

To all interested industry parties

Email: esoperformance@ofgem.gov.uk

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Open letter on our review of spring and summer 2020

This letter sets out our intention to evaluate the high balancing costs on the GB electricity system this spring and summer and identify lessons that need to be explored further in order to reduce costs to consumers going forward. This letter also describes how we intend to engage with stakeholders in this process.

Background

The GB electricity system has seen an increase in balancing costs this spring and summer 2020, coinciding with the onset of the COVID-19 pandemic. Specifically, the period from March to July 2020 has seen balancing costs of £718 million¹, which is 39% higher than the ESO expected costs would look like in this period². These costs increased at the same time as nationwide lockdowns changed consumer electricity consumption behaviour and reduced industrial activity. Moreover, some of this period saw high level of renewables output, which required the ESO to take a large number of actions to balance the system and ensure system operability.

During this spring and summer, the ESO introduced three changes to the GB arrangements to enable it to better manage the system:

¹ Total balancing costs were calculated from MBSS data apart from July. July was calculated using Settlement Final and Initial Interim data, however excludes the 31st of July as data was not available upon writing of this report.

² Forecasted figures were taken from February's 'Monthly BSUs Forecast'. All data was taken from the National Grid data portal.

- It contracted with Sizewell B to reduce its output by 50% during the spring and summer to provide the control room with more tools to manage system stability.
- It designed and procured a new service, Operational Downwards Flexibility . This service allowed the ESO to access downward flexibility from distributed generation that do not normally provide balancing services to the ESO.
- It clarified the emergency arrangements for the disconnection of distributed generation if necessary, although to date these have not been used.

Actions by the ESO to manage this demand were charged to suppliers and generators on the system via the Balancing Use of System charges, which saw record charges through the spring and summer period.

Throughout this spring and summer, we have been regularly engaging with the ESO on its preparedness and the actions it has taken to balance the system. We also worked with the ESO on a framework for regulatory flexibility that provided a process for the ESO and us to have a common understanding on the need to temporarily deprioritise certain Lower Priority Activities, in response to current Government advice, and/or to focus capacity on delivering High Priority Activities in the event of escalating impacts of Covid-19 on the capacity of its workforce.³

We expect a high level of service from the ESO. Based on its commitments under the existing RIIO-T1 price control and the obligations contained within its licence, the ESO must be economic, efficient, and demonstrate the behaviours and standards described in our Roles and Principles Guidance.⁴ In addition, we set incentives on the ESO for going above and beyond baseline expectations, where the ESO demonstrates actions which deliver additional consumer benefit, and commensurably whenever the ESO falls short of our baseline expectations.

Our incentive scheme is evaluative and therefore requires us to assess the actions taken by the ESO every year. Given the high balancing costs incurred this summer, it is important that we understand in more detail what happened in this period and identify whether there are lessons for the ESO to learn to manage these kinds of issues in future.

³ Our letter to the ESO on its COVID-19 pandemic response: <https://www.ofgem.gov.uk/publications-and-updates/letter-electricity-system-operator-priorities-during-covid-19>

⁴ ESO Roles and Principles Guidance for 2019-20: https://www.ofgem.gov.uk/system/files/docs/2019/03/eso_roles_and_principles_guidance_2019-20.pdf

More broadly, in order to undertake future policy development, we require a body of evidence to inform our thinking. This review will enable us to do that, looking at both system operation actions and how well the market responded to the system challenges and the actions taken by the ESO, including any lessons that need to be learned.

Scope of review

Our review will examine three areas (set out below).

- Long term preparedness:
 - The extent that any of the operability challenges experienced this spring/summer were known or foreseeable system limitations;
 - The actions taken to address any known or foreseeable system operability challenges and how successful they were;
 - The extent to which the specific situation this spring and summer was due to the COVID-19 pandemic and/or minimum demand falling year on year and other system trends.
- Crisis management and response:
 - The extent to which the ESO response to operability challenges met the standard required of the ESO;
 - The ESO engagement with the market, including:
 - The transparency of those actions,
 - The impact of those ESO actions on market self-dispatch decisions, and
 - The balancing market respond to the challenges faced this spring and summer; and
 - The extent to which the actions taken by the ESO delivered value for money to consumers.
- Lessons for the future:
 - The changes needed to further develop the three amendments to the GB arrangements introduced by the ESO this spring and summer;
 - The changes needed to address growing operability issues in the future; and
 - The extent that the current system and market rules conducive to effective system operation, and what the evidence suggests about market design and running a carbon free network.

We will be seeking evidence from the ESO throughout August and intend to hold industry roundtables in early September to gather stakeholder views on these and any other

questions stakeholders believe are relevant. It is our intention to finish the review by the end of October to coincide with our mid-year review.

Stakeholder engagement

We would welcome information from industry on these points. In order to engage with industry in an agile and dynamic way, we believe that holding virtual roundtables are the best format for compiling a broad range of stakeholder views. We expect to hold these at the beginning of September this year. We will also accept written submissions but encourage all industry participants to engage at these roundtables. If you do not receive an invitation but are interested in attending or if you wish to make a representation by email please contact esoperformance@ofgem.gov.uk.

Yours faithfully,

Eleanor Warburton

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