

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

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Dear Colleagues

## **Decision to continue the Supplemental Balancing Reserve (SBR) and Demand Side Balancing Reserve (DSBR) cost recovery arrangements for 2016/17 and 2017/18**

In September 2015 National Grid Electricity Transmission plc (NGET) asked us<sup>1</sup> to direct a continuation to the SBR and DSBR cost recovery arrangements until 2017/18. This will allow NGET to recover the economic and efficient costs incurred with procuring, testing and utilising SBR and DSBR in 2016/17 and 2017/18.

This letter sets out our decision to allow these cost recovery arrangements until 2017/18. This means that NGET would also have access to these services for 2016/17 and 2017/18 if needed. A direction to this effect is attached to the letter. Under the direction NGET are required to submit new methodologies in respect of procuring, testing and utilising SBR and DSBR.

### **Background**

In December 2013, the Authority approved NGET's application<sup>2</sup> to introduce two new balancing services, the Supplemental Balancing Reserve (SBR)<sup>3</sup> and Demand Side Balancing Reserve (DSBR)<sup>4</sup>. These services provide NGET with additional tools to help balance the system in the rare event that the market is unable to provide sufficient reserves to do so.

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<sup>5</sup>. The relevant licence condition (Special condition (SpC) 4K<sup>6</sup> of NGET's Electricity Transmission Licence) came into effect on 6 June 2014.

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<sup>1</sup> The notice to the Authority can be found at <http://www2.nationalgrid.com/UK/Services/Balancing-services/System-security/Contingency-balancing-reserve/Contingency-Balancing-Reserve-Consultation/>

<sup>2</sup> National Grid's proposed new balancing services decision letter can be found here: <https://www.ofgem.gov.uk/publications-and-updates/national-grid's-proposed-new-balancing-services-decision-letter>

<sup>3</sup> Supplementary Balancing Reserve (SBR) is a generation service where a generator is kept on standby should NGET require additional resources to balance the system.

<sup>4</sup> 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.

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

<sup>6</sup> National Grid's Electricity Transmission licence Special Conditions can be found here: <https://epr.ofgem.gov.uk/Content/Documents/National%20Grid%20Electricity%20Transmission%20Plc%20-%20Special%20Conditions%20-%20Current%20Version.pdf>

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<sup>7</sup>. NGET consulted stakeholders on the appropriateness of maintaining the ability to procure these services for the 2016/17 and 2017/18 winters before asking us to continue the cost recovery arrangements.

On 15<sup>th</sup> October 2015 the Authority published a consultation on our minded to decision to extend the SBR and DSBR cost recovery arrangements for 2016/17 and 2017/18<sup>8</sup>. This provided stakeholders with the opportunity to comment on our minded to position prior to making a decision. A summary of responses is provided below.

### **Consultation response summary**

The consultation closed on 12th November 2015. We received six responses to our minded to decision to extend these services for 2016/17 and 2017/18. The responses (excluding any that were clearly marked as confidential) are published alongside the decision letter on our website.

#### *Short term Price impact and long-term investment signals*

A number of respondents stated that these services dampen price signals impacting marginal plant and undermine long term investment signals.

SBR and DSBR are 'last resort' services. NGET cannot call on these services unless it is clear they are required after taking count of all bids and offers in the BM. As such, SBR and DSBR should not directly affect price signals. In addition, cash-out reforms will ensure that cash-out prices will go to the Value of Lost Load (VoLL) (£3,000/MWh for 2015/16) when these services are used which should support market prices and investment signals. In addition, in relation to any long-term risk that SBR is impacting investment signals, we note that the introduction of the Capacity Mechanism in 2018/19 is intended to act as a stimulus to encourage investment in new generation.

#### *Impact Assessment (IA)*

A number of respondents felt that the Authority should undertake and publish an assessment of the impact SBR and DSBR has on the market prior to approving continuation of the service until 2017/18. One respondent felt an IA was required because the existing analysis was not sufficient. We however consider that this analysis (see below) is still sufficient and relevant to our decision to extend SBR and DSBR for 2016/17 and 2017/18.

The impact that SBR and DSBR has on the market has previously been assessed. In December 2013 the Authority published a Final IA<sup>9</sup> following consultation on a draft IA.<sup>10</sup> In October 2013 NGET also carried out and consulted on its own review on the impacts of SBR and DSBR<sup>11</sup>.

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<sup>7</sup> 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/>

<sup>8</sup> Minded to decision to extend SBR & DSBR cost recovery for 2016/17 & 2017/18 can be found at [https://www.ofgem.gov.uk/sites/default/files/docs/2015/10/minded\\_to\\_decision\\_to\\_extend\\_sbr\\_and\\_dsbr\\_cost\\_recovery\\_arrangements\\_until\\_2017-18\\_v1.1\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2015/10/minded_to_decision_to_extend_sbr_and_dsbr_cost_recovery_arrangements_until_2017-18_v1.1_0.pdf)

<sup>9</sup> National Grid's Proposed New Balancing Services: Final Impact Assessment: [https://www.ofgem.gov.uk/sites/default/files/docs/2013/12/decision\\_to\\_accept\\_nget\\_application\\_to\\_introduce\\_two\\_new\\_balancing\\_services\\_and\\_subsequent\\_consultation\\_on\\_funding\\_arrangements.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2013/12/decision_to_accept_nget_application_to_introduce_two_new_balancing_services_and_subsequent_consultation_on_funding_arrangements.pdf)

<sup>10</sup> National Grid's proposed new balancing services: Draft impact assessment: <https://www.ofgem.gov.uk/publications-and-updates/national-grid-s-proposed-new-balancing-services-draft-impact-assessment>

<sup>11</sup> DSBR & SBR Final proposals consultation: <http://www2.nationalgrid.com/WorkArea/DownloadAsset.aspx?id=36456>

Our IA considered the impact of SBR and DSBR on competition, wholesale prices and the efficient functioning of the wholesale market, in order to assess the net effect on consumers. In our IA we noted that there are both positive and negative impacts arising from these balancing services, including impacts on wholesale market prices and plant profitability. We concluded that, "the assessment of impacts did not raise concerns that were sufficient to outweigh the interest of consumers" and that the service "provides consumers an additional safeguard against the increased risk to mid-decade security of supply if those risks eventuate".

We do not think that a further IA is necessary. We have reviewed the responses to the consultation carefully. The responses did not raise any new issues (or point to any significant changes in circumstances) that materially change the conclusions of our IA.

### **Our Determination**

Having carefully considered all the responses to our consultation the Authority has decided to continue the cost recovery arrangements for SBR and DSBR for 2016/17 and 2017/18. We agree with NGET that the outlook for 2016/17 and 2017/18 is uncertain and it is therefore prudent to continue the cost recovery arrangements for these services if they are required.

Yours sincerely,

Philippa Pickford  
Associate Partner, Markets