

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

Email: esoperformance@ofgem.gov.uk

Date: 17 December 2020

Dear colleagues,

Decision to approve the proposal for the definition and the use of Short Term Operating Reserve and the Balancing Mechanism as specific products pursuant to Article 26(1) of Commission Regulation (EU) 2017/2195

On 8 December 2020 The Electricity System Operator (ESO) submitted to us¹, a proposal to define and use Short Term Operating Reserve (STOR) and the Balancing Mechanism (BM) as specific products for energy balancing in Great Britain (GB) in accordance with Article 26 of Commission Regulation (EU) 2017/2195² establishing a guideline on electricity balancing (the EGBL Regulation).

This letter sets out our decision to approve the proposal to define and use STOR and the BM as specific products for energy balancing in GB and outlines the necessary next steps that must be taken. This letter also confirms that the conditions³ we had previously set out in our decision to approve Dynamic Containment (DC)⁴ as a specific product⁵ have been met by the ESO.

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 Commission Regulation (EU) 2017/2195 available here: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017R2195>

³ Previously, the proposal from the ESO for DC had not contained a consultation on the totality of the proposal to define and use DC as a specific product in accordance with Article 10 of the EGBL Regulation prior to its intended soft launch date.

⁴ DC is a Frequency Containment Response (FCR) product which responds rapidly to frequency changes (for example, in the case of loss of a large generator), aiming to maintain frequency within the ± 0.5 Hz statutory requirement. DC has been procured as of 01 October 2020 in a soft-launch of the product.

⁵ Our decision is available at the following address: <https://www.ofgem.gov.uk/publications-and-updates/decision-approve-proposal-definition-and-use-dynamic-containment-specific-product>

Background

STOR and the BM are products that the ESO already uses within the GB system for the purposes of balancing. The BM is a product used to ensure that electricity supply and demand are balanced in each half-hourly trading period. The BM allows BSC Parties to submit offers to sell energy to the system (by either increasing generation or decreasing consumption) and bids to buy energy from the system (by either decreasing generation or increasing consumption). STOR is a provision of reserve energy which is dispatched by the ESO in response to a fault on the network (e.g. in response to the loss of a generator).

The ESO has submitted a proposal for the definition and the use of STOR and the BM as specific products pursuant to Article 26(1). In accordance with Article 26(1) of the EBGL Regulation, a proposal for the definition and the use of specific products must contain the following information:

- (a) a definition of specific products and of the time period in which they will be used;*
- (b) a demonstration that standard products are not sufficient to ensure operational security and to maintain the system balance efficiently or a demonstration that some balancing resources cannot participate in the balancing market through standard products;*
- (c) a description of measures proposed to minimise the use of specific products subject to economic efficiency;*
- (d) where applicable, the rules for converting the balancing energy bids from specific products into balancing energy bids from standard products;*
- (e) where applicable, the information on the process for the conversion of balancing energy bids from specific products into balancing energy bids from standard products and the information on which common merit order list the conversion will take place; and*
- (f) a demonstration that the specific products do not create significant inefficiencies and distortions in the balancing market within and outside the scheduling area.*

The proposal from the ESO for STOR and the BM was submitted in accordance with Article 26(1) and contained all necessary information⁶.

The proposals from the ESO for STOR, the BM and DC set out that they are products necessary for maintaining operational security, and that either there is no alternative product available or that alternative products are insufficient for ensuring this. Hence, the

⁶ The ESO does not intend to convert balancing energy bids for these products into balancing energy bids for standard products. The ESO has stated that STOR, the BM and DC will only be activated locally, and therefore Article 26(1)(d) and (e) do not apply in these submissions.

ESO believes that it is necessary to define and use them as specific products in order to continue to utilise them.

Reasons for our decision

We have reviewed the proposals submitted to us in line with the requirements of the EBGL Regulation, the wider objectives of Regulation (EU) 2019/943⁷ (the Electricity Regulation) and our statutory duties and obligations. We have also engaged with the ESO to clarify our understanding of the proposals.

When assessing the ESO's proposal for the definition and the use of STOR and the BM as specific products, we considered the following aspects set out in Article 26(1) of the EBGL Regulation:

(a) a definition of specific products and of the time period in which they will be used

We understand that STOR has been defined by the ESO as one of a number of products that contribute to the Operating Reserve Requirement (ORR) which they hold. STOR can be provided by BM and non-BM participants via a flexible or committed service. For the committed service, a provider must be available for all contracted availability windows. For the flexible service, providers can specify how many hours they wish to make the service available, and when the service is offered.

The BM is also defined as a product contributing to the total ORR held by the ESO. The BM is used to balance generation and demand in each half-hourly settlement period of every day. It is procured up to one hour before gate closure. The BM can be used for a variety of purposes, but is used chiefly for energy balancing and constraint management.

