

Julian Roberts
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6 December 2013

Dear Julian,

**NATIONAL GRID'S PROPOSED NEW BALANCING SERVICES:
DRAFT IMPACT ASSESSMENT**

Thank you for the opportunity to comment on your draft Impact Assessment for the proposed Demand Side Balancing Reserve (DSBR) and Supplemental Balancing Reserve (SBR).

We remain of the view that steps need to be taken to address the security of supply risks in the middle of the decade. These risks were helpfully set out in Ofgem's Capacity Assessment report. On the basis that the question before the Authority is whether to allow National Grid to proceed with its proposals or not, we consider that it is appropriate to let them proceed – not because the proposals are necessarily the best way forward, but because they are better than doing nothing.

Throughout the New Balancing Services assessment process we have emphasised our view that there are better approaches to addressing these security of supply challenges. In particular, we believe that it would be preferable to bring forward the delivery date of the market-wide Capacity Mechanism, using administratively set prices if it is not possible to address concerns about auctioning. In the event that this is not possible and the SBR is introduced, it should only be for a clear, certain, and time-limited period, so as to minimise the risk of distortionary impacts on the market.

Under an SBR scheme, National Grid's main challenge will be determining the right amount of capacity to procure. For example, plant that is currently mothballed is likely to face competition from those CCGTs that remain unprofitable and face major overhaul decisions. If National Grid is not able to estimate the volume of plant required correctly, there could be detrimental effects both on security of supply and on costs for consumers.

In this context, we welcome the removal of the requirement for a declaration signed by the Board of Directors that their plant bidding for an SBR contract would not otherwise be available. This is helpful in terms of mitigating the possible detrimental impacts on security of supply should National Grid incorrectly estimate the volume of plant required.

However, we would question how appropriate it is to set a cap to procurement at 5% of average cold spell peak demand. We still consider that a better solution to mitigating over-contracting risks would have been to include a buy-out clause in the contract, whereby SBR plant could exit the contract for the year should they be used for more than a specified number of hours. This would provide a safety valve that would benefit consumers if the SBR plant had to be used extensively, whether as a result of over-contracting or other factors.

If these proposals are approved, National Grid will need to work with Ofgem's Electricity Balancing Significant Code Review (EBSCR) team and the industry to determine how best SBR should feed into imbalance prices ahead of any EBSCR changes being implemented. We are concerned that National Grid's proposal will introduce an element of risk and associated cost to the market that may not have been considered in forward trading, so it will be important to address these issues quickly.

We would, of course, be happy to discuss this further if that would be of assistance.

Yours sincerely,

A handwritten signature in blue ink that reads "Rupert Steele". The signature is written in a cursive style and is positioned above a thin horizontal line.

Rupert Steele
Director of Regulation