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Dear Peter,

Demand Side Balancing Reserve and Supplemental Balancing Reserve

Thank you for the opportunity to respond to the above consultation. In principle, we do not believe that these products should be introduced as we are concerned that they could distort the wider wholesale market and undermine efforts to bring in more robust mechanisms through the introduction of a Capacity Market. We are particularly concerned about the introduction of the Supplementary Balancing Reserve product, not least because it very similar to the Strategic Reserve proposal which was rejected as an option for delivering the Capacity Market under Electricity Market Reform.

We believe that effort should be focussed on implementing the capacity mechanism as soon as possible. Indeed, one of our main concerns with the proposed products is that rolling over their use into future years may be seen as an "easy fix", rather than creating more effective mechanisms through the introduction of the Capacity Market. If as time progresses concerns develop regarding the amount of available capacity in the market, the most pragmatic solution would appear to be for National Grid to increase the amount of Short Term Operating Reserve it procures for a while to cover any shortfall until the capacity mechanism takes effect.

Although we disagree with the implementation of the products, we have answered the main questions on the design of the products set out in the consultation. I hope that you find the comments helpful.

Yours sincerely

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Trading Arrangements Manager

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DSBR1: Do you agree with our proposed participation criteria?

Whilst it is understandable that this should be limited to demand which doesn't already participate in providing reserve, it is unclear how £500/MWh was arrived at as a minimum threshold.

DSBR2: Do you agree with our proposed product definition?

Presumably the window that has been chosen is influenced by the use of historical peak demand to estimate the baseline against which demand response is deemed to occur. This is understandable, but it does then reduce the availability of the service when system stress occurs outside of those periods too.

DSBR3: Do you agree with our proposed payment arrangements? Do you have any views on the proposed level of set-up payment?

Although we understand why the payment mechanism has been structured as it has, in order to incentivise realistic tenders from providers, it may have the effect of preventing providers from providing a partial service which still may be of some use to the system. That is, they may just not provide anything at all rather than be paid a lower rate or nothing at all for a partial response.

DSBR4: Do you agree with our measurement and baseline proposals?

They seem to be simple and pragmatic. Our question would be about how good a proxy for baseline demand this measure would be for all periods when this product could be called.

DSBR5: Do you agree with the proposed arrangements for despatch?

Clearly, they need to be simple but there is a concern that the provision of the service may be uncertain and not very transparent. In particular there needs to be more information on how the smart phone despatch method will work. As there is no penalty associated with non delivery, how will National Grid be assured that the amount of response that has been despatched will deliver? Will there need to be a confirmation from providers?

Additionally, other market participants need to be made aware of what has been procured, the prices agreed for these services and details of what has been despatched, in similar timescales as for other actions on the system such as BM actions.

DSBR6: Do you agree with our proposals on procurement?

These seem reasonable.

DSBR7: Do you agree with our proposals on verification?

Yes.

DSBR8: Do you agree with that there should be a de-minimis dispute threshold?

Disputes cost money to resolve and there should be threshold to ensure that the value of the dispute is proportionate to the resources required to resolve it.

DSBR9: Do you agree with our proposed approach to contracting?

Keeping the contract terms standard and simple will help understanding and promote participation. Clearly, a lack of penalty associated with the service reduces certainty that it will always be delivered.

DSBR10: Do you agree with our proposals on imbalance pricing?

No. The product should be included in imbalance pricing in a similar manner to STOR, particularly as it will be called in price order and compete with other balancing services.

DSBR11: Do you agree with our proposals on how the service should interact with triad demand reducers?

Yes this seems reasonable.

DSBR12: Do you agree with our proposals in respect of Committed and Flexible STOR providers?

Yes.

DSBR13: Do you have any comments on our procurement options?

If National Grid procures the services directly with customers, then the party who is responsible for the relevant site in settlement, such as a supplier or aggregator, needs to be made aware of this. This could be achieved through wider transparency associated with successful tenders as we mention in our response to question DSBR5. If the intention is for this product to be rolled out to a relatively large number of customers, then consideration needs to be given to how logistically this will be managed.

SBR1: Do you agree with our basic product proposals?

Although we do not agree with the product itself the principles set out in paragraphs 116 to 119 of the consultation appear reasonable.

SBR2: Do you agree with our proposals on participation and our proposals to seek reasonably satisfactory evidence regarding additionality?

We believe that it would be reasonable to expect a station that is claimed would close without a contract under this service, to make a relevant application to reduce Transmission Entry Capacity. Clearly, if a contract is awarded then this reduction would have to be withdrawn or rejected to ensure that the generator has sufficient TEC to meet its obligations under the contract. Similarly, we would expect any plant returning from mothballing to provide this service to have sufficient TEC to enable it to do so.

The 50MW minimum threshold would seem to preclude a number of auxiliary OCGTs from providing the service. If these were unsuccessful in the STOR tenders, it is not clear why it would be prevented from providing this service when presumably any capacity would be valuable at times of such system stress as to warrant the use of the product.

SBR3: Do you have any comments on the proposals to infer outage rates by allowing service providers to choose their non-delivery charge? Views are also invited on the approach to creating the appropriate trade-off between non-delivery charges and de-rating factors.

This seems reasonable.

SBR4: Do you agree with our verification proposals?

Who pays for a proving test to be carried out? This could be a significant cost and if it is the generator who picks up the cost, then those tendering will need to know how often they can expect to be tested so that this risk can be priced accordingly in their tenders. An alternative approach would be that used for Black Start tests where the cost is negotiated between National Grid and the relevant party.

SBR5: Do you agree with our proposals to despatch SBR only after other non- emergency balancing services have been exhausted and do have any views on whether SBR should be despatched through the Balancing Mechanism or outside it?

Yes, if SBR is implemented it must be ring fenced as proposed and despatched as a last resort before taking emergency actions.

The second issue is to some extent interlinked with the question regarding whether the service would affect imbalance pricing. If the intention was that the cost of the service would be fed into imbalance prices in a similar manner to other reserve contracts, then it might as well be done through the Balancing Mechanism, with the utilisation prices forming the relevant offers. However, this would need an appropriate mechanism to ensure that the availability payments were reflected appropriately in the relevant periods when the service was likely to be called.

SBR6: Do you agree with our proposals for Settlement, and in particular, regarding the payment of 20% of the capacity payment up front?

The capacity payment is there to pay the fixed costs associated with making the relevant capacity available. Therefore, this would imply it needs to be payable up front. If penalty payments are to be charged these should be recovered from the generator if and when they are incurred.

SBR7: Do you agree that imbalance prices should not be affected by any SBR procurement ahead of Ofgem's Energy Balancing Significant Code Review?

No. This proposal essentially causes similar issues to the Strategic Reserve proposal which was rejected as the basis for the Capacity Market under EMR. That is, it has the potential to undermine the market by providing a source of generation margin, but smearing the cost across all BSUoS payers, rather than targeting it at those who may have caused the relevant shortfall by failing to purchase enough capacity through the wholesale market arrangements.

This has the potential to distort prices so that other generators become uneconomic and seek recompense through these arrangements, thereby potentially setting up a "slippery slope" whereby more and more plant are drawn in. One approach to avoiding this effect would be to ensure that this product is priced accordingly in imbalance pricing, including capacity, warming and utilisation costs.