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

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Dear Colleagues

Our view on Supplemental Balancing Reserve and Demand Side Balancing Reserve for 2017/18 given government's proposal to run a Capacity Auction for delivery in the same year

This letter sets out our view on the future of Supplemental Balancing Reserve[1] (SBR) and Demand Side Balancing Reserve[2] (DSBR) given the government's proposal to bring forward the Capacity Market (CM) by a year.

Our position on the government's consultation

Government has decided to consult on bringing forward the CM by one year, subject to stakeholder views and State Aid clearance.

As such, we believe that it is beneficial for the Authority to note its view on the future of SBR and DSBR in order to provide market participants with the most up to date information with which to respond to Government's consultation.

In its September 2015 application to extend the cost recovery arrangements for SBR and DSBR to cover 2016/17 and 2017/18, National Grid Electricity Transmission plc (NGET) noted that "the successful introduction of [changes to the cash out regime and the Capacity Market] should negate the need for the continuation of the Contingency Balancing Reserve products"[3]. As indicated in our subsequent consultation document[4] following NGET's request, we would expect the balancing need for SBR and DSBR to disappear with the introduction of the CM.

We would expect a 2017/18 CM auction to procure enough capacity to meet the government's reliability standard. Therefore, SBR and DSBR services would not be needed for that year. This is because the CM procurement is designed to ensure the government's reliability standard is met and as such provide sufficient market capacity to allow NGET to balance the system through the Balancing Mechanism (BM) and its other ancillary services.

[1] Supplemental Balancing Reserve (SBR) is a generation service where a generator is kept on standby, outside the market, should NGET require additional resources to balance the system.
[2] Demand Side Balancing Reserve (DSBR) is a demand side response service aimed predominantly at large scale customers and aggregators prepared to shift or shed demand when instructed by NGET.
[3] NGET's statement can be found here http://www2.nationalgrid.com/WorkArea/DownloadAsset.aspx?id=43346
[4] Our consultation document can be found on https://www.ofgem.gov.uk/publications-and-updates/minded-decision-extend-sbr-and-dsbr-cost-recovery-arrangements-201617-and-201718

Next steps

We would therefore expect to amend the direction issued on 23 November 2015 ahead of winter 2017/18 so as to ensure that the cost recovery arrangements no longer apply for that winter (the first CM year). We would also intend to bring forward our plan to work with NGET to ensure the appropriate changes are made to its licence to remove the provision for SBR and DSBR.

Background

In December 2013, the Authority approved NGET's application to introduce two new balancing services, SBR and DSBR. These services provide NGET with additional tools to help balance the system in the event that the market is unable to provide sufficient reserves to do so. Both SBR and DSBR can only be used by NGET when it has taken or expects to take all available balancing actions (including all Balancing Mechanism, BM, offers) and for this to be insufficient to balance the system. As such, these services sit outside of normal market operation. NGET must take into account the market response to price signals and market notification in the face of tight margins, and the volume of all other pre-contracted balancing actions before it can use SBR and DSBR.

Subsequently, we modified 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.[5] The relevant licence condition (Special Condition (SpC) 4K) came into effect on 6 June 2014.

These cost recovery arrangements were set for 2014/15 and 2015/16 aligned with NGET's intention to review the need for access to these services beyond winter 2015/16, if needed.[6] At the time, we introduced the flexibility to extend these arrangements if NGET concluded that it needed to retain the ability to procure these services for 2016/17 and 2017/18.

We agreed with NGET that the outlook was uncertain and that it was prudent to extend the cost recovery arrangements so as to allow NGET to recover the economic and efficient costs incurred on these services. Similarly to NGET, the Authority in its consultation noted that it did not intend to extend the cost recovery arrangements beyond 2017/18 given its expectation that the introduction of the CM would make the balancing need for these services disappear.

If you have any questions about this letter, please contact Leonardo Costa on soincentive@ofgem.gov.uk or 0203 263 2764.

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Philippa Pickford
Associate Partner, Wholesale Markets
For and on behalf of the Gas and Electricity Markets Authority

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[5] Our decision can be found at https://www.ofgem.gov.uk/publications-and-updates/decision-funding-arrangements-new-balancing-services

[6] NGET indicated its intention to review the services in its reports to the Authority available at http://www2.nationalgrid.com/UK/Services/Balancing-services/System-security/Contingency-balancing-reserve/Archive/