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11 November, 2013

Dear Peter,

Demand Side Balancing Reserve and Supplemental Balancing Reserve Final Proposals Consultation

Thank you for the opportunity to respond to the above consultation. This response is made on behalf of E.ON.

In our response we do not propose to address the issue of whether there is a need for the proposed services. There seems to be a strong desire within National Grid to have the option to procure these services should the need arise. Therefore, the following comments address issues associated with implementing the products as proposed. Whilst in some areas the new proposals appear to have addressed some concerns raised in response to the original June consultation document, we believe that there are number of issues which still need to be addressed.

Supplemental Balancing Reserve (SBR)

There are two main concerns which remain with the SBR proposals. The first of these regards the proposals around additionality. We agree that there is a need to ensure that a strategic reserve product of this type does not distort the normal efficient operation of the market and is therefore ring fenced in some manner. Therefore, we would support the proposal to ensure that the successful SBR contracted plant cannot be used ordinarily in the market and is despatched only once all other non emergency actions have been taken.

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However, we are concerned about the requirement for a declaration from the board of directors of a company entering into a tender, that the relevant station will not participate in the market for energy or balancing services for the duration of the contract it is tending for, even if a contract is not actually awarded. Whilst we understand National Grid's rationale for wanting such a commitment, it would not be appropriate to constrain the commercial operation of an unsuccessful station in this manner.

The operators of a plant may well wish to enter the tender in the belief that a plant would otherwise be uneconomic in the energy market in light of the circumstances facing them at the time. However, it is reasonable to believe that market conditions could subsequently change so as to alter that position, for instance due to a significant increase in demand or a loss of a large amount of generation capacity, or combination of the two. If this happens, then preventing the plant from operating is not necessarily the correct thing to do as it could significantly drive up prices for customers, put pressure on security of supply and leave the operators of the plant open to charges that they have acted anti-competitively. Therefore, this requirement will make entering the tender a very risky exercise for a company and is likely to prevent plant from coming forward to do so.

Secondly, whilst it is intended that SBR should be an interim product to be used until the capacity market is in place, there are considerable concerns within the industry that it could be used on an ongoing basis. As this product is in effect a strategic reserve which was rejected by the Government as an option for a capacity mechanism in favour of the capacity market proposal, there is a considerable body of opinion which believes that this would be an inferior solution and that a market wide capacity market should be brought in as soon as possible.

In order to ensure momentum in the implementation of the CM is maintained, we believe that if the SBR is implemented it should be subject to a sunset clause. We would suggest April 2018 as an appropriate date for these provisions to fall away, in time for the planned commencement of payments under the capacity market in the winter of 2018.

Demand Side Balancing Reserve (DSBR)

The revised proposals for DSBR appear to be an improvement on those originally published in June. We do however have a number of comments to make on some aspects of proposed service.

We agree with the implementation of a 1MW minimum threshold for the provision of these services. This seems sensible to minimise the transaction costs that National Grid could incur attempting to contract directly with smaller parties. Aggregator services already exist in the market, so smaller loads can be included in the arrangements if necessary without the need for National Grid to replicate these.

We are not certain, however, why National Grid believe that the DSBR would be an ongoing service which would continue when demand side response is included in the

Capacity Market. If the intention is to remove SBR when the Capacity Market is up and running then a similar treatment would appear appropriate for DSBR. Otherwise, there is the danger of two mechanisms rewarding the same capacity twice for providing the same service. Additionally, if the intention is for this to be an enduring service then it does not make sense to restrict it to non domestic customers and embedded generation as is currently proposed. In the longer term and as more smart metering is rolled out to customers, it is more likely that parties will wish to aggregate domestic premises to provide response as well.

In terms of how best to set the baseline for measuring the provision of DSBR against, we believe that the current proposal to set it at the level of the 10 highest demands over the previous 12 months could be improved upon. We would suggest that using the previous 10 similar days (e.g. previous 10 Mondays which weren't holidays etc) would be more appropriate and would encourage more accurate delivery of loads. However we agree with the sentiment that the baseline should be relatively simple and should be calculable at time of delivery of the load rather than retrospectively at end of year. We note that DSBR can be instructed outside of the availability windows. Is National Grid happy that the normal baseline would be appropriate for measuring performance in these circumstances?

Generic issues

It appears that the forecast implementation and running costs of the service are relatively high. The total cost for these is estimated as £16m over two years. The implementation costs of DSBR are significantly higher than those of SBR which presumably is to do with setting up a new bespoke despatch system. It is worth considering whether the amount of response which might be provided over the two year period would justify the outlay on temporary dispatch systems to enable it.

Both services will result in additional costs and it should not be assumed that suppliers and/or customers can keep absorbing costs continuously. It is really important that, if the services are introduced, there are arrangements in place to keep the cost associated with them down. We can understand the rationale for not including the costs of procuring SBP in National Grid's Balancing Services Incentive Scheme (BSIS) target. This service is not intended to be used in the normal operation of the market and is expected to be called as a last resort when all other non emergency actions have been taken. Nevertheless, there should be some form of regulatory oversight to ensure that National Grid procures this service in an economically efficient manner.

The case for excluding DSBR from the BSIS scheme is less clear however. This is intended to be used more often than SBR in economic order with other balancing actions and services. Therefore, it arguably should form part of the overall target agreed under the BSIS scheme. This will ensure that National Grid's procurement and despatch decisions associated with this service are optimised when compared with the alternative services that can be achieved elsewhere in the market.

For instance, we note that the DSBR service may be instructed with a reasonably long

lead time and is also intended not to be cancelled once instructed. If National Grid does not pay sufficient care it is possible that it might instruct the service, but that the need for it subsequently does not transpire closer to time. If the instruction cannot be rewound then other actions would have to be taken to balance the system, increasing the cost to customers.

Finally, the volumes and costs of both services should be fully transparent to the market. This includes real time reporting of any capacity instructed under the services with its price and ex ante reporting of the stack of successful bidders including volumes and prices. This is of particular importance with respect to the costs of DSBR which is intended to be called in economic order, not as a last resort, and will therefore interact with the operation of the wider market to a greater extent than SBR. Nevertheless, the costs and volumes of SBR should be fully transparent as it will affect the level of customers' bills.

I hope the above comments prove helpful. Should you want to discuss this further, please do not hesitate to contact me on the above number.

Yours sincerely

Paul Jones
Upstream Trading Arrangements Manager