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**Request for derogation under Article 6(14) of the recast Electricity Regulation from the requirements under Article 6(4) of the recast Electricity Regulation in respect of specific balancing products**

Dear Leonardo,

Please consider this letter as a formal derogation request to Ofgem, under Article 6(14) of Regulation (EU) 2019/943, relating to the settlement of balancing energy for specific balancing products under Article 6(4). In accordance with Article 6(4) of Regulation (EU) 2019/943, the settlement of balancing energy for standard balancing products and specific balancing products shall be based on marginal pricing (pay-as-cleared) unless:

1. Under Article 6(4), all regulatory authorities approve an alternative pricing method on the basis of a joint proposal by all transmission system operators following an analysis demonstrating that the alternative pricing method is more efficient; or
2. Under Article 6(14), where standard balancing products are not sufficient to ensure operational security, a proposal for derogation from the requirements of Article 6(4) can be made for those 'specific balancing products which are activated locally without exchanging them with other transmission system operators'.

Within Great Britain, standard balancing products and specific balancing products are in the process of being established and implemented under EBGL. In accordance with Articles 25 and 26 of EBGL, the standard balancing products and specific balancing products will be implemented in parallel and in alignment (and incrementally) with the implementation frameworks for the European platforms under Articles 19, 20 and 21 of EBGL. In accordance with its implementation framework and Ofgem's approval of our extension request, TERRE, the first of these European platforms, is expected to be implemented in June 2020. To date, the TERRE implementation framework establishes standard balancing energy products for replacement reserve and we have proposed the specific balancing products of the Balancing Mechanism for energy balancing and STOR. Article 6(4) has been considered against this background and timeline and it will be revisited as further standard balancing products and specific balancing products are established in future.

Once these standard and specific balancing products are implemented we will need to comply with Article 6(4) for those standard and specific products but for the reasons set out below these standard balancing products will not be sufficient to ensure operational security. We are therefore seeking a derogation from Article 6(4) under Article 6(14) for the following two specific balancing products which will be activated locally and without exchanging them with other TSOs.

- **Balancing Mechanism activations for the purposes of energy balancing:** The Balancing Mechanism is a pay-as-bid market (rather than pay-as-cleared) and it is used to set the price of bids and offers for balancing energy<sup>1</sup>; and
- **Short Term Operating Reserve (STOR):** STOR balancing energy is settled on a pay-as-bid basis rather than a pay-as-cleared basis.

**Therefore, under Article 6(14) of Regulation (EU) 2019/943 and for the reasons set out below, we are seeking a derogation from the requirement for balancing energy to be settled on a pay-as-cleared basis for these two specific balancing products as is required under Article 6(4) from the date those products are implemented for the purposes of EBGL Article 26(3). We are requesting the derogation for a period of two years from this date to align with the obligations to review specific products every two years in accordance with EBGL Article 26(2) and we will consider the ongoing need for derogation during this initial two-year period.**

<sup>1</sup> The Balancing Mechanism is also used to price actions taken for electricity system operation to alleviate congestion. These actions are not considered balancing under the requirements of the recast Electricity Regulation.

Article 6(14) requires “a description of measures proposed to minimise the use of specific products, subject to economic efficiency, a demonstration that the specific products do not create significant inefficiencies and distortions in the balancing market either inside or outside the scheduling area, as well as, where applicable, the rules and information for the process for converting the balancing energy bids from specific balancing products into balancing energy bids from standard balancing products” in support of our derogation proposal.

The Balancing Mechanism and STOR are established mechanisms within Great Britain for managing the operational security requirements of the national electricity transmission system within the parameters of the NGESO licence. There is work ongoing to deliver increased balancing energy through standard balancing products (such as via TERRE) and to reduce the use of specific balancing products in future. However, the standard balancing products introduced through TERRE (and any other platforms in future) have not yet been implemented and are therefore not tested as to whether they can provide the operational security requirements of our domestic national electricity transmission system. Therefore, we are taking measures which will minimise the use of specific balancing products in a way that is commensurate with our general obligations under European regulations, whilst maintaining a secure and economically efficient domestic national electricity transmission system.

Within Great Britain we routinely offer the full cross-border interconnection capacity to the market, with the market then deciding how much to flow on the interconnector subject to the price spread between the GB and BE/FR/IE/NL markets. Interconnector capacity offered to the market is only reduced in exceptional circumstances when other commercial means have been exhausted by the ESO, or when those other commercial means are likely to prove ineffective, for example due to the specific market spread. The reduction in capacity is taken to ensure a secure system can be operated in real-time. Therefore, there is no evidence to suggest that the use of specific balancing products causes inefficiencies and distortions in the balancing market either within or outside of Great Britain<sup>2</sup>.

The rules for converting specific balancing products to standard balancing products at the border are being considered as part of the implementation of the standard balancing products via TERRE but we plan to activate the balancing energy bids from specific products locally without exchanging them at this point in time.

In addition, the attached report at Appendix 1 outlines the specific and general economic arguments for maintaining the Balancing Mechanism and STOR as pay-as-bid (rather than becoming pay-as-cleared) and outlines the consumer benefits of maintaining our pay-as-bid arrangements. This analysis supports our request for a time-limited derogation.

Whilst we are requesting a derogation against Article 6(4) for these two specific balancing products, we expect to continue to work in partnership with industry to move towards the target model and so we would expect to periodically review the need for this derogation to ensure that if circumstances change for one or both specific balancing products the decision to derogate against Article 6(4) can be revisited in future. This derogation will allow our response and reserve reform programme to be undertaken in a structured manner as per our ESO Forward Plan 2019-2021 and draft ESO RIIO-2 Business Plan whereby we will keep the need for this derogation (especially related to STOR) under review.

As further specific balancing products are expected to be established and implemented as further standard balancing products are established and implemented in future (in accordance with EBGL) we will also need to reconsider the scope of this derogation at an appropriate point in time in respect of any new standard balancing products and their associated specific balancing products.

In respect of the two-year derogation period and the interactions with our response and reserve roadmap we are happy to provide regular updates to Ofgem and/or industry throughout the derogated period in respect of our views on the need for and extent of any further derogation in relation to the development of our response and reserve products.

If you have any queries regarding this derogation request or supporting evidence, please contact Bernie Dolan in the first instance on 07787669574 or at [Bernie.Dolan@nationalgrideso.com](mailto:Bernie.Dolan@nationalgrideso.com).

Yours sincerely,

**John Twomey**  
Acting Head of Future Markets

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<sup>2</sup> These points and others are further explored in our Article 26 proposal for defining and using specific products currently being considered by Ofgem.