

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

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Dear Colleagues

Decision to approve the sensitivities proposed by NGET in accordance with the volume requirement methodology for tender round two of SBR and DSBR

This letter sets out the Authority's decision to approve the sensitivities listed below for the tender round closed on 7 May 2015 (tender round two) of the Supplemental Balancing Reserve (SBR) and Demand Side Balancing Reserve (DSBR).¹

Background

In December 2013, the Authority approved National Grid Electricity Transmission plc's (NGET) application to introduce two new balancing services, the Supplemental Balancing Reserve (SBR) and Demand Side Balancing Reserve (DSBR). These services 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 in the mid-decade period.

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 (SpC) 4K) came into effect on 6 June 2014.

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

If NGET wishes to recover costs relating to the procurement and use of SBR or DSBR, it has to demonstrate how those payments were incurred in accordance with the approved methodologies. Ofgem is then able to assess NGET's 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.

To allow NGET to apply lessons learned from using these services, the licence includes a mechanism (SpC 4K.12) that allowed it to submit revised methodologies to Ofgem for approval by 31 March 2015.

On 31 March 2015, NGET submitted revised volume requirement, procurement and operational methodologies for the Authority's approval.²

On 1 May 2015, the Authority approved all of the revised methodologies submitted by NGET.

¹ Information on the current tender can be found at <http://www2.nationalgrid.com/UK/Services/Balancing-services/System-security/Contingency-Balancing-Reserve/>

² The approved methodologies for SBR and DSBR can be found at <http://www2.nationalgrid.com/UK/Services/Balancing-services/System-security/Contingency-balancing-reserve/Methodologies/>

Authority's role in assessing sensitivities

NGET's volume requirement methodology describes how NGET determines the economic and efficient volume of SBR and DSBR to procure for a particular winter. Even over this relatively short time horizon (between procurement and service delivery) there is significant uncertainty over the electricity market outlook. NGET assesses this uncertainty by using a range of sensitivities around key scenarios. A 'least worst regret' approach is then applied to the sensitivities: it identifies areas where a relatively small increase in cost could eliminate significant risk, whilst attempting to avoid incurring significant costs while leaving overall risk to the system largely unchanged.

As the volume that can be procured through SBR and DSBR is capped (the Volume Cap), the previous version of the volume requirement methodology that was in force for the purposes of winter 14/15, automatically disregarded sensitivities that showed a requirement above the Volume Cap from being considered in the 'least worst regret' analysis. NGET was concerned that this could result in credible sensitivities not being considered. It therefore proposed as part of the package of revisions submitted to the Authority on 31 March 2015 that the automatic exclusion of sensitivities above the Volume Cap should be removed. NGET proposed that it would instead assess whether each proposed sensitivity could be considered a credible outcome within a reasonable range of uncertainty.³ NGET would then provide the sensitivities they deemed appropriate and their justifications for doing so to the Authority for approval. To be clear: the Volume Cap itself would still remain in place.

We agreed that NGET's proposal to analyse sensitivities on a case-by-case basis was an improvement over the previous methodology. We expressed our belief that this improves the quality of decisions as sensitivities are included or excluded based on their own merit rather than mechanically.

We also agreed that it was appropriate to introduce a requirement for Authority approval of NGET's submission of credible sensitivities. However, we noted, that the onus would be on NGET to demonstrate that the sensitivities it proposes to include are economic and efficient and meet the sensitivity criteria as defined in the methodology.

We therefore approved the proposed change on 1 May 2015.

Our decision

On 8 April 2015 NGET submitted to the Authority the range of sensitivities⁴ it proposed to include in its modelling for 2015-16. These sensitivities, listed below, would be applied to the Slow Progression FES scenario as per the volume requirement methodology:

- Cold winter
- Warm winter
- Low Wind
- More mothballed generators
- Less mothballed generators
- High plant availability
- Low demand
- Interconnector (IC) flows of 250MW – 3 GW imports from the Continent⁵
- Low Plant availability
- High demand

³ NGET defines in the volume requirement methodology that the sensitivities cover "a credible and reasonable range of uncertainties for elements that may vary independently of the demand and generation mix without affecting the internal consistency of the scenario."

⁴ The full range of sensitivities that NGET can include in the volume requirement calculation is defined in the volume requirement methodology. To note, NGET did not submit any sensitivities which assumed an export from GB to the continent or no imports from the continent at times of tightness in the market.

⁵ NGET assumes that GB exports to Ireland in all their scenarios and sensitivities; exports to Ireland amount to 0.75 GW.

As described in our decision letter on the revision of the methodologies⁶, we have assessed the evidence submitted by NGET against the definition of sensitivity defined in the volume requirement methodology.

We have decided to approve the following sensitivities:

- Cold winter
- Warm winter
- Low Wind
- More mothballed plant
- Less mothballed plant
- High plant availability
- Low demand
- IC sensitivities btw 0.5 – 3 GW imports from the Continent

The evidence provided by NGET demonstrated that these sensitivities were both credible and reflected a reasonable range of uncertainty that would not necessarily lead to a market reaction.

For example, NGET's evidence demonstrated that there is a natural uncertainty on the weather and it is credible and reasonable to assume that a cold winter, similar to those observed in the past seven years could occur again and that the market may be unable to react to this by returning plants to the market. Also, we agree that it is credible and reasonable to consider the possibility that a generator may return from mothballing following the previous closure announcements.

Following our initial assessment, we considered that there was insufficient evidence to support approval of the low plant availability and high demand sensitivities. Working with NGET, we were able to establish that the inclusion or exclusion of these sensitivities had no bearing on the outcome of the "least worst regret" analysis. As a consequence, NGET agreed with us that these sensitivities could effectively be ignored in the volume calculation for this procurement round.

In relation to the IC sensitivities, after exchanging extra analysis with NGET, including information on IC flows during relatively tight periods in recent years, both parties agreed that sensitivities between 0.5 and 3GW imports from the Continent (and assuming a 0.75GW export to Ireland) represented a credible range for inclusion in the least worst regret analysis.

Next steps

We have written to NGET to confirm the Authority's decision to approve the sensitivities listed above.

If you have any questions regarding the content of this letter, please contact Leonardo Costa on 0203 263 2764 or by email Leonardo.Costa@ofgem.gov.uk.

Yours faithfully

Emma Kelso
Partner, Markets

⁶ Our decision to approve the revised methodologies can be found at <https://www.ofgem.gov.uk/publications-and-updates/decision-approve-revised-sbr-and-dsbr-volume-requirement-procurement-and-operational-methodologies>