4.7 Issue Form

Issue Form - BSCP40/04	Issue Number 83 *(mandatory by BSCCo)*

Issue Title *(Mandatory by originator)*

Ensuring that the Buy Price Price Adjustment reflects all additional balancing costs incurred by NGESO.

Issue Description *(Mandatory by originator)*

This Issue originates from the discussion tabled in the context of BSC Modification Proposal P371 'Inclusion of non-BM Fast Reserve actions into the Imbalance Price calculation', which seeks to correct the calculation of the Imbalance Price (cash-out) by capturing non-Balancing Mechanism (BM) Fast Reserve actions.

The Proposer also notes that in accordance with Article 52(2) of the Commission Regulation (EU) 2017/2195 of 23 November 2017 establishing a guideline on electricity balancing, the All Transmission System Operator (TSO) Proposal on the Harmonisation of Imbalance Settlement (ISH) has been submitted to regulatory authorities. If the ISH proposal is accepted in its current form, then the Buy Price Price Adjustment (BPA), which forms part of the Imbalance Price calculation, would cease to be acceptable. The Proposer therefore believes that the Issue Group should assess how the components of the BPA can continue to be used in the Imbalance Price calculation to ensure that it continues to be reflective of the actions taken by National Grid Electricity System Operator (NGESO).

In addition to ensuring that the Imbalance Price continues to be reflective of the actions taken by NGESO, the Issue Group should consider what other reserve actions and costs should also be added to the Imbalance Price. This includes the cost of option fees, paid by NGESO to providers which are not currently taken into account for the calculation of the Imbalance Price, which makes it not truly reflective of all balancing costs incurred by NGESO.

Fast Reserve (the biggest share of which is represented by Spin-Gen contracts[1]) is contracted from providers in advance of delivery. The availability of capacity is procured at a pre-agreed availability and utilisation price, which risks not reflecting the value of such capacity to the market at times of scarcity. Capturing Spin-Gen option fees in the calculation of the Imbalance Price will make the Imbalance Price more cost reflective. In addition, data on prices and volumes awarded to individual Spin-Gen service providers should be openly shared.

NGESO spent between £4m and £6m/month on Hydro Spin-Gen Fast Reserve in 2018-19 for availability only (excluding utilisation via offers and bids) [2], yet:

1. No data is provided on the prices or the volumes awarded to the individual service providers. Such lack of transparency is sending incorrect messages to the industry and distorting the market signal, impacting the behaviour of market participants, with overall effects to the costs to end consumers.
2. This spending is not captured in the cash-out, as such failing to provide a signal to those participants who are out of balance as to the total costs of ensuring available reserve capacity.

Justification for Examining Issue *(Mandatory by originator)*

This defect has been previously discussed by the P371 Workgroup as part of the Modification Proposal. The debate showed that the inclusion of Spin-Gen payments into the calculation of the cash-out requires further analysis and wider review, which the Proposer decided to undertake in a separate BSC Issue, so that P371 could progress in a timelier manner.

[1] As per data presented by NG in their MBSS reports
[2] National Grid, Monthly Balancing Services Summary (MBSS) February 2019.
Available here: https://www.nationalgrideso.com/document/140571/download

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Because the Imbalance Price is based on costs of NGESO actions, the lack of inclusion of option fees contributes to reserve costs being reflected inaccurately.

As a consequence, the signal to market participants is distorted and cash-out prices are dampened, particularly during times of system stress. This leads to insufficient signal to balance, trade and invest in flexible capacity, with further negative impact on security of supply and balancing efficiency. The total costs of Option Fees are socialised in BSUoS. The dampened incentive to self-balance leads to higher costs borne by all parties.

In 2001, Ofgem clarified its position in the context of its decision on P003[3], where it sought to establish the principle that 'all the costs of energy balancing should be targeted on participants who are out of energy balance whilst the costs of system balancing should be recovered from all participants'. This position could be seen as in confliction with the EB GL principle that only actions that result in energy being delivered should be included in the Imbalance Price calculation in relation to that Settlement Period.

This Issue seeks to confirm with industry that the current arrangements do not guarantee a correct calculation of the Imbalance Price, fair and harmonised treatment of all services the cost of which should be included, and, ultimately, greater transparency and clarity of the Balancing Services Adjustment Data (BSAD), in particular the BPA methodology.

The BSAD Methodology Statement shows instances where availability payments are captured in the cash-out price. Section 3, which covers Price Adjusters, reads: "With the exception of STOR services, where National Grid pays option fees to either, facilitate access to MW capacity within the Balancing Mechanism or to facilitate the withdrawal of MW capacity from the Balancing Mechanism, such fees will be represented through the Price Adjusters. Specifically, fees paid to facilitate additional MW capacity will be represented through the BPA and fees paid to facilitate the withdrawal of MW capacity through the Sell Price Adjuster".

