

Energy UK response to Ofgem consultation on funding arrangements for new balancing services: Initial Proposals

20 January 2014

Introduction

Energy UK is the trade association for the energy industry. Energy UK has over 80 companies as members¹ that together cover the broad range of energy providers and suppliers and include companies of all sizes working in all forms of gas and electricity supply and energy networks. Energy UK members generate more than 90% of UK electricity, provide light and heat to some 26 million homes.

Energy UK welcomes the opportunity to respond to this consultation, as we recognise the importance of ensuring that the new Supplemental Balancing Reserve and Demand Side Balancing Reserve products are efficiently procured and dispatched at minimum cost to consumers.

Executive Summary

Energy UK broadly agrees with Ofgem's proposed funding arrangements for the new SBR and DSBR balancing services in that internal costs associated with establishing these products should be covered within the RIIO-T1 price control and examined at the mid-period review as necessary.

In terms of external costs we agree that a financial incentives scheme is not appropriate as this scheme is introducing a new set of balancing services which are therefore being procured without the benefit of any historical performance against which to make an assessment of efficient delivery. Therefore, we are also supportive of the 'targeted efficiency check' approach proposed by Ofgem to ensure efficient procurement, minimise market distortion and value for money. However, Ofgem should ensure that it has the technical expertise to scrutinise National Grid's assessments.

An additional point for consideration raised by one of our members is concern that the uncertain and potentially significant BSUoS costs of procuring SBR and DSBR will have an impact on a hedged position, particularly in the short term.

Energy UK believes that there must be a robust methodology adopted for establishing the requirement for SBR and DSBR and that that it should be made publically available. Ofgem should also focus on ensuring National Grid sets an absolute cap on the MW volume of service that can be procured. This cap should be as low as possible to minimise the potential for market distortion and is particularly important given that National Grid has decided not to introduce any additionality measures in place for procurement of SBR. Evidence must be provided to Ofgem that any plant is truly additional. However, we note a member's concern that it will be difficult to set a cap due to prevailing market conditions and uncertainty over further mothball\closures. Therefore, in their view a cap on procurement may have unintended consequences.

¹ NOTE: National Grid is a member of Energy UK but has not provided input to this consultation response.

Finally, we believe it is important that a comprehensive review of SBR and DSBR is undertaken in 2016 encompassing total costs incurred, impact on the market, benefits delivered in relation to security of supply and value for money. Energy UK does not believe that SBR will be required beyond winter 2017/18 as the Capacity Market, being developed as part of the electricity market reform measures, will be the main driver for valuing capacity and thereby security of supply.

Consultation questions

Chapter One

Question 1: Do the draft licence conditions published alongside this document appropriately reflect our initial proposals?

The license conditions appear to reflect initial proposals.

Question 2: Do you agree with our assessment that a financial incentive would not be fit-for-purpose at this time?

We agree that a financial incentive would not be appropriate at this time for these new products given the lack of historical performance to compare against, although we note an argument made by one member that there are interactions with other activities which National Grid undertake for which they have financial incentives. It may be appropriate to build in an incentive if SBR and DSBR is procured beyond the next two winters, although Energy UK members do not envisage that SBR will be required beyond winter 2017/18, as the Capacity Market should be delivering capacity by that point.

Chapter Two

Question 1: Do you agree with our approach towards funding for the internal costs associated with the services?

Energy UK members agree that funding for the internal costs associated with these services should form part of the System Operator's spending within RII0-T1 but that the situation should be reviewed as part of the mid-period review.

Question 2: Do you agree with our view that the targeted efficiency check protects consumers and increases transparency to industry?

We support the use of a targeted efficiency check so that the procurement, despatch and cost of the new products can be carefully scrutinised and are transparent to all parties. However, Ofgem should ensure that it has the technical expertise to scrutinise National Grid's assessments.

Question 3: Do you agree with how we have proposed to fund each of the cost components of SBR and DSBR?

We agree with the proposed funding arrangements.

Question 4: Do you have any views on NGET's proposed approach towards identifying a volume cap and volume requirement?

Energy UK members believe that a robust methodology for identifying a requirement and volume cap for both SBR and DSBR is vital to ensure that procurement is transparent, efficient and value for money.

We believe that an absolute volume cap in GW should also be set out so the market is clearer about how much will be procured and thereby helping to mitigate unintended consequences. This cap should be as low as possible to minimise the potential for market distortion and is particularly important given that National Grid has decided not to put any additional measures in place for procurement of SBR.

However, we note a member's concern that it will be difficult to set a cap due to prevailing market conditions and uncertainty over further mothball\closures. Therefore, in their view a cap on procurement may have unintended consequences.

Question 5: Do you agree with the principles behind each of the ex ante methodologies and any proposed details that we or NGET have suggested should be included within the methodologies?

We agree with the principles and ex ante methodologies proposed.

Question 6: Are there any other principles or details that should be included within our targeted efficiency check approach?

No further comments.

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