

Rachel Fletcher  
Interim Senior Partner, Markets  
Ofgem,  
9 Millbank  
London  
SW1P 3GE

Cc: DECC, NGT

[wholesale.markets@ofgem.gov.uk](mailto:wholesale.markets@ofgem.gov.uk)

Reference Number: 106/13  
Date: 26<sup>th</sup> July 2013

**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**

Dear Rachel,

SmartestEnergy welcomes the opportunity to comment on Ofgem's and NGT's consultations on the potential requirement for new balancing services by National Grid Electricity Transmission plc (NGET).

**Please note that this letter contains answers to both Ofgem's consultation and NGT's.**

SmartestEnergy is a supplier in the half hourly electricity market and an aggregator of embedded generation.

We note the following paragraph in the report: "These balancing services would not provide a substitute to Government's EMR Capacity Market, or indeed Ofgem's proposed reform of cash out arrangements. These new products do not address the challenges of incentivising the industry to invest in providing adequate security of supply. Rather, they would provide a further tool to assist NGET in balancing the system to avoid disruption to customer supply against a background of narrowing margins."

We also note that Ofgem do not consider that any disruptions to consumers' supply are imminent or likely, providing the industry manages the problem

effectively. In our view greater use of existing plant and demand side could be used in the EMR mechanisms earlier than currently planned.

Ofgem themselves also acknowledge that NGT's proposals "could lead to incentives for plant to close in pursuit of reserve contracts" and are "mindful that the products deliver appropriate levels of reliability to ensure value for money to consumers."

We are of the view that the simplest approach would be to hold an auction in 2014 for delivery of demand side response/existing generation capacity in 2015. DECC should also reaffirm that the auctions will only take place each year if there is a need identified from the annual capacity assessments.

However, given where we are we understand that practicalities of the legislative and subsequent implementation timetable make it difficult to bring the demand side with the capacity market forward.

We can also see that there is an advantage with NGT's most recent proposals in that DSBR could kick-start an interest in demand side which could go beyond 2016. The SBR is slightly at odds with the capacity mechanism and should be time limited.

We would ordinarily be wary of giving demand special treatment and believe that generation and demand should be treated as two sides of the same coin. Solutions should therefore preferably involve both sides. For the short term we can see that DSBR and SBR could be seen as such complementary schemes.

In essence, though, we believe that both of NGT's balancing reserve proposals are worthy of further consideration for the short term and the DSBR could prove useful in the longer term if STOR/Capacity mechanism fail to bring demand side forward on an equal footing with generation.

We answer Ofgem's questions below:

1. Do you agree with our assessment regarding the risk to mid-decade electricity security of supply?

Ofgem's capacity assessment is a useful piece of analysis. The 'worst case' scenario in our view is probably a bit worse than Ofgem assess it to be, and a bit more likely. However, we would also refer Ofgem to a recent contribution to the Regulatory Policy Institute's (RPI) Letters and Notes on Regulation dated June 2012, RPI by Nigel Evans which argues that the UK is not facing a capacity crisis; Ofgem's October 2012 analysis

showed that the fall in the de-rated capacity margin will only amount to 3,400MWh, or 0.0001% of total electricity supplied; the annual loss of supplies arising from transmission and distribution outages is roughly three times higher than this; during the year of the tightest margins, 2015-16, the loss of load expectancy given by Ofgem in its analysis is still within the reliability criteria used by neighbouring countries including France, Ireland and Belgium.

Our conclusion therefore, unhelpful as it is, is that the situation could be better or worse.

2. If so, do you agree with our view that it is prudent to consider the development by NGET of additional balancing services, which NGET would procure and use if there is a need for them?

Rather than developing additional balancing services to make up for the late implementation of the capacity mechanism NGET could make a clear signal to the STOR market by providing some longer contracts. However, given where we are we believe the proposals are sensible.

We are aware that there is a danger of paying consumers to reduce demand if they are already shutting off consumption/increasing embedded generation for an hour and a half to avoid a potential triad period (TNUoS). However, this could indicate that Triad is not sufficient an incentive.

3. Do you agree with our assessment of the key factors we should have regard to when considering whether to approve any changes to NGET's Balancing Services Procurement Guidelines and associated documents?

We comment on the factors below:

- a) *NGET's procurement must be economic and efficient and the products must represent value for money to electricity consumers.*

We agree that it is important to demonstrate that the additional mechanisms will represent value for money to consumers.

- b) *NGET's product design and proposed use of the new products must minimise unintended consequences to market participants and the operation of the market.*

In our view, the proposed mechanisms create further uncertainty in terms of attracting investment away from the capacity mechanism, but the capacity mechanism should never be a permanent feature of the arrangements anyway.

c) *NGET's procurement process must be objective and transparent.*

The existence of these arrangements alongside STOR, the Balancing Mechanism and the Capacity mechanism may make the optimisation of the system even more opaque; how will it be judged that one mechanism is more efficient than the others, especially if actions in one mechanism are to be exhausted before another mechanism is invoked? Nonetheless, economic despatch across mechanisms is required.

We answer NGT's questions below:

DSBR1 Do you agree with our proposed participation criteria?

Yes. We understand the need to try to engage with customers who have not thus far been interested in STOR or the BM.

