



16<sup>th</sup> January 2014

Leonardo Costa

System Operation

Wholesale Market Performance

Ofgem

9 Millbank

London

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Dear Leonardo,

The UK Demand Response Association has reviewed Ofgem's Initial proposals for funding arrangements for new balancing services and we would like to submit the following responses to the questions in the consultation for your consideration:

CHAPTER: One

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

Yes, we believe the licence conditions appropriately reflect the 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 targeted efficiency check is an appropriate approach to assessing these services however we believe that to ensure cost efficiency for customers a more involved assessment is required, described below in Chapter Two, Question 2. We also agree that the success of these programmes is difficult to determine prior to their launch. We have previously expressed concern about the design of the programmes and these design features are likely to impact on the success of the programmes.

Chapter Two

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

We believe the focus for these costs should remain on efficiency for customers and NGET should be encouraged to utilise as many existing processes and systems as possible in order to keep these internal costs down.



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

Provided the targeted efficiency check genuinely ensures that the most economically efficient services are procured, this is the right approach. However we believe that the design of DSBR will not lead to the most economically efficient approach and therefore the targeted efficiency check for DSBR needs to include design features in order to be effective. We believe the following design elements need to be amended to achieve the appropriate design to protect customers and ensure NGET procures these balancing services in the most economically efficient manner:

- We do not believe that this product strikes the appropriate balance between set-up payment and utilisation fee required to encourage the greatest participation from the demand side.<sup>1</sup> Given the expected short duration of DSBR as a product, we do not believe that the £10/kW annual set-up fee is sufficiently high to encourage new market participants. Our experience suggests that an annual set-up fee in the region of £20-£25/kW would be effective. Indeed, a payment of £20 - £25/kW in lieu of high utilisation rates, coupled with a commitment to run for up to a maximum number of hours (e.g., up to 4 hours) would be a much more suitable proposition than as the product design currently stands. These “maximum run hours” could be pre-agreed, so as to facilitate the 250 MW tranches that National Grid intends to use. Although National Grid has stated that it is possible that DSBR could endure beyond 2015/16, and although utilisation payments are part of DSBR, neither of those is a bankable commitment, and so neither will support investment. A higher set-up fee offset by the re-introduction of a lower band of utilisation payment would be a welcome improvement.
- The proposed payment scheme does not provide participants with sufficient information on which to submit tenders. The utilisation payment tranches are priced at levels outside the experience of all current demand response providers. We recommend that National Grid issue an estimation of the amount of utilisation (including the number of separate events and duration for same) which may be expected at each price point, and that National Grid provide an explanation of how tenders that include both a setup fee and a utilisation price point will be evaluated. This is particularly important if National Grid intends to assess the value of tenders as compared to VoLL with the assumption that DSBR will only be utilised between one and three hours per season. In this range, it appears there are few tranches available to providers that would be less than VoLL when including the setup fee in their tenders. We recognise that assumptions on volumes of DSBR and other services will be required to make such predictions, and such assumptions must be stated alongside suitable caveats. We consider that this information is a vital part of ensuring that participants have realistic expectations of utilisation revenues when considering whether or not to tender a set-up fee.
- The requirement that 12 months of half-hourly data be available excludes new-build sites (for example, no supermarkets built during 2013 may participate in 2014), any

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<sup>1</sup> Effective Use of Demand Side Resources: The Continued Need for Availability Payments, Nera, Oct 2013 [www.nera.com](http://www.nera.com) This paper describes that availability payments, and not utilisation payments, are required to incent DSR (DR) to participate in markets. It is fundamental, stemming from behavioral science, and evidenced by looking at program and market results in the US over the past 10 years



standby generation which may exceed the load of the site (as the export meter may show little or no data for a generator which has not run in demand response mode before), and any site which has invested in new process equipment (whose consumption would not be shown in historical data). Our alternative baseline method, proposed below, would reduce this requirement to less than one month, which would thereby include most or all of these categories.

- We do not support the baseline method proposed, as it excludes new sites, sites which have invested in new processes, and potentially some generation. It will also tend to exclude sites which have previously offered flexible STOR, as STOR calls tend to fall on high demand periods, giving a zero baseline. Furthermore, National Grid has cited no precedent in selecting this baseline method. On the other hand, the “X of Y” with a day-of adjustment methodology employed in Low Carbon London and various US demand response markets, and selected for DECC’s Capacity Mechanism, has a long history and substantial historical analysis to support its validity and guide its application. In this instance, the previous Y similar days (for example, weekdays excluding public holidays) are examined to determine the site’s consumption on those days, and the highest X of those days are averaged to create the unadjusted baseline, on a settlement-period basis, and further adjusted to reflect what is happening at the facility in real time. Various enhancements are possible; Low Carbon London, for example, uses a “5 of 10” method with “asymmetric day-of adjustment”, which is well documented. We argue strongly for the implementation of such a method in DSBR. In this case, we would suggest that the method consider export to be the equivalent of negative import, thus allowing generation to participate. We would also argue for the exclusion from the baseline of days in which either DSBR or flexible STOR had been called, because flexible STOR is to be permitted to co-exist alongside DSBR.
- The arrangements exclude sites practicing triad management from DSBR. While we understand National Grid’s stated philosophy on this point in preferring “new resources” for DSBR, we are genuinely stunned by National Grid’s expectation that any new resource would prefer DSBR over triad management. The universal experience of the demand response industry has been that new resources emerge because of the total value of the basket of opportunities open to them. Exclusive arrangements simply lower the value driver, causing some resources to withdraw and causing others to choose the best value option at any time. Universally during winter evening weekdays (the key periods for DSBR), this option is triad management. Any resource which is not presently being developed in pursuit of triad benefit has virtually no chance of being developed for DSBR. Absent a payment structure that incentivises providers to choose DSBR over Triad, there will simply be no addressable load for the DSBR program, whether by individual end-use customers or by aggregators. We therefore urge National Grid to select methods which enable triad management and DSBR to co-exist, so that the combined basket of benefits is sufficient to attract genuinely new resources. The baseline method which we have proposed above would achieve this.
- The current design of DSBR vs. SBR seems to heavily favour SBR, since SBR resources are able to tender in their own availability and utilisation prices, while DSBR is restricted to pre-decided prescribed levels of utilisation payment, and a static set-up payment. There is no justification for this wide gap in approach that we can see. Demand Side Response (non-BM participants) can indeed tender their required availability and utilisation price



for a sizable portfolio (i.e. 50 MW), have a single point of dispatch and a single set of parameters. Aggregators are already in a position to this, and already have portfolios of such customers available.

- NGET appears to be unclear about the timing of the tenders for DSBR and SBR and has expressed uncertainty about whether to run tenders concurrently or tender for SBR first and then tender for DSBR or vice versa. We believe the most economically efficient approach is to tender for both services concurrently to ensure price transparency and the most economically efficient service is selected.

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

Yes, in our experience successful schemes are those that place the largest rewards on availability, not utilisation and in funding the costs of procurement by a targeted efficiency check Ofgem has clearly recognised this.

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

It is not possible for us to provide pertinent comments on the volumes details without the detail behind the methodology.

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 on the principals but it is not possible for us to provide pertinent comments on the methodologies until NGET provides the detail behind the methodology. We understand NGET will be holding a workshop to explain these methodologies to industry stakeholders.

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

Please see our answer to Chapter Two, Question 2 above.

Should you have any questions about our responses to this consultation, please do not hesitate to contact me.

Yours faithfully

Sara Bell

Principal

UK Demand Response Association