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Creating the right environment for demand-side response

Dear Ben,

SmartestEnergy welcomes the opportunity to comment on Ofgem's consultation on creating the right environment for demand-side response.

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

The greatest barriers to a more effective demand side in our opinion are the lack of markets in general, and price signals in particular, that allow consumers to sell their potential dynamic response to distributors (in the way that it exists in the form of STOR) or more generally bilaterally or in the wholesale market. This is in part compounded by a lack of interaction between the distribution and transmission markets to ensure that parties are sufficiently compensated, either for the positive actions taken or as affected parties when system actions are taken.

There are two ways in which an effective demand side could be introduced over time: the first is for suppliers to take control of customers' demand. This works well in the STOR market at the moment and there are numerous examples of technologies and contract structures being effective in the demand side response (DSR) market, although at the lower end it will be difficult to communicate in an easy-to-understand manner exactly what interruptions were called and at what value. This is solvable with the correct infrastructure and companies such as GE have systems that can effectively do this.

The second, and ultimately, likely to be the most successful approach will be through incentivising customers to make their own decisions through tariffs with pricing signals. Customers may take control of their own decisions, aided with timing/smart meter devices. This will involve half-hourly settlement and increased complexity of tariffs, the acceptance of which would require something of a cultural shift. It is important to emphasise that incentives, and not penalties, are the best way forward.

Our vision is therefore one of "SmartGrids" which are supplier-centric. Distributors may have legitimate reasons to control demand. But this does not mean that a SmartGrid should be built around the distributor. Distributors should not be allowed to control customers demand without an industry-wide mechanism to compensate consumers for any inconvenience and suppliers for any imbalance their actions cause.

Another challenge for a demand side is that there is often no way of proving that load reductions were the result of positive actions (although large scale demand could form part of the capacity mechanism.) This is a perennial problem with demand side management (DSM) but not unsolvable. The critical point is that reduction volumes should be committed [facilitated by aggregators] in MW terms that are then demonstrated when called. A fairly sophisticated method of forecasting what the demand would have been will need to be developed but it is important that it is not possible to receive money for nothing.

The remainder of this document addresses the questions in the consultation document in the order in which they appear.

Question 1: Are there any additional key challenges associated with revealing the value of demand-side response across the system? If so, please identify and explain these challenges.

No. Ensuring that systems are cost-effective is an important element to SmartestEnergy. However, we see this as a commercial exercise to be performed by those wishing to offer services into the market. We see little value in an industry-wide exercise like the one proposed in the consultation document being undertaken because it will not translate into a commercial offering and will be biased by good intentions which may not translate into positive action.

Question 2: Can current regulatory and commercial arrangements provide the means to secure demand-side response being delivered? If not, what will regulatory and commercial arrangements need to deliver in future?

This is certainly an issue for the capacity mechanism. However, as stated in our introductory section to this response, the most successful arrangement for smaller customers will be one where the driver is the pricing signal and the benefit to the customer is efficient usage of electricity, not necessarily additional payments for reduction.

Question 3: Is current work on improving clarity around interactions between industry parties sufficient? If not, what further work is needed to provide this clarity?

It is clearly imperative to ensure that suppliers can make full use of smart meters along with other equipment such that they can hold tariff information against which the customer can make decisions. But, as stated in our introductory section, the area which needs most attention overall is that of how distributors interact with the market. They should be active participants taking system actions in such a way that customers can be properly rewarded/compensated for any imbalance the system actions cause.

Question 4: Are there any additional key challenges associated with effectively signalling the value of demand-side response to consumers? If so, please identify and explain these challenges.

No, not that we have already discussed elsewhere in this response.

Question 5: Do you agree that signals to customers need to improve in order for customers to realise the full value of demand-side response? Does improving these signals require incremental adaptation of current arrangements, or a new set of arrangements?

Yes. This would require a complementary set of arrangements although if at all possible they should not replace current arrangements.

Question 6: To what extent can current or new arrangements better accommodate cross-party impacts resulting from the use of demand-side response?

It is important to consider the possibility of 'double paying' for a single demand reduction action. i.e. distributor level and grid level reduction requirement should not pay for the same action.

We can envisage a distribution balancing mechanism in each area which would be added in to settlement along with NGET's. Participants would be able to bid into either balancing mechanism (but not both). Payments would be made in accordance with variance to contract position. Alternatively the current balancing mechanism would need to be made regional and open to smaller participants and distributors.

Question 7: Are there any additional key challenges associated with customer awareness and access to opportunities around demand-side response? If so please identify and explain these challenges.

The key challenge is to avoid the need for unnecessary market intervention. As far as customers are concerned, improved price signals through suppliers and an emerging market in demand control technology are the best way for demand side to develop under market conditions. Making assumptions about customer engagement could lead to over engineered central solutions which are not cost-effective and this needs to be carefully considered. It is not possible to force customers to engage and Ofgem should note DECC's experience with the Green Deal, for instance.

We agree that simplifying products (whilst maintaining the correct signals) for customers will be key to widespread engagement, but this should be left to the market. Those suppliers which succeed in this will be rewarded through greater penetration.

Question 8: Is any additional work needed to explore the role of third parties in helping customers to access and assess demand-side response offerings?

The government may wish to explore further the concept of incentivising/subsidising use of demand reduction technology. However, this should not form part of the market arrangements, merely a subsidy around them. We are intrigued by the recent government announcement that permanent demand side reduction would be included in the capacity market and that this would be piloted; such a market should be for variable demand response. Such a mechanism could work if the mechanism creates a pot of money which is then used as a subsidy. We are, however, slightly

uncomfortable with this merging of the market with subsidy within the capacity mechanism itself.

Question 9: Are there additional preconditions for delivering the right environment for demand-side response? If so, please explain what these are and why they are important, as well as attaching a priority relative to those challenges we have already identified.

It is important to think carefully about control of DSR and the balance between incentives and obligations i.e. what happens if DSR is not delivered to contract. It is important to ensure consumers are incentivised but not obliged to provide DSR.

Question 10: Do you agree with the priority and timing we have attached to addressing each of the key challenges identified above?

We generally agree with the timing and priorities given in the document but for the reasons stated in our answer to Q1 we do not think that "revealing the value in the system" should be high priority. What is a high priority (over and above our main themes of price signals and correct distributor involvement) is making things simple and allowing technology to develop.

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

Please note that our response is not confidential.

Yours sincerely,

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