DSBR2 Do you agree with our proposed product definition?

Yes. By making it open for a relatively short period at the end of the day, large customers can benefit from shutting manufacturing down early and being compensated without worrying about being called at any time during the day.

DSBR3 Do you agree with our proposed payment arrangements? Do you have any views on the proposed level of set-up payment?

We do not agree with the concept of a set-up payment. If it is available we believe that all customers would opt for it, but in the absence of a claw-back for non-performance, it should not be available.

DSBR4 Do you agree with our measurement and baseline proposals?

Yes. We think it is appropriate to take the average of periods on which demand side was not called so that previous activity does not affect the average. However, further thought needs to be given to the eventuality

that there are many calls made during the winter. This will reduce the average baseline and thus make any reductions appear to be less productive.

DSBR5 Do you agree with the proposed arrangements for despatch?

We agree with making despatch more accessible. However, it is important that those receiving the instructions can keep a record of the calls they have received. Smartphone should only be used in conjunction with more permanent methods of communication, possibly simultaneous with email/fax so that there is a retrievable record.

DSBR6 Do you agree with our proposals on procurement?

Yes

DSBR7 Do you agree with our proposals on verification?

Yes

DSBR8 Do you agree with that there should be a de-minimis dispute threshold?

It's difficult to know whether to agree with this or not. On the face of it, it would be sensible if it is set at an appropriate level.

DSBR9 Do you agree with our proposed approach to contracting?

Not a great deal of thought seems to have been given to how an aggregator may take part in these proposals. If contracting is direct with customers, how does an aggregator receive payments for facilitating the demand response?

DSBR10 Do you agree with our proposals on imbalance pricing?

The fact that Ofgem are conducting a review of cash out is irrelevant. If it is appropriate to send a price signal through imbalance, then that should be the preferred arrangement and Ofgem can take account of this in the broader picture. The question is whether it is appropriate to load these costs onto customers (bearing in mind that CMP201 could double these costs for the demand side) when these are short term utilisation costs more akin to the BM than STOR (esp since it is, as we have previously stated, it is not appropriate to pay set-up costs)

DSBR11 Do you agree with our proposals on how the service should interact with triaddemand reducers?

There is inevitably a cross-over here and it could be argued that some payments will double reward Triad avoidance. However, it is acknowledged that it is necessary to pay out more to encourage more demand response.

DSBR12 Do you agree with our proposals in respect of Committed and Flexible STOR providers?

Yes. The requirements quite rightly exclude those offering STOR during the same windows.

DSBR13 Do you have any comments on our procurement options?

We can see the advantage of these arrangements for NGT to contract direct with end customers who are looking for low cost entry. We do not believe it is appropriate for NGT to contract with distributors unless there are arrangements in place to compensate suppliers for imbalance. It is also inappropriate to sub-contract out certain functions to aggregators and contract direct with the customers if those aggregators did not themselves put the commercial proposition together.

SBR1 Do you agree with our basic product proposals?

We do not believe that this product is appropriate for the demand side as there is no equivalent of coming out of mothball on the demand side. We appreciate that NGT are keen to engage with the demand side but the DSBR is the other side of the coin.

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

Yes. On the generation side the proposals are sensible. On the demand side the document acknowledges that demand side would not be able to demonstrate that it did not otherwise intend to reduce demand, i.e. that it intended to continue taking demand, irrespective of price or any other signal.

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 find this a curious feature. It could only work if the penalties become proportionately greater with better disappearance ratios i.e. it is important that generators are not indifferent to where they pitch themselves because the relationship between profit and penalty are linear.

SBR4 Do you agree with our verification proposals?

Given the existence of non-delivery charges (and assuming that these are proportionately punitive) verification is not necessary.

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

The issue of despatch should really be an economic one. SBR should be despatched through the BM since the target market will be ex-BM plant.

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

Yes

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

No. These arrangements, regardless of their impact on cash-out/BSUoS, will need to be reviewed by Ofgem. Having said that, a cash out review should be completed before this product is implemented so guidance should therefore be forthcoming.

TAC1 Do you agree with the way in which we propose to assess Demand Side Balancing Reserve?

In the absence of any data to analyse DR of 0.25 seems sensible.

TAC2 Do you have any particular comments on the way we propose to use Disappearance Ratios (DRs) for Demand Side Balancing Reserve in the assessment process?

No

TAC3 Do you agree that we should enter into a contract with all Demand Side Balancing Reserve with a utilisation price of less than the Value of Lost Load (VoLL) that has no set-up fee?

VoLL is an important area for discussion in the Cash Out review. There is currently no way for customers to set their own VoLL, nor is it clear that any single number is appropriate for customers as a whole. We are therefore unconvinced that VoLL (whatever value that is) should be used as part of the calculation.

TAC4 Do you have any comments on our proposed assessment of Supplemental Balancing Reserve?

No

TAC5 Do you agree with our proposed call-off arrangements?

No comment.

If you have any questions, please do not hesitate to contact me.

Please note that our response is not confidential.

Yours sincerely,

Colin Prestwich  
Head of Regulatory Affairs  
SmartestEnergy Limited.

T: 020 7195 1007  
M: 07764 949374