

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

Direct Dial: 020 7901 7000
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Date: 28 April 2017

Dear Colleagues

Decision on the costs incurred by National Grid Electricity Transmission plc associated with the procurement and testing of the Supplemental Balancing Reserve and Demand Side Balancing Reserve for Winter 2016/17

On 31 March 2017 the Gas and Electricity Markets Authority ('the Authority') received a notice from National Grid Electricity Transmission plc ('NGET') setting out its application for cost recovery of costs incurred in relation to procurement and operation of Supplemental Balancing Reserve ('SBR') and Demand Side Balancing Reserve ('DSBR') for Winter 2016/17. These costs totalled £119,402,163.32 (see table 1).

Following our assessment, we have determined that the above-mentioned costs were incurred by NGET in line with the relevant methodologies. Therefore, we are directing that costs in respect of SBR Availability Payment may be recovered and that no adjustments are required in respect of costs relating to SBR Capability Payments and SBR Testing Payments. We outline below details of NGET's application and our conclusions.

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 rare event that there is insufficient capacity in the market to meet demand. They were introduced to bridge the gap between tightening generation margins in the mid-decade period and the introduction of the Capacity Market.

We modified NGET's transmission licence to implement arrangements for cost recovery of the economic and efficient costs relating to the procurement and use of SBR and DSBR for 2014/15 and 2015/16.¹ This licence modification came into effect on 6 June 2014 and required NGET to have in place methodologies, approved by us, which provide detail on how it will procure and use SBR and DSBR in an economic and efficient way.²

NGET subsequently identified a need for SBR and DSBR in 2016/17 and 2017/18 – i.e. until the first Capacity Market delivery year (then expected to be in 2018/19). Following

¹ Our decision can be found at <https://www.ofgem.gov.uk/publications-and-updates/decision-funding-arrangements-new-balancing-services>

² The approved methodologies can be found at <http://www2.nationalgrid.com/UK/Services/Balancing-services/System-security/Contingency-balancingreserve/Methodologies/>

consultation, we issued a direction³ in November 2015 to extend the arrangements accordingly. In March 2017 we issued a further direction which has the effect of removing the cost recovery arrangements for 2017/18. As we set out in letter dated 7 March 2017, we expect 2016/17 to have been the last winter in which the procurement of these service was required.⁴

If NGET considers and can provide supporting evidence that it has incurred 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 will then review NGET’s compliance with these 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 2016/17

On 31 March 2017 NGET submitted a notice to the Authority pursuant to Special Condition 4K Part H of the licence seeking to recover costs incurred for procuring and testing of SBR and DSBR in 2016/17.

NGET purchased around 3.5GW of de-rated capability for Winter 2016/17 at a cost of £119.4 million. Table 1 below shows the breakdown of these costs:

Table 1: SBR costs per category

SBR Capability Payments	£113,586,648.27
SBR Testing Payments	£4,948,907.69
SBR Availability Payments (these are costs associated with warming the plants for SBR testing)	£866,607.36
SBR total cost	£119,402,163.32

The notice also included a description of how the costs were calculated and how, in NGET’s view, they were incurred in accordance with the relevant approved methodologies.

In August 2016, NGET published its decision not to procure any DSBR capability for 2016/17. There are therefore no costs associated with DSBR included in the Notice.⁵

Our Determination

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 and test these SBR 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 to determine compliance with the approved methodologies.

³https://www.ofgem.gov.uk/sites/default/files/docs/direction_issued_to_national_grid_electricity_transmission_plc.pdf

⁴ Our decision to remove cost recovery from NGET’s licence can be found at https://www.ofgem.gov.uk/system/files/docs/2017/03/decision_to_remove_sbr_and_dsbr_cost_recovery_arrangements_for_2017-18.pdf

⁵ <http://www2.nationalgrid.com/WorkArea/DownloadAsset.aspx?id=8589936396>

Our analysis has confirmed that the process NGET followed resulted in them procuring volumes and individual units of SBR consistent with the approved methodologies. We therefore find that costs in respect of SBR Availability Payment may be recovered.

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. We are satisfied that NGET calculated the costs in accordance with the approved methodologies, and that no adjustments are required in respect of costs relating to SBR Capability Payments and SBR Testing Payments.

Our Decision

Attached to this letter is the direction we issued to NGET today which sets out:

- our determination under Special Condition 4K.25 that costs in relation to SBR Availability Payments were incurred in accordance of the approved methodologies and directing that these costs may be recovered; and
- our determination under Special Condition 4K.33 that costs in relation to SBR Testing and Capability Payments were incurred in accordance with the approved methodologies and that no cost recovery adjustments are required.

Yours faithfully

Mark Copley
Associate Partner, Wholesale Markets

To the Company Secretary

National Grid Electricity Transmission Plc
(Company Number: 02366977)

Direction issued to National Grid Electricity Transmission plc ('NGET') by the Gas and Electricity Markets Authority ('the Authority') pursuant to paragraphs 4K.25 and 4K.33 of Special Condition 4K of NGET's Electricity Transmission Licence

WHEREAS

1. National Grid Electricity Transmission Plc ('the licensee') is the holder of an electricity transmission licence ('the licence') granted or treated as granted under section 6(1)(b) of the Electricity Act 1989 ('the Act') that includes Special Conditions.
2. 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 ('DSBR') and Supplemental Balancing Reserve ('SBR') for the purposes of the Balancing Services Activity that the licensee may recover in each Relevant Year.
3. On 31 March 2017, NGET submitted a notice to the Authority under paragraphs 4K.20 and 4K.27 of Special Condition 4K setting out:
 - a. SBR Availability, Testing and Capability Payments it has incurred in respect of Relevant Year 2016/17 including supporting evidence of these costs; and
 - b. that no costs were incurred with relation to DSBR in respect of Relevant Year 2016/17, following a decision by NGET not to procure any DSBR services during this period.
4. Following our assessment, the Authority has:
 - a. Determined, under Special Condition 4K.25, that costs in relation to SBR Availability payments were incurred in accordance of the approved methodologies for 2016/17; and
5. Determined, under Special Condition 4K.33, that costs in relation to SBR Testing and Capability payments were incurred in accordance with the approved methodologies for 2016/17 and that no cost recovery adjustments are required.

Therefore, the Authority hereby directs:

Under paragraph 4K.25, that NGET may recover costs in relation to SBR Availability payments.

This Direction shall have immediate effect and expire on the date upon which the Authority exercises its right to revoke it.

This document constitutes notice of the reasons for the decision to issue the direction as required by section 49A(2) of the Act.

Dated: 28 April 2017

Mark Copley
Associate Partner, Wholesale Markets
Duly authorised on behalf of the Gas and Electricity Markets Authority

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