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Dear Anthony,

National Grid Electricity Transmission's (NGET) Market Facilitation Activities, unfunded by the RIIO-T1 regulatory regime

Please find attached revised narrative and supporting spreadsheet associated with delivering additional market facilitation activities which are unfunded under RIIO-T1. As discussed and agreed between us this submission seeks to address the issues raised by you in the various telephone conference calls that we have held over recent weeks. Also as agreed a DAG assessment will follow.

New Balancing Services

The delivery of the Supplemental Balancing Reserve (SBR) and Demand Side Balancing Reserve (DSBR) products, together referred to as New Balancing Services (NBS), were introduced prior to winter 2014/15 in response to concerns around insufficient capacity being available for balancing purposes in the years before the first delivery year of the Capacity Market (2018/19). The External Costs efficiently incurred through procurement, testing and use of these services are funded under Special Condition 4K: Demand Side Balancing Reserve Revenue Restriction on External Costs. Our Internal Costs are currently not funded. Ofgem's Final Proposals¹ in relation to the funding of NBS stated: "*We recognise that the provision of these services are new activities for NGET. Where NGET is able to demonstrate that there are new outputs associated with these activities then, if there are any significant additional costs involved, these may be considered under any RIIO-T1 mid-period review.*"

Ofgem has recently indicated that if a Supplemental Capacity Auction is run, with the purpose of advancing the Capacity Market delivery year to 2017/18, the funding arrangements for the NBS External Costs will be removed from NGET's licence after winter 2016/17. We are therefore including information relating to our efficiently incurred costs for three historic years and one forecast year.

Unfunded Activity

These additional market facilitation activities are delivering important outputs for our customers. The cost for delivering the NBS (SBR and DSBR) outputs to 2016/17 is £5.449m. Further breakdown of these costs are detailed in the appendix below, and in the the supporting spread sheet.

¹ *Funding arrangements for new balancing services: Final Proposals. 7th March 2014*

One of the significant differences between the original and revised submission is the greater clarity that we now have as a result of the proposal to run an additional Capacity Market auction for 2017/18. DSBR will only be utilised for one more winter and we have therefore revised IS strategy for the 'Salesforce' to reflect this and we have not included any forward looking costs (apart from 2016/17).

We look forward to your consideration of our submission for DSBR/SBR funding. In the meantime if you have any questions please do not hesitate to contact me. .

Yours sincerely,

[by email]

Andy Balkwill
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National Grid Electricity Transmission

Appendix – Internal Costs Relating To The Provision of The New Balancing Services

Our Internal Costs in respect of NBS are currently not funded. Ofgem's Final Proposals² in relation to the funding of NBS stated "We recognise that the provision of these services are new activities for NGET. Where NGET is able to demonstrate that there are new outputs associated with these activities then, if there are any significant additional costs involved, these may be considered under any RIIO-T1 mid-period review."

NGET's provision of these services enables the achievement of a new output, introduced through DECC's development of Electricity Market Reform. This output is to achieve a Loss of Load Expectation of 3 hours. Ofgem recognised the contribution of these services to this output in its impact assessment³ on their introduction:

"The benefit to consumers is that these products would provide some insurance against involuntary disconnections and against having to pay the cost of other emergency actions. The value of this insurance depends on the probability of National Grid needing to take emergency actions. In short, the benefits are directly related to the loss of load expectation (LOLE). While it is not possible to assess LOLE accurately our 2013 Capacity Assessment suggests that the risks to security of supply are increasing and that there are credible outlooks where the mid-decade LOLE might exceed an acceptable level of risk, such as that established by DECC's draft reliability standard."

DECC has recently announced that there will be an Early Auction for the Capacity Market, to secure capacity for 2017/18. Ofgem has previously confirmed that at the point the Capacity Market is introduced, the funding mechanism for the external costs of NBS will be removed from NGET's licence, effectively terminating the products.

