

System operators, Transmission
System Owners, Generators,
Suppliers, Traders, Consumers,
Aggregators and other interested
parties

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Date: 8 July 2016

Dear Colleagues

Decision on the costs incurred by National Grid Electricity Transmission plc associated with the procurement, testing and utilisation of the Supplemental Balancing Reserve and Demand Side Balancing Reserve for winter 2015/16

The Gas and Electricity Markets Authority (the Authority) has considered the notice received from National Grid Electricity Transmission Plc (NGET) on 31 March 2016. Following our assessment, we have decided not to direct any adjustments to the costs incurred by NGET set out in Table 1. We outline the details of NGET's application and our conclusions further below.

Background

In December 2013, the Authority approved NGET's application to introduce two new balancing services, SBR and 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 costs 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.

NGET submission for costs incurred during winter 2015/16

On 31 March 2016 NGET provided a notice to the Authority pursuant to Special Condition 4K Part H. This notice set out the amount of the relevant payments incurred by NGET in

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-balancingreserve/Methodologies/>

association with the procurement and testing of DSBR and SBR as well as utilisation of DSBR in 2015/16. Table 1 below shows the breakdown of these costs:

Table 1: SBR and DSBR costs per category

SBR capability payments	£26,482,178.18
SBR testing costs	£2,318,623.87
SBR total cost	£28,800,802.05
DSBR set up fees	£1,664,302.77
DSBR admin fees	£183,000.00
DSBR testing costs	£443,843.66
DSBR utilisation costs	£17,494.16
DSBR total cost	£2,308,640.59
Total NBS cost	£31,109,442.64

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, testing and utilisation cost of SBR and DSBR for winter 2015/16 was just over £31.1m. This is approximately £0.2m less than the cost incurred by NGET for these services in 2014/15. On a £/kW basis the cost of providing these services was £28.4/kW in 2014/15 and £12.8/kW in 2015/16.

Our Determination

In accordance with the methodology, and similar to last year’s decision,³ 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, test and utilise 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 assessed NGET’s procurement process for SBR and DSBR to determine whether the costs incurred on **SBR capability payments**, and **DSBR Set Up** and **DSBR Administration Payments** complied with the approved methodologies.

Our analysis has confirmed that the process NGET followed has resulted in their procuring overall volumes and individual units of DSBR and SBR consistent with the volumes and individual units determined by the methodology. We therefore find that no adjustment is needed to the amounts NGET proposes to pass through to customers. We note that NGET adopted a process which differs in some respects from the published methodology. NGET ran the procurement for SBR until it reached what it viewed as the marginal unit. It then fixed this price and procured all DSBR units as long as the unit price did not exceed that marginal SBR unit.

We have therefore sought further clarification from NGET as to how the methodology will be applied when assessing future DSBR tenders.

Calculation of the costs to test these services against the approved methodologies

We have re-calculated the costs incurred by NGET against all the relevant methodologies for SBR and DSBR testing. We are satisfied that NGET calculated the costs in accordance with the approved methodologies. As such, we are not disallowing any of these costs.

³ <https://www.ofgem.gov.uk/publications-and-updates/decision-supplemental-balancing-reserve-and-demand-side-balancing-reserve-costs-winter-2014-15>

Assessment of the process and costs used by NGET to utilise DSBR

On 4 November 2015, NGET utilised DSBR for the first time. NGET issued an instruction for 43MW of DSBR to provide the service, with 21MW being delivered at a cost of £17,494.16.

We have assessed NGET's dispatch decision against the DSBR operational methodology. We are satisfied that NGET dispatched DSBR in accordance with the operational methodology. However, we note that NGET dispatched DSBR 15 minutes after the two-hour notice required for DSBR units. This resulted in units being paid the full utilisation rate rather than the stepped payment. Had the stepped payment been applied, NGET would have incurred approximately £10,500 fewer costs.

NGET explained that it waited until the last minute to dispatch DSBR to give the market more time to respond to the shortfall and, as a result of the novelty of the dispatch mechanism (which had not been used before), there was a 15-minute delay. We accept that the novelty of the dispatch mechanism means that NGET could not meet its intention to instruct DSBR with the appropriate notice. While this is reasonable in this instance, it may not be acceptable if it were to occur again, given that NGET has now operational experience in dispatching this service.

Our Conclusions

Attached to this letter is the direction we issued to NGET on 8 July 2016 directing the adjustment to the cost recovery under paragraph 4K.28 and the direction allowing the cost recovery for the DSBR utilisation under paragraph 4K.20.

Yours sincerely,

Emma Kelso
Partner, Wholesale Markets

Annex 1- Direction to NGET in regards to the costs incurred on SBR and DSBR for 2015/16

Directions issued to National Grid Electricity Transmission plc (NGET) by the Gas and Electricity Markets Authority (the Authority) pursuant to paragraphs 4K.24, 4K.33 and 4K.34 of Special Condition 4K of NGET's Electricity Transmission Licence

1. The objective of Special Condition 4K of NGET's Electricity Transmission Licence is to establish arrangements to determine the allowed revenue derived from procuring and using Demand Side Balancing Reserve and Supplemental Balancing Reserve for the purposes of the Balancing Services Activity that the licensee may recover in each Relevant Year.
2. On 31 March 2016, NGET submitted a notice to the Authority under paragraphs 4K.20 and 4K.27 of Special Condition 4K setting out:
 - a. all DSBR Utilisation Payments it considers, and it can provide supporting evidence that, it has incurred in respect of Relevant Year 2015/16;
 - b. all of the DSBR Set Up Payments, SBR Capability Payments, DSBR Administration Payments, SBR Testing Payments and DSBR Testing Payments it considers, and can provide supporting evidence that, it has incurred in respect of Relevant Year 2015/16.
3. On 26 April 2016, the Authority directed under paragraphs 4K.23 and 4K.32 an extension for determination under paragraphs 4K.25 and 4K.34 to the end of June.
4. On 30 June 2016 the Authority directed under paragraphs 4K.23 and 4K.32 an extension for determination under paragraphs 4K.25 and 4K.34 to 8 July 2016.
5. Following our assessment, the Authority has decided that NGET incurred £17,494.16 in accordance with the approved methodology for the DSBR utilisation on 4 November 2015. Under paragraph 4K.33, the Authority has also decided that NGET followed a process which the Authority considers to be different to the DSBR and SBR procurement methodologies in the second tender for 2015/16. However, given that there is no difference in the cost incurred by consumers, the Authority has decided to adjust the costs associated with the DSBR Set Up and DSBR Administration Payments, and SBR capability payments by £0.

6. The Authority hereby directs:

- a. **Under paragraph 4K.24 of Special Condition 4K that NGET has incurred DSBR utilisation payments in accordance to the methodology and that it recovers the amount of £17,494.16.**
- b. **Under paragraph 4K.34, the Authority directs that NGET adjusts the recovery of DSBR Set Up, DSBR Administration Payment, SBR capability payments by £0.**

Dated: 8 July 2016

Emma Kelso
Partner, Wholesale Markets
Duly authorised on behalf of the Gas and Electricity Markets Authority