Energy UK

The voice of the energy industry

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Energy UK response to Ofgem consultation on the potential requirement for new balancing services by National Grid Electricity Transmission plc (NGET) to support an uncertain mid-decade electricity security of supply outlook

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Introduction

Energy UK is the trade association for the energy industry. Energy UK has over 80 companies as members[1] that together cover the broad range of energy providers and suppliers and include companies of all sizes working in all forms of gas and electricity supply and energy networks. Energy UK members generate more than 90% of UK electricity, provide light and heat to some 26 million homes.

Energy UK welcomes the opportunity to respond to Ofgem's letter with respect to the publication of the 2013 Capacity Assessment report and the consultation on the two potential new balancing services that would be procured by National Grid Electricity Transmission (NGET).

This Energy UK response is focused on the high level principles and key concerns that should be considered by Ofgem in its decision on whether to instruct NGET to procure the proposed new balancing services – Demand Side Balancing Reserve (DSBR) and Supplemental Balancing Reserve (SBR) - and how they are designed. This response will be copied to National Grid. Please note that Energy UK will not be responding to the National Grid consultation directly as it is more appropriate for industry participants to respond to the detailed design questions individually.

Executive Summary

- Energy UK agrees there could be credible scenarios whereby, mid-decade, electricity capacity margins are tight, due to the impact of several factors. We recognise therefore that it is prudent for Ofgem and National Grid to plan for such an event.

- In theory, a functioning energy market should respond to the tightening of capacity margins by providing the appropriate price signals either to build new capacity, bring mothballed capacity back online or keep existing capacity available. We therefore consider that interventions in the market should minimise any distortions to pricing signals so as to avoid negative impacts on investment and unintended consequences.

- The primary mechanism to ensure sufficient capacity margins should be the Capacity Market.

- The Supplemental Balancing Reserve (SBR) and Demand Side Balancing Reserve (DSBR) should therefore be considered as an interim last resort option.

[1] NOTE: National Grid is a member of Energy UK but has not provided input to this consultation response.

- In the event that the SBR and DSBR options are progressed, there must be clear, non-discriminatory and transparent criteria governing National Grid's procurement of these additional balancing services. Moreover, clear and transparent rules will be needed to determine the operation of the SBR to minimise the risk of price distortions that undermine the effective operation of the market.

Ofgem's Capacity Assessment

Energy UK agrees that there may be credible scenarios whereby, mid-decade, electricity capacity margins become tight, due to the impact of several factors:

- Coal-fired plant opted out of the Large Combustion Plant Directive (LCPD), closing earlier than expected, after having used up their limited running hour allowance, partly due to current lower than expected fuel costs;

- Decision making in respect of the IED and the interaction of the carbon price floor;

- The uncertainty regarding Electricity Market Reform policy and the Capacity Market;

- The increasing requirement for available capacity as more intermittent renewables generation is commissioned;

- Electricity Market Reform policy uncertainty causing delays with respect to decisions to invest in maintaining existing generation assets and new low carbon generation assets.

Whilst, the level of risk to security of supply depends on many factors such as the flow of interconnectors and assumptions on electricity demand, Ofgem predicts that de-rated capacity margins could tighten to between 2 and 5 per cent in 2015-2016. Energy UK recognises that it is, therefore, prudent to explore options to manage such an event.

Procurement of additional balancing services

Energy UK has consulted widely with members and we wish to draw the attention of Ofgem to the following points:

- In theory, a functioning energy market should respond to the tightening of capacity margins by providing the appropriate price signals either to build new capacity, bring mothballed capacity back online or keep existing capacity available. We therefore consider that interventions in the market should minimise any distortions to pricing signals so as to avoid negative impacts on investment and unintended consequences.

- The primary mechanism to ensure sufficient capacity margins for the long term is the enduring Capacity Mechanism. The Supplemental Balancing Reserve (SBR) and Demand Side Balancing Reserve (DSBR) should be considered as last resort options. An assessment of the likely effects on imbalance prices and BSUoS would need to be carried out to determine whether any increase in price volatility is material. Should this be the case then Ofgem would need to include the assessment in its decision-making. We remain unclear as to the interaction between the proposed additional balancing services and STOR.

