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Cc: Ofgem, DECC

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By email

Dear Peter

Re: Demand Side Balancing Reserve and Supplemental Balancing Reserve

Thank you for the opportunity to respond to your consultation. Our response reflects the views of the Centrica group of companies excluding Centrica Storage.

We note Ofgem's 2013 Electricity Capacity Assessment Report and the observation that Loss of Load Expectation (LOLE) may exceed DECC's proposed 3 hours / year reliability standard in some of the modelled scenarios. Whilst we accept that mid-decade capacity margins are forecast to be tight, particularly in 2015/16, we do not agree that the introduction of Supplemental Balancing Reserve (SBR) is the right solution.

Centrica has consistently argued that the Capacity Market should be the instrument for ensuring security of supply in GB. The Capacity Market's design has been subject to a far greater degree of expert scrutiny than SBR and is much less likely to give rise to unintended consequences. Given the first round of Capacity Market auctions is scheduled for 2014, we maintain it should be possible to bring forward the date at which capacity is deliverable to the System Operator (SO) to most if not all of the mid-decade winters in question. National Grid and Ofgem should, in conjunction with DECC, look again at whether the Capacity Market's availability to the SO can be accelerated.

We believe your proposed Demand Side Balancing Reserve (DSBR) merits further consideration, but we have two key concerns with it:

1. It risks being less effective than an accelerated Capacity Market, which allows for demand side participation and has been subject to a far greater degree of expert scrutiny.

2. More engagement with suppliers is needed to address the question of whether the SO or the electricity supplier is best placed to be the counterparty to a retail customer providing DSBR. The current customer relationship sits with the supplier and DSBR services provided via the supplier are likely to be more cost efficient and minimise customer confusion. Suppliers would welcome the opportunity to discuss this interface with National Grid before a decision to tender for DSBR is taken.

In light of the above, we would make the following high level recommendations:

1. National Grid, Ofgem and DECC should in the first instance assess whether the Capacity Market can be brought forward to cover at least some of the mid-decade winters in question.
2. To the extent there are mid-decade winters which cannot be covered by an accelerated Capacity Market - and LOLE is sufficiently high in those winters to warrant further intervention - National Grid should take the temporary step of increasing volumes available to it through STOR. This should lapse once the Capacity Market is available.
3. National Grid should consult electricity suppliers further on DSBR to determine:
 - (i) Whether DSBR offers a genuinely additional service to the SO over accelerated introduction of the Capacity Market.

If parties agree that DSBR is a genuinely additional service:
 - (ii) How best to engage with retail customers providing the DSBR service.
 - (iii) How to manage information flows between the parties.
 - (iv) How to ensure DSBR is compatible with suppliers' contracts with their customers and balancing and settlement arrangements more generally.

We have responded to your specific questions on SBR in Annex 1 below. We also provide some initial observations on the challenges of DSBR as we currently see them, but have not responded to your specific DSBR questions at this stage. We would of course be happy to engage in further dialogue with you on either of the proposed services at any time.

Yours sincerely,

Tim Collins
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Centrica Energy

Annex 1 – Initial Centrica views on DSBR and SBR

Initial Centrica views on DSBR

In principle we are strong supporters of demand side response and recognise the significant savings it could deliver to consumers. British Gas is already taking a lead role engaging Ofgem around creating the right environment for demand side response in general¹.

We are, however, concerned that:

1. DSBR risks being less effective than an accelerated Capacity Market, which allows for demand side participation and has been subject to a far greater degree of expert scrutiny.
2. National Grid is considering a procurement approach to DSBR which could circumvent electricity suppliers entirely, without adequate consultation with suppliers on the pros and cons of that approach.

To the extent DSBR provides additional benefits over an accelerated Capacity Market, it could well be more appropriate to procure DSBR through suppliers rather than opt for direct procurement by the SO. The core business of electricity suppliers is engaging in relationships with retail customers, offering and delivering new commercial opportunities to them. Whilst there may be advantages to direct SO procurement of DSBR from retail customers, we believe there may also be significant drawbacks:

- It would require National Grid to develop its own set of retail customer infrastructure – suppliers could more easily and cheaply adapt their existing infrastructure for DSBR purposes.
- It would risk bringing retail customers into conflict with their electricity supply contract (e.g. if supply contracts contain clauses governing deviations in demand).
- It increases risks of information asymmetries and confusion between suppliers, retail customers and the SO. For example, it gives rise to questions of how balancing and settlement would be dealt with where the SO issues demand reduction instructions to retail customers without the supplier's knowledge.
- It could create confusion among retail customers about whether National Grid or the supplier was the appropriate point of contact in the wider energy market.

We believe the right way to progress your DSBR proposals is to further engage electricity suppliers on whether DSBR is the right service – and if so, how best to interact with customers / procure it - before proceeding further.

¹British Gas's response to Ofgem's recent consultation "*Creating the right environment for demand side response*" should be published on the [Ofgem website](#) shortly.

Initial Centrica views on SBR (and responses to specific questions)

General

Centrica has consistently argued that the Capacity Market should be the instrument for ensuring security of supply in GB. The Capacity Market's design has been subject to a far greater degree of expert scrutiny than SBR and is much less likely to give rise to unintended consequences. Given the first round of Capacity Market auctions is scheduled for 2014, we maintain it should be possible to bring forward the date at which capacity is deliverable to the SO to most if not all of the mid-decade winters in question. National Grid and Ofgem should, in conjunction with DECC, look again at whether the Capacity Market's availability to the SO can be accelerated. There is a precedent for this approach in PJM. When their capacity market was introduced in 2007, the SO immediately ran three consecutive auctions for delivery in 2008, 2009, and 2010. This demonstrates there are no practical obstacles to initiating capacity payments quickly if there is political will to do so.

