

System operators, transmission system owners, generators, suppliers, traders, consumers, aggregators and other interested parties

Direct Dial: 020 7901 7000
Email: soincentive@ofgem.gov.uk

Date: 10 June 2014

Dear Colleagues

Decision to approve National Grid Electricity Transmission plc's volume and procurement methodologies for the new electricity balancing services

Background

In November 2013, National Grid Electricity Transmission plc (NGET) applied to us to introduce two new balancing services: the Supplemental Balancing Reserve (SBR) and Demand Side Balancing Reserve (DSBR).¹ These services provide NGET with additional tools to help balance the system in anticipation of tighter generation capacity in the next few winters and ahead of the first delivery year of the Capacity Market. In December 2013, the Authority approved the option for NGET to use these new services, if required.

Subsequently, we issued a direction to modify NGET's transmission licence to incorporate funding arrangements relating to these services.² These licence conditions came into effect on 6 June 2014.

Pursuant to these funding arrangements, NGET must submit detailed methodologies to us for approval. These methodologies cover how NGET will determine the volume of services required and how it intends to procure and use these services. We believe these methodologies will provide a clear and transparent process for economic and efficient cost recovery: NGET can only recover costs that are consistent with these methodologies.

NGET has submitted volume and procurement methodologies to the Authority in accordance with its licence conditions. These methodologies are available on NGET's website.³ NGET has not yet submitted the operational methodology following our direction on 6 June 2014 extending the deadline for submission to 6 August 2014.⁴

Our position

We have decided to approve the volume and procurement methodologies, having assessed them against the following criteria:

- a) NGET's procurement must be economic and efficient and the products must represent value for money to electricity consumers.
- b) NGET's product design and proposed use of the new products must minimise unintended consequences to market participants and the operation of the market.

¹DSBR is a demand-side service that offers payments to half-hourly metered non-domestic consumers if they reduce their demand between 4pm and 8pm on winter weekdays. SBR is a supply-based balancing service that is available between 6am and 8pm on winter weekdays. Further information can be found [here](#)

² The direction to modify NGET's licence can be found [here](#)

³ The volume and procurement methodologies can be found [here](#)

⁴ The direction to change the submission date for the operational methodology can be found [here](#)

c) NGET's procurement process must be objective and transparent.

Volume methodology

The volume methodology describes how NGET will calculate any requirement for DSBR or SBR. The methodology selects the most cost-effective and optimal volume to procure to meet the Government's reliability standard. It is based on NGET's Future Energy Scenarios with sensitivities to capture short-term effects of demand and supply changes. It also defines a volume cap, which is the maximum aggregate volume of these services NGET could procure, and is a proportion of peak demand during an average cold spell.

We are satisfied that this methodology meets the criteria set out above.

Procurement methodologies

The procurement methodologies describe how NGET will determine that any procurement of either DSBR or SBR is economic and efficient and provide value to consumers. NGET's procurement methodologies propose that both SBR and DSBR are procured in economic merit order (cheapest providers procured first) through an open tender. They also set the cost threshold beyond which procurement is not deemed economic or efficient.

We consider that provided these are implemented correctly, the procurement methodologies presented by NGET meet our three main criteria noted above.

NGET anticipates only a very limited volume requirement for 2014/15. As a result, we note that for 2014/15, NGET proposes a specific arrangement, where it intends to meet this limited requirement by conducting a DSBR pilot ahead of procuring both SBR and DSBR competitively for winter 2015/16.

It wants to be sure that any DSBR it procures for 2015/16 is as firm as possible and gain experience using new DSBR systems and processes. This will give it the opportunity to evolve the product if necessary. This should benefit consumers as it increases the chances of a credible and cost effective mix of SBR and DSBR in 2015/16.

We are satisfied that, provided this pilot is run in a manner consistent with the DSBR procurement methodology, it will deliver a net benefit to consumers.

Next steps

Following this decision, the licence conditions allow reviews of the methodologies in two instances: through an annual review process or if there is an exceptional change in circumstances. The scope of these reviews does not include the volume cap.

NGET must also submit to us the operational methodologies which describe how NGET intends to test and use these services by 6 August 2014. We expect to reach a decision on these methodologies ahead of this winter.

If NGET incurs any cost in the procurement or use of these services it will have to submit notices and reports to us to demonstrate compliance with the methodologies. We may then either allow NGET to recover economic and efficient costs or disallow any costs which have not been incurred in such a manner.

Yours sincerely,

Rachel Fletcher
Senior Partner, Markets