The BSAD also states that the BPA may include, but is not limited to BM Start Up and Regulating Reserve. This implies that there may be other products that should be reflected in the BPA, which should be clarified. This could include Spin-Gen contracts as the characteristics are similar to the specified services.

The P371 Workgroup recognised the issue around Price Adjusters and the need to clarify whether availability payments should be reflected in the cash-out price. The Workgroup expressed concern that simply including all other costs may lead to unpredictable spikes in the Imbalance Price, during periods when a relatively small volume of Offers is accepted. Although the P371 Workgroup felt the need to reflect all costs in the Imbalance Price, the unpredictable nature of the BPA and lack of transparency may lead to higher Imbalance Prices, which Parties are unable to predict and therefore react to.

A Modification Proposal emerging from this BSC Issue will therefore ensure the Imbalance Price fully captures the value provided by all types of Fast Reserve to the system, including Non-Tendered Fast Reserve (typical of Spin-Gen contracts). Capturing Spin-Gen payments in the calculation of the Imbalance Price will make it more reflective, ensuring data on prices and volumes awarded to individual Spin-Gen service providers is openly shared. These bilateral contracts between NGESO and Spin-Gen providers (BM) are in fact signed outside of the scope of commercial procurement of ancillary services. Furthermore, any Modification should ensure that the inclusion of these fees is not contrary to the principles established by the EB GL.

Since 2001, there have been other instances of Ofgem seeking to put a higher value on capacity when the system is tight, e.g. the 2014 EBSCR. This led to P305 'Electricity Balancing Significant Code Review Developments' which extended the Imbalance Price calculation to include Short Term Operating Reserve (STOR) actions. If at the time the changes were limited to STOR because this was considered the main source of reserve, then since then, the GB balancing system has undergone a range of deep changes, including recent rationalisation and harmonisation of Reserve products[4], and so this should be reviewed.

The defect identified for this Issue is particularly exacerbated by two issues:

[3] Ofgem, Correction of price spikes in the Balancing Mechanism, Decision Document, April 2001. Available here: https://www.elexon.co.uk/wp-content/uploads/2012/02/p3decision.pdf

[4] National Grid's work on the Future of Balancing Services. Here: https://www.nationalgrid.com/uk/electricity/balancing-services/future-balancing-services

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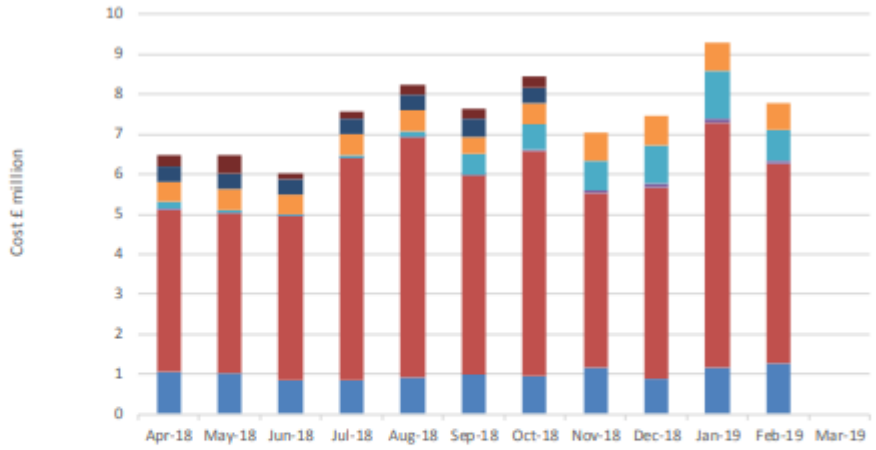
1) Non-Tendered Fast Reserve actions represent the lion share of the costs paid by the ESO for Reserve products and these are not captured in the calculation of the cash-out price.
NGESO spent between £4m and £6m/month on Hydro Spin-Gen Fast Reserve in 2018-19 for availability only (excluding utilisation via offers and bids) [5], yet no data is provided on the prices or the volumes awarded to the individual service providers.

In addition to sending incorrect messages to the industry and distorting the market signal, this lack of transparency impacts the behaviour of market participants, with overall effects to the costs to end consumers. The graphic below, from NGESO's Monthly Balancing Services Summary (MBSS), highlights the disparity in spending between tendered and bilateral services. The stark contrast shown here risks sending incorrect messages to the industry and distorts the market signal.

