reserve Service Terms led to some respondents stating that they were unable to comment on these references within the documentation, focusing on the response aspects only. By removing reference to the Reserve Service Terms and reserve services within the "Response Services Procurement Rules", there is no substantive change to the terms beyond recognition that the reserve services are not being procured through this approach. To introduce its proposed new reserve services in the future, the ESO would need to undertake industry consultation and submit to the Authority for approval.<sup>10</sup>

We are supportive of the design of EAC, the goals it is trying to achieve, the eligibility requirements for participation outlined in the Response Service Terms, and the Response

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<sup>8</sup> We understand the term 'New Response Services' in this title is used to refer to the ESO's newest frequency response services (DC, DM and DR), but does not include its legacy suite of services such as Static and Dynamic Firm Frequency Response or Mandatory Frequency Response.

<sup>9</sup> The only addition to this document is section 1A, which describes the process by which the New Response Services Procurement Rules will terminate.

<sup>10</sup> This would include reintroducing the services to the Response Services Procurement Guidelines, and updating the title of the document to acknowledge that it no longer applies solely to Response Services.

Services Procurement Rules. We expect this improved approach to balancing services procurement to deliver an efficient market outcome (starting with dynamic response markets) leading to benefit to the end consumer.

However, we recognise that there are some hurdles remaining for the ESO to overcome. One challenge facing the launch of EAC is ensuring the industry is prepared from a knowledge and understanding perspective. Many respondents raised points on the complexity of the new auction platform, the algorithm itself and the procurement rules that come with it. The ESO ran mock auctions during October 2023, which we consider have gone some way in helping industry prepare for the full launch of EAC. Furthermore, we believe that clarity on why provider offers are accepted or rejected by the EAC algorithm will build understanding within the industry on how best to compete in the market, maximising the ability of market participants to offer efficiently in auctions. Clarity can be provided through the auction results the ESO will publish on their data portal and so we expect the ESO to provide sufficiently detailed information in those reports.

The ESO proposed to allow providers to offer negative prices in the auction, where previous auction designs had a floor price of £0/MW/h. Several respondents raised concerns on the limited value negative pricing gives them, and that this could prevent them participating in these markets. From our engagement with the ESO, we understand that this is not a concern in terms of market participation: no party is required to submit negatively priced sell orders, and no party is required to have the capability to do so either. If a negative clearing price is unattractive, participants are still able to engage at a price that suits them.

Although the EAC brings with it increased complexity, functionality and control for market participants, there is no barrier for participants to continue with the auction behaviour they follow today. Participants can still participate in each available market separately and there is no requirement for a participant to stack services or to use any of the additional functionality that EAC brings.

Respondents fed back on the penalty arrangements outlined in the Procurement rules with negative pricing now a possibility, believing the ESO's original proposal (of penalties being proportional to the market clearing price) to be overly harsh and a potential disincentive to offer those more attractive (negative) prices. The ESO took suggestions on board and balanced the need to incentivise accurate delivery of services by market participants against prohibitively expensive penalties. As such, they have decided on a 'Minimum Adjustment Price' of £1/MW/h which is the value applied for settlement calculation if delivery standards are not met in cases where the market clears at less than the minimum adjustment price. We consider that the ESO has found an appropriate compromise here,

though the value of the Minimum Adjustment Price and this approach to delivery incentivisation is something we understand that the ESO will keep under review.

### **Our decision**

Considering our rationale above, we thereby conclude 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 acknowledge that the design of EAC creates a more efficient environment for the ESO to procure Response Services, whilst also fulfilling the needs of market participants in facilitating a co-optimised, stackable auction. Combined, we expect this to benefit the consumer as the ESO can clear this auction in a way that maximises market welfare. We note that the ESO does not intend to procure by optimising against the buy orders for its services from day 1,<sup>11</sup> but that this is possible through the service design and the Response Services Procurement Rules. As and when the ESO does decide to begin this practice we expect them to give suitable notice to industry of the change before enacting it.

We encourage the ESO to publish the revised documents consulted on as soon as practical, including any associated guidance documentation. The ESO has run auction trials to prepare participants for the EAC go-live date, and we trust that any issues or feedback shared from these are acted upon where they add benefit to the EAC and consumers. Alongside these trials, the ESO should ensure that market participants receive the best possible information to support involvement in these markets. A focus should be placed on the reasons for any paradoxically rejected bids to help participants understand how to operate within the market efficiently and encourage competition.

We understand that there will be two sets of Procurement Rules live for a period during which the crossover to procuring Response Services on EAC occurs. The addition of section 1A to the New Response Services Procurement Rules adds a termination date to that document. The ESO must make clear to market participants when the EAC Go-Live Date is, as this is the indication of when the new Procurement Rules document takes force, and the old Procurement Rules document will be retired.

We expect the ESO to include updates to the "Response Services Procurement Rules" in its consultation if it does plan to launch Reserve Services and by extension needs the Reserve

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<sup>11</sup> That is to say, the ESO has the option to move some volume between services to procure most efficiently where this would result in the same system operability / security outcome. The ESO will procure in an optimised fashion for sell orders, that is, offers from providers will be matched to services to provide the greatest overall welfare.

Service Terms document. As part of this, we expect the ESO to give a clear timeline on how and when it plans to add other services to EAC.

We will monitor the information provided to industry and the transparency of results from the go-live date of EAC.

If you have any queries regarding the information contained in this letter, please contact Matthew Fovargue ([matthew.fovargue@ofgem.gov.uk](mailto:matthew.fovargue@ofgem.gov.uk)).

Yours faithfully,

**James Hill**

Principal Policy Expert – Electricity System Operation

For and on behalf of the Gas and Electricity Markets Authority