

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: 28/04/2015

Dear Colleagues,

Decision not to direct an adjustment to any of the costs recovered by National Grid Electricity Transmission plc associated with the procurement and testing of the Supplemental Balancing Reserve and Demand Side Balancing Reserve for winter 2014-15

The Gas and Electricity Markets Authority (the Authority) has considered the notice received from National Grid Electricity Transmission Plc (NGET) on 31 March 2015 and has decided not to direct any adjustment to the recovery of the sum of £31,288,683 associated with the procurement and testing of Supplemental Balancing Reserve (SBR) and Demand Side Balancing Reserve (DSBR) for 2014-15.

Background

In December 2013, the Authority approved NGET's application to introduce two new balancing services, the Supplemental Balancing Reserve (SBR) and Demand Side Balancing Reserve (DSBR).¹

Subsequently, we issued a direction to modify NGET's transmission licence to include arrangements for NGET to be able to recover the economic and efficient costs relating to the procurement and use of SBR and DSBR. The relevant licence condition (Special Condition 4K) came into effect on 6 June 2014.

Under Special Condition 4K NGET is required to have in place certain approved methodologies which provide detail on how it will procure and use SBR and DSBR in an economic and efficient way.²

If NGET wishes to recover costs relating to the procurement and use of SBR or DSBR, it is required to submit notices to Ofgem demonstrating how those payments were incurred in accordance with the approved methodologies. We then assess its compliance with the methodologies and depending on the outcome of that review, direct NGET to recover these costs or to adjust the costs it has already recovered, as appropriate.

¹ SBR and DSBR provide NGET with additional tools to help balance the system in the rare event that there is insufficient capacity in the market to meet demand.

² The approved methodologies can be found in National Grid's website at <http://www2.nationalgrid.com/UK/Services/Balancing-services/System-security/Contingency-balancing-reserve/Methodologies/>

NGET report submission for costs incurred during winter 2014-15

On 31 March NGET provided a notice to the Authority pursuant to Special Condition 4K.27.

This notice set out and provided particulars of the amount of the relevant payments incurred by NGET in association with the procurement and testing of DSBR and SBR.³ Table 1 below shows the breakdown of these costs for 2014-15:

Table 1: SBR and DSBR costs per category

Costs	Cost Incurred (£)
DSBR Administration Payments	99,000
DSBR Set-up Payments	802,381
DSBR Testing Payments	795,625
<i>Total DSBR Costs</i>	<i>1,697,006</i>
SBR Capability Payments	23,505,210
SBR Testing Payments	6,086,467
<i>Total SBR Costs</i>	<i>29,591,677</i>
Total DSBR and SBR Costs	31,288,683

The notice also included a description of how the costs were calculated and how, in its view, they were in accordance with the relevant approved methodologies.

The procurement and testing of SBR and DSBR for winter 2014-15 cost approximately £31m, less than half of the £75m annual cost that we estimated in our impact assessment. However, the cost estimate assumed a higher volume requirement of both SBR and DSBR, more in line with the procurement expected for winter 2015-16. Hence, we expect total cost for these services to increase in 2015-16, but to continue to have an impact of less than £1 in the average consumer bill.

Our Determination

We have assessed NGET's submission using two main tests for determining whether the payments were incurred in accordance with the relevant approved methodologies:

- Assessment of the process used by NGET to procure and test these services
- Calculation of the costs incurred against the approved methodologies

Assessment of the process used by NGET to procure and test these services

We have sought to establish whether the processes NGET used to contract and test these services were in accordance with the approved methodologies. Based on our analysis, we are confident that NGET calculated the volume requirement for both tenders in accordance with the volume requirement methodology, by appropriately applying the sensitivities and running the Least Worst Regret (LWR) calculation. We are also confident that NGET ran competitive tenders for both services and has contracted service providers in accordance with the economic merit order as defined in the procurement methodology. On testing, we have confirmed that the tests of DSBR and SBR service providers were conducted in accordance with the criteria set out in the operational methodology.

Calculation of the costs incurred against the approved methodologies

We have recalculated the costs submitted by NGET using the formulas in the approved methodologies. We are content that the DSBR Set-up Payments, DSBR Administration Payments and SBR Capability Payments submitted by NGET are in accordance to the

³ NGET did not submit a notice according to Special Condition 4K.20 as there were no costs incurred on utilisation or warming of service providers.

procurement methodology. We are also content that the DSBR testing budget was appropriately calculated and that the DSBR Testing Payments and SBR Testing Payments submitted by NGET are in accordance with the operational methodology.

Hence, the Authority is satisfied, having reviewed the information submitted in accordance with Special Condition 4K.28 that NGET has demonstrated that the costs were incurred in accordance with the relevant methodologies and were therefore incurred in an economic and efficient manner. Accordingly the Authority has written to NGET to state that it will not be directing any adjustment to the recovery of the sum of £31,288,683.

Yours sincerely,

Philippa Pickford
Associate Partner, Wholesale Markets Performance