

Jamie Webb / Company Secretary
National Grid Electricity System Operator Limited
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Email: ESOperformance@ofgem.gov.uk

Date: 21 March 2024

Dear colleagues,

**Decision to use our power of direction in relation to a revision of the NGESO
Procurement Guidelines Statement 2024-2025**

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

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 Authority¹.

The changes proposed to these documents by the ESO following an annual review include:

- Inclusion of Balancing Reserve ("BR") and Quick Reserve ("QR") as new services
- Updates to the wording for Demand Flexibility Service ("DFS")
- Amendments to the wording for Local Constraint Market ("LCM")
- Updates to the naming for the Pathfinder projects

¹ The Gas and Electricity Markets Authority. Ofgem is the Office of the Authority. The terms "Ofgem", "the Authority", "we" and "us" are used interchangeably in this letter.

- Housekeeping updates

The Authority's decision

Our decision is to veto one of the proposed revisions to the C16 statements. Under C16(9)(iv), we are directing the ESO to remove one sentence from the proposed revisions to the PGS. This is covered under the 'Changes to the PGS' section of this letter.

In assessing proposed revisions submitted by the ESO, we considered the positions brought forward to the ESO during the industry forum², informal consultation³, and formal consultation⁴, including responses from stakeholders in relation to each proposed group of changes. We have summarised our conclusions below.

1. Changes to the PGS

We have decided to direct the ESO to not include the following sentence "NGESO expects to use DFS from 30 October 2023 to 31 March 2024 with a potential extension beyond that if required". We do not believe this sentence adds any clarity to the PGS, considering the date range will have expired by the time the revisions come into effect on 1 April 2024 and would relate to the previous regulatory year rather than the current. While we understand that the text properly reflected the intentions of the ESO with respect to procurement of DFS, the wording that remains without this sentence is unaffected in this regard. We are not directing the ESO to remove any other revisions from this section.

We understand that the position set out in the PGS reflects the intentions of the ESO, though the ESO remains able to procure DFS in its current form until 30 April 2024 without further regulatory approval. Should the ESO's intentions change in regards procurement of DFS over the regulatory year, we would expect a prompt ad-hoc review of the C16 licence statements alongside any necessary stakeholder engagement and Authority decisions.

We consider that the other revisions the ESO seeks to include do add clarity to the PGS. This includes moving details of some services to sit under clearer headings, through the re-formatting of Table 2.

Alongside industry, we agree with the removal of Operational Downward Flexibility Management ("ODFM") and Demand Turn Up from the PGS. As the ESO no longer intends to procure this service, it's inclusion here is unnecessary. Though the ESO is not intending

² You can find the ESO held webinar at: <https://www.nationalgrideso.com/industry-information/codes/balancing-settlement-code-bsc/c16-statements-and-consultations>

³ You can find the full informal submission at: <https://www.nationalgrideso.com/industry-information/codes/balancing-settlement-code-bsc/c16-statements-and-consultations#Past-C16-consultations>

⁴ The ESO's formal consultation can be found at: <https://www.nationalgrideso.com/industry-information/codes/balancing-settlement-code-bsc/c16-statements-and-consultations#C16-Consultations>

to procure SuperSEL going forwards, we are aware that existing contracts mean inclusion of this description is relevant information. The ESO has provided clarity for the use case of SuperSEL (which essentially provides a negative reserve of energy) under constraint management services.

Another addition of note is text on Stability. Inclusion of this is valid and we understand it does accurately reflect the ESO's intentions. However, we are conscious of the fact that every respondent to this question queried the exclusion of assets below 132kV from the new stability markets. Though the design of this market is outside of the scope of C16, the ESO should consider these comments in the relevant workstream to ensure that industry views are taken on board. The ESO have committed to sharing this feedback with the Stability Y-1 market team directly.

Finally, the replacement of the word 'Pathfinder' from the PGS with the currently understood titles such as 'Voltage Network Services Procurement' and 'Constraint Management Intertrip Service' updates the statement to reflect the current titles in use by ESO when procuring these services.

2. Changes to the ABSVD

We consider that the addition of QR⁵ and BR to the list of Applicable Balancing Services is sensible, reinforcing the ESO's intentions to introduce QR and procure BR this year. We similarly agree that the removal of ODFM reflects the ESO's intentions.

The other revisions proposed by the ESO are sensible and have received positive support from industry respondents to the formal consultation. This mainly covers the formatting and restructuring of sections in the ABSVD to bring additional clarity and improve legibility.

Negative Slow Reserve has been removed from the list of ABSVD. As of writing, this service is not planned for implementation for at least another year, meaning its presence in these documents now only adds unnecessary wording.

We note that the ESO did not include revisions relating to LCM in their final proposal to us despite consulting on them, we discuss this later in this letter.