Fast Reserve services costs, in pounds sterling (£m)



	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19
NBM Firm Fast Reserve Utilisation (Tendered)	0.28	0.46	0.14	0.18	0.26	0.24	0.29	0.00	0.00	0.00	0.00	
NBM Firm Fast Reserve Avail + Nom (Tendered)	0.37	0.39	0.37	0.39	0.39	0.47	0.39	0.00	0.00	0.00	0.00	
BM Firm Fast Reserve (Tendered)	0.50	0.51	0.50	0.51	0.51	0.40	0.52	0.70	0.72	0.71	0.66	
NBM Optional Fast Reserve Utilisation (Commercial)	0.16	0.06	0.02	0.05	0.12	0.53	0.66	0.74	0.95	1.17	0.77	
NBM Optional Fast Reserve Availability (Commercial)	0.03	0.02	0.01	0.01	0.01	0.01	0.01	0.06	0.11	0.14	0.07	
BM Optional Fast Reserve (Commercial)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Hydro Spin Gen No LF (Commercial)	4.05	4.00	4.10	5.56	6.00	4.98	5.63	4.38	4.77	6.11	4.98	
BM - Fast Reserves	1.08	1.03	0.87	0.84	0.94	0.99	0.96	1.16	0.89	1.16	1.29	

In addition to the above, as the Imbalance Price should be truly reflecting the costs of all actions taken by NGESO, it becomes apparent that the increasing annual expenditure for Non-Tendered Fast Reserve actions represent the lion share of the costs paid by NGESO for Reserve products and should therefore be duly captured in the calculation.

2) Some units are allowed to be in receipt of STOR and Spin-Gen payments simultaneously.

A small number of units receive both STOR and Spin-Gen payments meaning that they are allowed to price their Reserve actions in a way that distorts competition. This contributes to impact the behaviour of market participants, with overall effects to the costs to end consumers.

To be consistent with the work undertaken by P305, these actions should be captured in the calculation of the cash-out price to reflect the real value of scarcity at time of system stress.

In light of all the above, cash-out prices should therefore more accurately reflect the underlying costs to NGESO, thus sending a better signal to market participants. In terms of ESO incentives, Ofgem has clearly stated in a number of documents including its guidance on ESO roles and principles, that they expect the ESO

[5] National Grid, Monthly Balancing Services Summary (MBSS) February 2019.
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to support the market to self-balance where possible, thereby minimising the ESO's own role as residual energy balancer.

Potential Solution(s) *(Optional by originator)*

If the ISH Proposal is accepted in its current form, there are some options of how the components of the BPA could continue to be captured in the Imbalance Price. These are:

- To include the costs as an additive component. The Proposal allows for additive components to be included in the Terms and Conditions for cases of scarcity, financial neutrality or incentivising fulfilment of nationally defined boundary conditions.
- Through a separate Settlement mechanism. This could be charged on the same volumes and time frames as the Imbalance charges.
- Through a separate existing mechanism such as Balancing Services Use of System (BSUoS charges), through this would require changes to the existing mechanism for this to work.

The Issue Group should assess which if any of these is appropriate to allow the continued inclusion of BPA components in the charging calculations.

Ideally the solution should allow option fees to be charged to parties in imbalance, as those contributing to the need for NGESO to contract available capacity for access to a quicker energy output.

If Spin-Gen contracts are utilised for both system and energy actions, the option fees could be pro-rated based on historic and forecast ratios of energy compared to system as long as this process is transparent, predictable and cost reflective. The same process can also be applied to how costs are assigned to Settlement periods.

Assumptions

In order to enable the discussions for this BSC Issue, a series of assumptions had to be made. These are due to the fact that there are currently some uncertainties stemming from the gradual implementation of the EB GL and the National Regulatory Authorities' (NRAs) decision on the ISH, which is still outstanding at the time of writing.

While the Proposer has acknowledged such uncertainties and the need to ensure that any Modification should not be contrary to the principles established by the EB GL, the following assumptions were made:

- NGESO will be granted exemption (as per Art 16.6 EB GL) by Ofgem and as such will still be paying option fees (the exemption request was recently rejected by Ofgem but NGESO will resubmit a new proposal within the next two months)
- Ofgem is still assessing whether the BPA could be treated as an additional component of the imbalance price.
- Even in case of removal of availability fees as legitimate Imbalance Price components, there are still on average ~£5m/month of availability fees paid to Spin-Gen providers that should be captured. These are bilateral contracts, which to date, industry has not received any update on the future of. We therefore have to assume that they will not be terminated and that availability fees will continue to be a considerable part of the revenues.

Issue objectives

The aim of the Issue Group is to:

- assess what components should be reflected in the BPA: the BSAD states that the BPA may include, but is not limited to BM Start Up and Regulating Reserve. This implies that there may be other products that should be reflected in the BPA, which should be clarified;
- determine whether the BPA needs to be adjusted/reviewed as a result of ISH, assess what components of the BPA can continue to be used in the Imbalance Price calculation to ensure that it continues to be reflective of the actions taken by NGESO;

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• assess how the components of the BPA can continue to be used in the calculation of the Imbalance Price: e.g. as additive components; through a separate Settlement mechanism; through a separate existing mechanism such as Balancing Services Use of System (BSUoS charges).
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