Our submission therefore for the recovery of costs efficiently incurred through the delivery of these services relates to three years of costs already incurred, and one year of forecast costs. The Internal Costs that have been incurred in relation to the delivery of NBS broadly fall under three main categories:

- Staff costs
- IT System costs
- Legal costs

Staff Costs

The development and operation of NBS has been delivered with a skeleton National Grid staff. A minimal core team has been in place throughout the lifetime of the products, with additional resource drafted in to manage peaks such as validation of meter provision data provided by demand side providers, contract negotiation and assessment of appropriate procurement volumes. We have not included time /cost for staff spending less than 20% of their time on the project, an allowance for such staff is contained within business support costs.

1.1 Core Project Team

The core project team was established in May 2013 in order to begin development of the products once it became apparent that transitional measures were required before the implementation of the

² *Funding arrangements for new balancing services: Final Proposals. 7th March 2014*

³ *National Grid's Proposed New Balancing Services: Draft Impact Assessment. 22nd November 2013*

Capacity Market. As workload increased, particularly in terms of developing IS systems, developing details of the services and running tender activities, the core project team has increased.

The core project team delivers the following activities:

- Initial product development and subsequent modifications and refinements
- Organising and running tender processes, including the development of Invitation to Tender Packs, promotion of the products to Demand Side Response providers and account management services
- Developing standard contracts
- Supporting development of operational procedures
- Developing and reviewing methodology statements
- Validation of potential demand side providers
- Account management activities
- External stakeholder engagement
- Post event cost analysis submissions to Ofgem
- Business interface on development of IS systems

One FTE for the entire period of the project, plus one for the period July 2014 and July 2015 were appointed to new roles created specifically to deliver the New Balancing Services products. Other resources within the core project team were appointed on secondment from other areas of the business with no backfill, meaning that other activities and deliverables have had to be prioritised in order to deliver the NBS products.

The core project team resource cost per year is as follows:

	2013/14	2014/15	2015/16	2016/17
FTE	2.2	3.2	2.4	0.4
Cost				

1.2 Tender Support Activities

Tender processes are particularly resource intensive and require different skill sets to those used within the core project team. It would not have been efficient to resource these activities on a permanent basis and so the resources were drafted in on ad hoc basis as and when required. One FTE from July 0214 to July 2015 was appointed to a new role created specifically to support validation activities and automation of processes. The remaining resources had to stop other work in order to deliver these activities.

The activities undertaken by these people are as follows:

- Determining volume requirement (amount to be procured) for tender rounds by assessing the volume required to achieve the agreed Loss of Load Projection across a range of scenarios
- Running tender assessment and making cost efficient procurement recommendation
- Support for resource intensive parts of tender assessment process i.e. promotion of products, account management services and validation of meter points for demand side response users

Resources in this category are phased as per below:

	2013/14	2014/15	2015/16	2016/17
FTE	0	1.4	1.9	0.9
Cost				

1.3 Account Management Services

At peak activity points, resources from within National Grid have been utilised for their account management skills in contract management etc. These resources had to stop other work in order to deliver these activities.

The activities undertaken by these resources are:

- Individual contract negotiations
- Query and dispute resolution

Resources in this category are phased as per below:

	2013/14	2014/15	2015/16	2016/17
FTE	0	0.2	0.3	0
Cost				

1.4 Operational Preparedness

In preparation for the NBS service period, significant activity has been undertaken within the control room support function to ensure operational preparedness. These resources had to stop other work in order to deliver these activities.

There deliverables include:

- Communicating with SBR and DSBR providers to confirm operational arrangements, technical characteristics, communications protocols etc
- Organising and facilitating testing of the services
- Developing new operational documentation for the control room
- Collating performance information following tests and utilisation
- Providing Subject Matter Expert advice in the event of utilisation

Resources in this category are phased as per below:

	2013/14	2014/15	2015/16	2016/17
FTE	0.7	1.3	1.2	0.5
Cost				

IT System Costs

The entire capital expenditure costs relating to SBR and DSBR relate to the IT system used for the tender activity, testing and dispatch of DSBR: “Salesforce”.