⁵ Quick Reserve is subject to ESO consultation (planned for summer 2024) and Authority approval. Thus, this inclusion only makes a practical difference following implementation of the service following these dependencies. We understand that this proposal reflects the ESO's intention for the service now, however if changes to this arose prior to the launch of the service (e.g. in response to consultation responses), we expect the ESO to provide a further proposal to us to reflect ABSVD treatment accurately prior to service launch such that there is no market impact.

3. Changes to the BPS

We consider the proposed minor changes to the BPS add clarity and note the industry support for these updates. This includes the inclusion of the ESO's BR product,⁶ and QR, the first product of the ESO's planned suite of new products to replace the existing reserve services. This is due to go live in 2024.

4. Changes to the SMAF

We consider the proposed minor changes to the SMAF bring clarity.

5. Changes to the BSAD

We consider the proposed revisions to the BSAD are sensible and improve clarity. Furthermore, we note the support from respondents to the consultation in this area. This includes the removal of all references to ODFM, now that the ESO are no longer procuring this.

For the same rationale as mentioned above in the ABSVD section, negative Slow Reserve has been removed from the BSAD.

Housekeeping updates

The housekeeping updates the ESO is proposing across all five statements keep these documents relevant and up to date.

Industry feedback on changes to the ABSVD to include a potential price adjustment mechanism for LCM

Although the ESO ultimately chose not to include proposals to change ABSVD treatment of LCM in their submission to us, we wanted to touch on the potential changes to the ABSVD in relation to LCM which were included in the consultation documents. We recognise that this was an area of contention amongst industry respondents, with a mixture of positive and negative feedback given to the ESO on their proposals.

We believe the ESO's decision to omit their proposal from the report is sensible, considering their statement that they don't want to break another area to fix this one. However, we also reflect that discussions on a potential solution in this market have been ongoing for many months and expect that a solution should continue to be worked on in a timely fashion.

⁶ More information on BR can be found at: <https://www.nationalgrideso.com/industry-information/balancing-services/reserve-services/balancing-reserve>

We note the ESO believes there is a strong case to address industry concerns around the unfairness in the LCM market and is planning to continue engagement in this area with industry over the coming months. It is clear that resolving the differing views on the introduction of the ESO's proposal will take robust fact finding and engagement before a final position is reached. We welcome an ad-hoc review of the C16 licence statements within the regulatory year should the ESO feel confident in delivery of a solution. Noting that there is on-going refinement of any potential solution, the ESO should formally consult on any future proposal in line with the conditions set out in C16.

Next steps

As indicated in the ESO's report to the Authority, the revisions proposed are to be reflected in the five C16 statements as of 1 April 2024. We expect the ESO to follow the outlined methodologies effective from that date. This excludes the revision which we are directing not be made.

Going forwards, we expect the ESO to continue reviewing and updating the C16 licence documents as required under its C16 licence obligations to ensure clarity and transparency for market participants.

Furthermore, the ESO has committed to continued assessment of the conditions under which LCM operates, and we trust that relevant stakeholders will be brought along with any changes the ESO plans to make. Balancing differing views in this area will require good transparency and clear evidence behind decision making.

We note that respondents have shared feedback and suggestions on a variety of topics within their responses to the consultation. We agree with the ESO's position that these comments are out of the scope of the C16 review, and trust that the ESO will fulfil its promises to pass these onto the relevant teams. Any updates off the back of this feedback should be shared with the respondents directly. This includes the feedback on Stability and Open Balancing Platform.

If you have any questions or feedback on the contents of this letter, please contact Matthew Fovargue (matthew.fovargue@ofgem.gov.uk) in the first instance.

Yours sincerely,

James Hill

Principal Policy Expert – Electricity System Operation

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 PARAGRAPH 9 OF STANDARD LICENCE 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), sub-paragraph 9(b)(vi) allows the Authority to direct NGESO not to make revisions to the statements prepared pursuant to paragraphs 4(a), 6(a), 7(b)(iii), 7A(b)(ii) and 8(b)(iii).
3. For the reasons set out in the letter to which this Direction is attached, the Authority has decided to direct the ESO not to include the proposed revision in full. The Authority directs NGESO to not include the sentence “NGESO expects to use DFS from 30 October 2023 to 31 March 2024 with a potential extension beyond that if required.” in the revised Procurement Guidelines statement.

Therefore:

In accordance with paragraph 9(b)(vi) of SLC C16, the Authority hereby directs NGESO to make the changes proposed to the Procurement Guidelines statement but without reference to the timings of the DFS service. 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.

James Hill

Principal Policy Expert – Electricity System Operation

For and on behalf of the Gas and Electricity Markets Authority

21 March 2024