To the extent there are mid-decade winters which cannot be covered by an accelerated Capacity Market - and LOLE is sufficiently high in those winters to warrant further intervention - National Grid should take the temporary step of increasing volumes available to it through STOR. This measure should lapse once the Capacity Market is available.

We recognise increasing the SO's STOR may also mean STOR needs to be used in a subtly different way than currently (i.e. a proportion of the SO's STOR may be needed to remedy *expected* shortfalls in generation on peak winter days, rather than just react to *unexpected* shortfalls). However, we note the ability of STOR to respond rapidly to an SO instruction makes it a better option of last resort than SBR, which would likely need to be called earlier on an expected tight day - distorting market prices to a greater extent than a STOR-based last resort intervention. STOR has the added advantage of being an existing service, with a procurement framework that is proven – further reducing the risk of unintended consequences.

When considering the introduction of SBR, it is important that National Grid and Ofgem recognise the wider economic context for existing thermal generation; particularly CCGTs. Clean spark spreads in GB have been extremely low – and at times negative – for more than two and half years. It has not been possible for CCGT plant to make anything like a reasonable return on capital over this period. Companies may have taken difficult decisions to accept economic losses on CCGT plant over these months on the reasonable expectation that tighter margins over the mid-decade winters will aid the recovery of the clean spark spread. The proposed introduction of SBR will work against this.

SBR1 Do you agree with our basic product proposals?

No. We do not support the introduction of SBR. We would prefer accelerated introduction of

the Capacity Market and failing that, procurement of additional STOR. We believe the dynamic properties of STOR make it better suited to being an option of last resort, because STOR can respond to an SO instruction at short notice. This property will allow the SO to let mainstream market arrangements prevail for longer at times of system tightness - and make genuine last resort decisions, as intended. STOR should therefore better fulfil principle 114 (d) in your consultation document:

114 (d) *“to avoid displacing to avoid displacing other plant from the markets for energy and balancing services, SBR would only be called, to the extent that dynamics and other technical considerations allow, irrespective of utilisation price, after all other relevant balancing services (including DSBR) have been exhausted and emergency actions would otherwise be required”*

We note your proposed SBR requirement of 50MW or more from a single despatch interface:

114 (f) *“provision of SBR would be only from individual resources which can be despatched to provide a capacity of 50 MW or more through a single despatch interface. Additional requirements, such as operational metering, etc would also apply”*

To the extent STOR could be deemed unwieldy for the SO to manage because it may be comprised of small units, National Grid could consider attaching weight to being a single despatch interface of 50 MW or more in its evaluation criteria for future STOR tenders.

SBR2 Do you agree with our proposals on participation and our proposals to seek reasonably satisfactory evidence regarding additionality?

If SBR is introduced, we agree there should be a general requirement on bidders to demonstrate their capacity would be otherwise unavailable to the market through evidence. We believe this general criterion should be sufficient to ensure procurement of SBR delivers genuinely additional reserve to the SO. We do not however support the introduction of SBR.

SBR3 Do you have any comments on the proposals to infer outage rates by allowing service providers to choose their non-delivery charge? Views are also invited on the approach to creating the appropriate trade-off between non-delivery charges and de-rating factors.

We understand why the ability for SBR bidders to choose their non-delivery charge (and corresponding de-rating factor) may give the SO a way of obtaining the SBR provider's objective view of its de-rated capacity (i.e. *capacity x probability of delivery*).

If SBR is introduced, we believe it would be simpler and more cost reflective for a uniform penalty rate for non-delivery of SBR to apply. Adoption of a uniform penalty rate would discourage unreliable capacity from bidding for SBR contracts as well as encouraging SBR providers to ensure their plant is in good working order (to minimise the risk of incurring penalties). These incentives, in conjunction with your proposed verification proposals, giving the SO the right to require contracted SBR to perform tests, should provide you with sufficient assurance that reliable capacity is available from contracted SBR plant.

SBR4 Do you agree with our verification proposals?

If SBR is introduced, we agree with your verification proposals.

SBR5 Do you agree with our proposals to despatch SBR only after other non-emergency balancing services have been exhausted and do you have any views on whether SBR should be despatched through the Balancing Mechanism or outside it?

If SBR is introduced, we believe SBR plant should be despatched within the Balancing Mechanism (BM) as it avoids the need for a new despatch system. This is subject to SBR being a last resort option that should not be despatched ahead of regular BM plant regardless of utilisation price.

SBR6 Do you agree with our proposals for Settlement, and in particular, regarding the payment of 20% of the capacity payment up front?

If SBR is introduced, we believe that at least 20% of the capacity element of the SBR contract should be payable upfront. Providers of SBR are likely to incur extensive costs in the course of having to return a plant to service (particularly in the case of plant that has been mothballed, which will also bear the costs of recruiting and re-training the requisite operational staff). The commercial attractiveness of SBR relies on providers being able to recover the significant upfront costs associated with returning plant to potential service over a reasonably short timeframe.

SBR7 Do you agree that imbalance prices should not be affected by any SBR procurement ahead of Ofgem's Energy Balancing Significant Code Review?

As a general principle, we believe the costs of SBR should be reflected in the imbalance prices of the settlement periods (if any) in which SBR is used (similar to STOR). Otherwise, the intervention risks dampening scarcity prices in the energy market - which could lead to further plant closures and retirements. In any event, the impact of SBR on imbalance costs will need to be considered by Ofgem in the course of the Electricity Balancing Significant Code Review.