UK Demand Response Association

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Subject: Responses of UK DRA to Ofgem Letter Consultation re: the potential requirement for new balancing services, dated 27 June 2013.

The UK DRA appreciates the opportunity to respond to this consultation. Below we first make some general comments to the consultation. These are followed by specific responses to the three questions raised in the consultation.

General Comments:

The UK DRA is encouraged that in seeking to address the near-term uncertainties in supply and demand, Ofgem, DECC and NGET have considered the role that demand response (DR) might play. Clearly, the demand side option in the proposed new balancing services is a recognition of the important resource that DR offers to the GB energy market, in that it represents a reliable, quick-to-market resource that could, under the correct programme design, address that near-term uncertainty.

The UK DRA is surprised and concerned by the way in which this initiative was developed prior to its announcement on 27th June 2013 – without any involvement whatsoever of the demand side response industry. Until that date, the UK DRA had been of the understanding that development of the capacity market (CM) was the mechanism for ensuring adequate supply of capacity, and that in particular, the transitional capacity mechanism was an approach to address adequacy in the near term, with delivery as soon as 2015. The UK DRA has been an active stakeholder in that process. The UK DRA welcome the opportunity to be directly involved in developing new demand side balancing services with National Grid and other stakeholders to unlock the environmental, security of supply and cost reduction benefits of demand side response for the UK.

As a matter of policy and urgency, we are extremely concerned that the DSBR programme could be "exchanged" for part of the transitional programme of the Capacity Mechanism (CM): on the day on which the DSBR was announced, DECC indicated that it intended to delay the start of the transitional CM market by at least one year. We understand from DECC that this change is directly linked to the proposal to introduce DSBR. We agree with Ofgem that the DSBR services do not provide a substitute to the Government's EMR Capacity Market. They fulfill different roles and can co-exist. Should there be any perception that there are issues with having them co-exist, we would be more than happy to work with Ofgem and NGET to overcome these issues.

Delaying the start of the transitional CM market due to the DSBR is disappointing to the UK DRA; it represents a significant risk to the continued development of DR in GB in the near term, because the CM transitional mechanism – in contrast to DSBR – provides a sustainable business case with the clear intention of leading directly to integration of DR into the enduring CM. Postponement of that transitional market means at the least treading water for the DR industry, or worse, the decision to focus elsewhere in international markets for DR opportunities. <u>At a minimum, the UK DRA recommends that if the proposed new balancing services programs go forward, this should NOT be</u>

at the expense of a delay to the transitional CM, and that latter should start with an auction in 2014 for delivery in 2015 as originally designed.

We also believe there is an urgency to the resolution of the above concern. The implementation phase of the CM is set to begin in August with key working group meetings. Absent a commitment to the start of the transitional CM via an auction in 2014 commensurate with the auction for the enduring market, the ability to implement that transitional market timing is compromised, and may be unrecoverable. Thus the DSBR proposal, whether a decision not to proceed with the DSBR is subsequently made, poses risk to the DSR industry in terms of a delayed transitional market opportunity unless that issue is immediately addressed.

The UK DRA believes the proposed programmes require significant modifications to be effective. These new balancing services are presented as short-lived products addressing mid-decade supply security risks; there is no intention that they will become permanent market opportunities thereafter, and therefore offer no sustainable business case for investment of end users' time or money. This is a barrier to entry for the demand side of the equation, independent of whether or not the Demand Side Balancing Reserve (DSBR) product represents a viable opportunity (which it does not). The idea of starting with a pilot is generally a good approach, but pilots that do not lead directly to sustainable market opportunities are short-term, stranded opportunities at best. They do not encourage investment or commitment on the part of providers, whether third-party aggregators of demand response, or direct participants.

Nor does the presentation of the DSBR as a simple product demanding very little up-front investment of participants mitigate the deficiency of a short-lived programme. From experience in other markets, this is seldom the case in demand response. Potential industrial and commercial (I&C) participants (aggregated or not) must, understand, assess, develop internal proposals, obtain internal approval, socialise the concept within their organisations, operate, monitor and settle. All of this comes with a substantial opportunity cost and is quite separate from any hardware costs which, in general, will also be incurred. Therefore, the lack of a medium-term business case to support this capital investment seriously undermines DSBR.

The UK DRA does not believe that the proposed DSBR product represents a viable product for the DR industry. Our specific comments are beyond the scope of OFGEM's consultation; we will be providing these to NGET's informal consultation and will make these available to OFGEM. The point which we must raise in this consultation is that the proposed DSBR will not result in a reliable resource for NGET. We believe that the risk of unreliability is built into the design. The UK DRA is distressed by this, for two reasons. Firstly, the nature of the problem to be addressed requires a reliable product. Secondly, the DR industry, on a global basis, has invested heavily and is dedicated to the delivery of a highly reliable product that competes, and exceeds, the reliability of other supply side resources. The industry has fought to overcome the legacy of earlier DR programs that were designed more as a tariff relief than as a supply side resource, and which as a consequence suffered from poor performance. The DSBR as currently designed is akin to those earlier legacy programs, and a backward step for the DR product which could do irreparable harm to the industry, as poor performance will be bad for and create a negative perception with National Grid and end user customers who sign up.

Rather than the proposed new balancing services, we would propose that the current STOR programme be modified to address this near to mid-decade demand/ supply uncertainty. Both DR and the generation sectors are already positioned for delivery to STOR. Increasing the procurement of reserves for that programme together with increasing the flexibility under which those resources can be tendered and committed would appear to be a much better use of the time and resources of OFGEM, DECC, NGET and the industry, and would provide a much better outcome for the supply side of the market. Doing so would enrich the participation of DSR in STOR, which is sorely needed, as well as address the current near term risk of adequate reserves that is the motivation for this consultation.

<u>Responses to consultation questions:</u>

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

The UK DRA agrees that there is additional uncertainty and a mid-decade risk. We agree that additional steps are necessary to address that risk.

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?

The UK DRA does agree that it would be prudent to develop additional reserve resources, but it does not agree that short-lived programmes will accomplish this. We believe that together STOR and the pending capacity market – including specifically the start of the transitional capacity market in 2014 – are the appropriate market mechanisms to address this uncertainty. Imposing a short-term programme into the mix will add additional and unnecessary complexity and confusion to the markets, regardless the duration of those pilots, and will do nothing to enhance the participation of DR in either of those two enduring markets; i.e., STOR and the CM. <u>This is a fundamental weakness of the current proposed approach.</u>

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?

The UK DRA agrees with OFGEM's assessment of the three key factors defined in the consultation. In particular we agree that the second factor – the importance of minimising unintended consequences to market participants and operation of the market – is extremely important. As described above, we believe the rollout of the proposed programmes, unless significantly revised relative to current design, will have significant negative consequences on the DR industry in GB. The fact that the proposed DSBR is an exchange for part of the CM, as described in our comments above, suggests that the proposals already violate this principle by jeopardising the start of the transitional capacity market.

The UK DRA believes that any review of NGET's Balancing Services Procurement Guidelines should consider changes in a holistic scope, which would, among other things, assess whether changes to STOR might be a better market approach to address this near to mid-decade risk of supply.