We believe that STOR and the BM, as defined within the ESO's proposal, will be able to ensure greater operational security and constraint management within the GB system, and that they are sufficiently different in functionality compared to standard products to justify their continued use.

⁷ 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>

(b) a demonstration that standard products are not sufficient to ensure operational security and to maintain the system balance efficiently or a demonstration that some balancing resources cannot participate in the balancing market through standard products

We believe that STOR and the BM, as defined within the ESO's proposal, will still be needed to help balance the system, even in future scenarios where Replacement Reserve (RR) is available through the Trans-European Replacement Reserves Exchange (TERRE) platform.⁸ Recognising that RR through TERRE is available through auction means that it may not ensure that the need for replacement reserve is met, and so specific products are necessary to ensure operational security. Further, we note that RR is likely to be used for energy balancing, but it is not suited to system constraint management. Thus, the BM is needed for constraint management, and this will not present a distortion to the market.

We would expect the ESO to procure RR through TERRE as a primary method of ensuring operational security, subject to economic efficiency, but recognise that where this method cannot provide sufficient reserves, STOR and / or the BM will be necessary. We understand that other standard balancing products do not, and will not, have all the capabilities required by the ESO to ensure operational security. We therefore believe that standard products are not sufficient to ensure operational security and to maintain the system balance efficiently, and that continued use of STOR and the BM as specific products will be necessary.

(c) a description of measures proposed to minimise the use of specific products subject to economic efficiency

The ESO has stated that it is committed to procuring RR primarily through the TERRE auction once it goes live. However, it has also stated that TERRE alone would not be able to ensure the operational security of the GB network, and thus STOR and the BM will still be necessary products. We understand that their procurement and utilisation should reduce once TERRE becomes available, but we note that there may still be occasions where 'out-of-merit' bids in the BM may need to be dispatched for constraint management reasons.

We also understand that the ESO will still need to procure STOR capacity ahead of the TERRE auction and BM market closures to protect against large system losses and ensure operational security, but that STOR will only be dispatched if sufficient RR

⁸ Details of the TERRE platform can be found at: https://www.entsoe.eu/network_codes/eb/terre/

cannot be provided over the TERRE platform. Once activated, STOR would be used to correct system frequency and RR would be dispatched to replace those reserves. We understand that it would be undesirable to dispatch reserve services such as STOR for balancing purposes as this depletes the amount of reserve held which may be required for unforeseen losses.

As a result of the above considerations, we understand that that use of STOR and the BM will be minimised.

(f) a demonstration that the specific products do not create significant inefficiencies and distortions in the balancing market within and outside the scheduling area

We have also not seen evidence to suggest any risk that continued use of STOR and the BM will create any significant inefficiencies and distortions in the balancing market inside the GB scheduling area. We believe the ESO has demonstrated that the market arrangements for STOR and the BM are sufficiently different to the standard RR product such that their continued use will not lead to any negative impacts. In addition, STOR and the BM are not intended to be converted into standard RR products and we understand that the ESO will only activate them locally. As a result we also believe that there is no risk of distortions outside of the GB scheduling area.

Where economic to do so, the ESO are committed to use of TERRE to dispatch RR products. The BM shall only be used where a shortfall in the amount of RR procurable through TERRE arises, and shall only be dispatched in economic priority, or where system constraints require it. STOR will continue to provide headroom to secure against the largest system loss.

Consultation on Dynamic Containment

The required consultation on DC was conducted in accordance with Article 10 of the EGBL Regulation. We therefore consider the conditions of the DC Article 26 request met in full. Responses to this consultation were submitted to us, and the majority were in favour of the proposal. One respondent noted that the 'synthetic inertia' provided by DC does not sufficiently replace 'real inertia'. However, we agree with the ESO's position that this does not preclude the definition and use of DC as a specific product which contributes to system security.

Decision and next steps

We agree with the ESO that STOR, the BM and DC are critical to ensuring future operational security, and based on our analysis of the information submitted to us by the ESO as required by Article 26(1) of the EBGL Regulation, and the need for energy reserve services to ensure security of supply we hereby:

- approve the ESO's proposal for the definition and the use of STOR and the BM as a specific products pursuant to Article 26(1); and
- confirm that the conditions set out in our decision to approve of DC as a specific product have been met.

In accordance with Article 26(2), the ESO must also review the necessity to use specific products in GB at least once every two years using the criteria in Article 26(1).

If you have any queries regarding the information contained within this letter, please contact James Hill (James.Hill@ofgem.gov.uk).

Yours faithfully,

Alastair Owen

Senior Manager – Systems and Networks