- In the event, that the SBR and DSBR options are progressed, there would need to be clear, non-discriminatory and transparent criteria in which National Grid procures these additional balancing services. In addition, a framework of clear and transparent rules would be needed to minimise the risk of distorting market prices. Furthermore, National Grid would need to be subject to an incentive to ensure the scheme runs efficiently and at an appropriate economic cost.

- The process for acquiring and delivering the services for both Supplemental Balancing Reserve (SBR) and the Demand Side Balancing Reserve (DSBR) would need to be as transparent as possible. Notification of all bidders whether successful or not should be revealed, as such information will be market sensitive.

Specific comments on the Supplemental Balancing Reserve

As National Grid further considers its proposals for a Supplemental Balancing Reserve, we urge that the following points are taken into account:

- Any framework needs to be developed to ensure that the plant that is providing the Supplemental Balancing Reserve service is clearly additional to that which would otherwise be provided. Given the amount of marginal gas plant around for which the SBR could be attractive, there is a real risk of the reserve becoming large with significant distortionary effects on the market and/or detrimental impacts on consumer costs.

- Further consideration should be given to the criteria for eligible plant. Whilst we understand why the focus is on plant that can provide evidence to National Grid's reasonable satisfaction that they would not otherwise be participating in the energy market or providing balancing services, it is important to ensure that the framework does not lead the System Operator making subjective judgements as to whether plant would or would not be participating in the energy market in the absence of an SBR contract.

- We would like to highlight again our concern that the proposed intervention in the energy market risks distorting price signals with detrimental impacts on market investment.   In this context, we would strongly emphasise that any SBR intervention should be subject to a clear time limitation with a transparent strategy for moving away from the intervention.

- There is a clear debate that needs to be pursued further on whether it is preferable to have a de-rating/penalty methodology formula or for market participants to present estimated reliability and the level of penalties that they are willing to accept as part of their bid submission. Whilst accepting the need to pursue speedy consideration of these new balancing services, nevertheless in some of these detailed issues we urge that there should be some further opportunities for analysis.

- Where services are to be provided by gas-fired plant, this will evidently have an impact on increases in gas off-take in short notice. Such a consequence flows through into both the contractual position and the physical scenarios.

Specific comments on the Demand Side Balancing Reserve

Energy UK is supportive of utilising demand side measures and believes that they are useful as a tool to help balance the system. We are well aware that there are a number of demand side measures already being used by the System Operator and that further consideration is being given to sensible and effective demand side response under the Capacity Market.

As there is already significant activity being undertaken in this area, we would propose that:

- Efforts should be directed at this stage to developing early Demand Side Response (DSR) proposals for the enduring Capacity Market, via a trial auction in 2014. The DSBR should only be progressed if the DSR plans under the Capacity Mechanism cannot be taken forward within these planned timescales.

- Any interim Demand Side Balancing Reserve, if it is ultimately decided that it is required, should be specific, transparent and clear and not interfere with the longer term outcomes envisaged in the enduring Capacity Market proposals.

- Supporting research is required to demonstrate that there is an interest in the provision of Demand Side Balancing Reserve from different sections of the customer base and specifically we note that smaller customers have shown little interest in the proposition.

- As we have commented in other responses, it is unlikely that any Demand Side Response is secure unless it is clearly doable and is backed up by a penalty regime. For there to be a credible outcome which is available when required, an effective framework will be needed where reliable performance judgements are made before a Demand Side Response proposition is accepted, backed up with appropriate penalties for failing to deliver.

- There are also a number of concerns that Energy UK members have raised about the design of the DSBR:

- The impact of large high utilisation fees on BSUoS volatility

- The lack of penalties for unavailability is unlikely to drive reliable performance and demonstration of 'reasonable endeavour; is insufficient.

Next steps

- Energy UK believes that Ofgem and National Grid need to give fuller account of how they arrived at the decision to consider procuring these additional services before making decisions on the detail of their procurement.

- Clarity is also needed on how these additional services would interact with existing balancing tools; the estimated costs involved in procuring them and how they would be funded.

- Impact assessments quantifying the costs and benefits of the SBR and DSBR should be carried out to support the statements about the cost reductions these services will provide, demonstrating value for money to customers.

- Energy UK would like to engage in discussion with Ofgem, DECC and National Grid on the interactions between these proposed new services; Ofgem's forthcoming cashout proposal; the use of VOLL; and the impact on all aspects of the market.

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