



22<sup>th</sup> October 2013

**Response to Ofgem's Electricity Balancing Significant Code Review Consultation**

The UK Demand Response Association welcomes the opportunity to provide our views on the Electricity Balancing Significant Code Review Consultation. We are particularly keen to ensure that the interaction between the Capacity Market design and changes taking place under the Electricity Balancing Significant Code Review are well understood and appropriately considered in any final decision.

**Questions for this consultation**

**Question for the Draft Policy Decision:**

**Question 1:** Do you agree with our proposal to make cash-out prices more marginal?

**In principal the UKDRA agrees with the proposal to make cash-out prices more cost reflective of marginal actions taken by the SO to ensure system balancing.**

**Question 2:** Do you agree with our rationale for going to PAR1 rather than PAR50? Are you concerned with potential flagging errors, and would you welcome introduction of a process to address them ex-post?

**We agree that marginal prices are more cost reflective and therefore support moving to either PAR1 or PAR50. However, it is likely that PAR1 will, on occasion, create very high price spikes that add little in terms of balancing incentives over those which would be achieved by PAR50. Due to the risk of unintended consequences from sporadic extreme cashout prices (discussed below) we favour PAR50 on balance.**

**Flagging errors have the potential to create significant distortions, and a process for ex-post correction of these seems reasonable.**

**Question 3:** Do you agree with our proposals for pricing of voltage reduction and disconnections, including the staggered approach?

**Despite the depth of analysis undertaken on behalf of OFGEM, it remains the case that calculations of VoLL are always in some sense arbitrary.**

**The increases in cash-out prices that include VoLL is a step change from the current approach and the market is likely to benefit from a staggered approach. It is currently difficult for suppliers to achieve balance as they have limited insight into their customers' electricity utilisation and limited opportunities to control or influence utilisation.**

**Programmes that provide incentives for technology implementation would be most effective in driving the technology infrastructure implementation required to ensure balance. Demand Response Aggregators operating across I&C customers install appropriate monitoring and control equipment to deliver robust services. In order to drive the increase in demand flexibility required**



for cost-effective and robust system balancing, the right balance of value and risk is vital to ensure that this technology implementation can be funded.

Although tying cashout prices to VoLL would create value, we are concerned that this value comes with two elements of risk. First, cashout at VoLL will be sporadic, and so may not be as effective an investment signal as more frequent but lower-magnitude cashout spikes. Second, there are knock-on effects in other areas, in particular, DECC's Capacity Mechanism, as noted below.

**Question 4:** Do you agree with our assessment of the interactions with the CM and its impact on setting prices for Demand Control actions?

Cashout will necessarily drive the level of performance penalties in the CM, and penalties of the order of VoLL would be strongly dissuasive of participation by demand response in that. DECC has suggested that CM participants might face penalties up to a cap of 101% to 150% of their net annual capacity payments. However, this cap excludes consideration of cashout, which falls differently on demand response and large generation.

Cashout payments are determined by imbalance volumes, and imbalance volumes in relation to balancing services are determined by the Applicable Balancing Services Volume Data Methodology Statement. In paragraph 1.1, this states that "The inclusion of any individual Applicable Balancing Service within the Applicable Balancing Services Volume Data is at the discretion of the Lead Party of the relevant BM Unit (see part C, section 2) unless otherwise directed in the CUSC." Within the Connection and Use of System Code (CUSC), only the Maximum Generation Service and System to Generator Operational Intertripping require that the ABSVD be used in calculation of its imbalance volume. Therefore, STOR and similar services, which are likely to be highly popular means of discharging a capacity obligation, do not require the application of ABSVD.

This means that a generator which expects most or all of its volume to be generated through participation in a balancing service would elect not to apply the ABSVD. Most STOR capacity is provided by OCGTs, for which such balancing services are the principle or only source of revenue; there is no advantage to an OCGT to apply the ABSVD. The upshot is that not only would such a generator not face cashout penalties in the event of a failure in the CM, it would also gain cashout benefit in the event of successful delivery (not necessarily overdelivery).

Under DECC's proposed treatment of DSR, all DSR will see a disadvantage in comparison to all OCGTs of £6,000 per MWh in stress events. The impact of this on the relative bankability of the two technologies is obvious – DSR will be severely disadvantaged.

While the mechanical aspects of the CM which create the unevenness between OCGT and DSR are principally a matter for DECC, the material point in respect of the EBSCR is that occasional, extreme cashout prices may create a large disincentive for DSR to participate in the CM, which is likely to result in construction of more large generation than is necessary to attain the same reliability standard. We look to OFGEM to be mindful of the potential for such unintended consequences, and to both discuss these matters with DECC while proceeding cautiously with the EBSCR.

A related issue for the investment in new generation and DSR is how the £6,000 figure feeds into the Capacity Market calculation of net-CONE. The net-CONE calculation assumes a certain level of



revenue from the energy market, but since DSR does not yet participate directly in the energy market, it cannot receive these revenues – meaning that it will be disadvantaged in the CM.

We would also like to make the wider point that while sharpening cash-out signals is an important part of providing the right signals for investment in new generation, it will not be enough on its own. It will help to reduce the so-called “missing money” problem but it falls well short of eliminating it due to the inherent volatility of such prices, and so should not be seen as an alternative to the Capacity Market.

**Question 5:** Do you agree that payments of £5/hr of outage for the provision of involuntary DSR services to the SO should be made to non-half-hourly metered (NHH) consumers, and for £10/hr for NHH business consumers?

The UKDRA believes all demand-side actions should be appropriately rewarded. Formal programmes that deliver robust DSR from customers who want to provide flexible services are preferable to ex-post payments for involuntary DSR. The monies would be better used in formal programmes that seek to avoid the need for involuntary DSR. The UKDRA would be happy to work with Ofgem, National Grid and DECC in ensuring sufficient availability of voluntary DSR. Formal programmes that provide known revenue to participants will drive the investment of technology required to provide robust DSR services and lead to greater security of supply.

We are concerned about the level of compensation particularly for the NHH business customers, as the figures are likely to be a significant underestimate of the true cost of the outage on business customers.

**Question 6:** Do you agree with the introduction of the Reserve Scarcity Pricing function and its high-level design? Explain your answer.

We are supportive of the principle of the RSP. If cashout prices are to be set to an administrative level when involuntary load-shedding occurs, rather than a market price, it makes sense to have a function which gradually moves towards that level rather than a single step.

**Question 7:** Do you agree with our rationale for a move to a single price, and in particular that it could make the system more efficient and help reduce balancing costs? Please explain your answer.

A single cash-out price makes no distinction between a long or short position in the market and creates more certainty for imbalance-responsible parties. Anecdotal evidence suggests that currently smaller players ensure they are long to avoid the penalties of a dual cash-out system. More directly, the spread between the two cashout prices tends to create a cost for electricity users seeking to balance their own positions; a single cashout price would remove that cost. The addition of VoLL in the cash-out price will drive an incentive to be long regardless of single or dual pricing.

**Question 8:** Do you have any other comments on this consultation, including on the considerations where we did not propose any changes?

Currently settlement in the UK market takes an excessively long time period. This has the impact of lessening the effect of cash-out reform as imbalance parties do not feel the cash implications of



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**their imbalance actions for up to 14 months. In the Netherlands a weekly settlement, 10 days after the ending week, has been implemented, and this has had an impact on imbalance parties as the costs are seen within a trading month, driving greater attempts at remaining balanced.**

Should you require any further clarification on our response to this consultation, please do not hesitate to contact me.

Sara Bell

For the UK Demand Response Association