

All interested parties,
stakeholders in GB and beyond,
and other regulatory bodies

Email: esoperformance@ofgem.gov.uk

Date: 25 September 2020

Dear colleagues,

Decision to grant the Electricity System Operator a derogation under Article 6(14) from the requirements of Article 6(2) of the Regulation (EU) 2019/943 for Dynamic Containment.

On the 23 September 2020, we¹ received a request from the Electricity System Operator (ESO) for a derogation under Article 6(14) from the requirements of Article 6(2) of the Regulation (EU) 2019/943 (Electricity Regulation)² for the new specific Frequency Containment Reserve (FCR) product Dynamic Containment (DC).

The ESO have requested the derogation from the requirements of Article 6(2) to allow the specific product, DC, to be launched with the price of balancing energy predetermined in the balancing capacity contract.

This letter sets out our decision to approve the derogation requests in accordance with Article 6(14) of the Electricity Regulation and also outlines the necessary next steps that must be taken.

¹ The terms “we”, “us”, “our”, “Ofgem” and “the “Authority” are used interchangeably in this document and refer to the Gas and Electricity Markets Authority. Ofgem is the office of the Authority.

² Regulation (EU) 2019/943 of the European Parliament and of the Council of 5 June 2019 on the internal market for electricity, available here: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32019R0943>

Background

FCR is defined in Commission Regulation (EU) 2017/1485 establishing a guideline for system operation (the SOGL Regulation) as “the active power reserves available to contain system frequency after the occurrence of an imbalance”.

DC is a new specific FCR balancing product developed by the ESO to arrest frequency in low-inertia, large loss scenarios where the Rate of Change of Frequency (RoCoF) is very fast. DC has been developed to meet the need to contain frequency within statutory limits (+/- 0.5Hz) for a range of loss sizes. Unlike other static frequency response products, delivery of DC is dynamic and able to deliver energy proportional to the change in frequency with an activation time of 1 second. DC has been developed with the price of balancing effectively predetermined at £0/MWh. The ESO believes that designing DC with a predetermined price for balancing energy is justified given that:

- the volume of balancing energy utilized is expected to be very small, and therefore the payment for this volume of energy would also be very small; and
- paying for the volume of energy delivered as part of DC doesn't provide any significant signal to market players, but would add additional costs and complexity to support the submission of non-zero prices close to real-time.

Article 6 of the Electricity Regulation, which became applicable on 1 January 2020, contains a series of new obligations on the organisation of the balancing markets which apply to FCR products. Amongst others, this includes Article 6(2) which requires that the price of balancing energy shall not be pre-determined in contracts for balancing capacity.

Article 6(14) of the Electricity Regulation allows the ESO, where standard balancing products are not sufficient to ensure operational security, to propose, and Ofgem may approve, derogations from paragraphs 2 and 4 for specific balancing products which are activated locally without exchanging them with other transmission system operators.

Given that the specific balancing product, DC, has been designed with a predetermined price for balancing energy, the ESO is requesting a derogation under Article 6(14) from the requirements of Article 6(2) of the Electricity Regulation for DC. In accordance with 6(14) of the Electricity Regulation, the proposal for a derogation must contain the following information:

- a) a description of measures proposed to minimise the use of specific products, subject to economic efficiency;

- b) a demonstration that the specific products do not create significant inefficiencies and distortions in the balancing market either inside or outside the scheduling area
- c) where applicable, the rules and information for the process for converting the balancing energy bids from specific products into balancing energy bids from standard balancing products

The ESO's derogation request was submitted in accordance with Article 6(14) and contained all necessary the information required. However, we note that the ESO does not intend to convert DC balancing energy bids into balancing energy bids for standard products. The ESO has stated that DC will only be activated locally, and therefore this specific requirement of Article 6(14) is not applicable to DC.

Decision

We have reviewed the requests submitted to us in line with the requirements of the Electricity Regulation, the wider objectives of the EBGL regulation and our statutory duties. We have also engaged with the ESO to clarify our understanding of the rationale for the request for derogation. When assessing the ESO's proposal for the definition and the use of Dynamic Containment as a specific product, we considered the following aspects:

- a) the need to design a specific FCR product with a pre-determined price of balancing energy in the balancing capacity contract*

Given that there is no equivalent standard product, and that other standard balancing products are not sufficient for ensuring operational security, we agree that there was a need for the ESO to develop a new specific FCR product (DC).

We understand that providers of DC will offer a volume of balancing energy and not be able to ascribe a value to that volume, effectively predetermining the value of the balancing energy bids in the balancing capacity contract at £0/MWh for the price of the energy.

We agree with the ESO's assessment that the utilisation of the balancing energy provided via DC is small enough to justify predetermining the price of balancing energy in this way in the contract for balancing capacity. In addition, we believe that any payment for this volume of energy would be too small to provide any significant economic signals to balancing service providers. Therefore, we consider that the existing design of the DC product, in which the balancing energy has a predetermined price, is appropriate.

b) a description of measures proposed to minimise the use of specific products, subject to economic efficiency;

We understand that there is no standard FCR product that can be used in preference to FCR specific products. We also understand that DC will be required at all times in order to protect the NETS from an unexpected demand or generation loss that could happen at any time.

However, as it procures DC, the ESO will be required to procure and use FCR products in line with its licence obligations to procure balancing services in an economic and efficient and co-ordinated manner. As a result, we believe that this ensures that the ESO will only procure the minimum amount of DC required to manage the system safely and effectively, and ensure system security.

c) a demonstration that the specific products do not create significant inefficiencies and distortions in the balancing market either inside or outside the scheduling area

We believe the ESO has demonstrated that the technical parameters of DC are sufficiently specific and different from existing frequency response products as to not create any significant inefficiencies and distortions in the balancing market inside the GB scheduling area. In addition, there is no standard FCR product traded across scheduling areas, and we understand that the ESO will only activate DC locally. As a result we also believe that there is no risk of distortions outside of the GB scheduling area.

We agree with the ESO that Dynamic Containment is critical to ensure future operational security, and based on our analysis of the information submitted to us by the ESO as required by Article 6(14) of the Electricity Regulation, and the current need for fast acting frequency response services to ensure security of supply we hereby:

- Grant the Electricity System Operator a derogation under Article 6(14) of the Electricity Regulation from the requirements of Article 6(2) of the Electricity Regulation for Dynamic Containment.

Our decision to derogate the ESO from the requirements of Article 6(2) of the Electricity Regulation is effective immediately. This derogation from the requirements of Article 6(2) shall apply to DC for the duration that the ESO can demonstrate that it is necessary to use DC as a specific product – noting that Article 26(2) of the EBGL Regulation states that each

TSO using specific products shall review at least once every two years the necessity to use specific products.

If you have any questions about the contents of this letter, please contact Alastair Owen (Alastair.Owen@ofgem.gov.uk)

Yours sincerely,

Eleanor Warburton

Deputy Director - ESO and Gas Systems