At the time the NBS were developed, an IS project was opened to analyse the potential IT solutions for delivery of the two services. The original proposal noted that “the project will make the most use possible of existing systems.” SBR is dispatched using existing control room systems. This has a number of complexities since a number of the sites contracted to SBR have non-standard arrangements which make it operationally complex to utilise the existing systems. However, following analysis, the use of existing systems was determined as the most efficient means of dispatching the SBR plant.

DSBR is procured and dispatched through a ‘cloud based’ system referred to as ‘Salesforce’. WiPro, CSC, TCS and IBM all attended introductory workshops and were invited to submit their proposals. A scoring process assessed the ability of each competitor to deliver the DSBR system to requirements, economically and within the timescales. Following a competitive tender process, TCS was selected as a solution delivery partner.

TCS proposed the use of a Software as a Service (SaaS) product to enable delivery of a solution within the timescales required. This enabled a solution to be developed on an existing platform which can already run on a mobile applications platform. The SaaS cloud solution enabled the solution to be run on a two year basis (the original life span of NBS) without the requirement to purchase new infrastructure and commit to on-going support costs. The use of SaaS in delivering a non-CNI product was considered the most efficient method of delivery, reducing the expected costs of the solution and keeping the system independent from existing CNI systems. The Salesforce product was selected as the most appropriate solution to meet the requirements.

The Salesforce system has just undergone an update to facilitate changes in the design of the DSBR product, as a result of an industry consultation carried out in summer 2015.

Licence renewals are currently under negotiation. The future management of the project is also under review. Post development an IS system would normally be passed over into a business as usual support process. However due to the limited lifetime left for the DSBR product with the advancement of the Capacity Market regime, it has been proposed that support of the system is maintained within the project as this will incur lower costs. Total projected final costs for the project are therefore £3.14m. This is phased as follows:

	2013/14	2014/15	2015/16	2016/17
Cost				

Legal Costs

As NBS are new products, new contracts were required to be drawn up to be entered into by National Grid and the successful service providers. Contracts have had to be updated as participation in the services has increased and some plants offering the services have unusual

technical complexities. Legal services have also been sought in providing general advice on the operation of the services, assessment of tenders etc.

Such a transactional activity comes in peaks and troughs but requires speed and agility to ensure we meet the relevant turnaround times. We require a service provider capable of providing sufficient resource to meet the demand and deliver the advice and documentation within the relevant timescales. If this service was provided by our in house legal team, they would need to resource themselves to an inefficient level on an ongoing basis, in order to be able to manage the peak periods when these occur. We therefore use an external law firm. Legal services for NBS are provided by Shakespeare Martineau (one of the panel of external legal firms we use who are appointed following a regular tender process). Shakespeare Martineau have the resources to deliver against these requirements and provide a cost effective service. We use the limited internal resources we have to contract manage Shakespeare Martineau to cost and quality.

Internal legal costs have been incurred in relation to providing support in the assessment of whether the NBS are in contradiction of European State Aid rules. These costs have been minor and therefore we have not included a claim for them.

Total legal costs, phased by year are as follows:

	2013/14	2014/15	2015/16	2016/17
Cost				

Total Costs for SBR/DSBR

Total Costs incurred in the delivery of these additional market facilitation activities in order to meet the output of a Loss of Load Expectation of 3 hours are:

	2013/14	2014/15	2015/16	2016/17	Total
Staff ⁴					
IS					
Legal					
Business and other support					
Total					

Supporting Spreadsheet



NBS Business Plan Allocations v2 submit

⁴ This row contains the sum of the numbers in the tables above covering Core Project Team, Tender Support Activities, Account Management Services and Operational Preparedness