National Grid Electricity Transmission plc

Overview of Proposed Changes

For Firm Frequency Response

And Fast Reserve

Balancing Services

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Firm Frequency Response / Fast Reserve Review 2008

Overview of Proposed Changes

Highlights across Fast Reserve and Firm Frequency Response

1. Multi month tender submission will continue to be monthly for medium term tenders contrary to initial proposals

2. Introduction of "Right to Withdraw a Tender"

3. Timing of tender submission will be modified for single month and medium term tenders

4. Introduction of longer term tender process

5. Improvement on Information provision through market reporting

6. Ability to submit overlapping tenders

7. Price indexation for tenders for a duration of over 12 months (see also Appendix A)

8. Increased flexibility for those providers who need to invest

9. Review of Fast Reserve optional service parameters

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Firm Frequency Response & Fast Reserve (FFR/FR) Commercial Review

Initial Proposed Changes

This document highlights the next step in proposed changes to be undertaken following an internal review of the feedback and comments received as part of the FFR/FR workshop held at National Grid House on the 04th July 2008.

The link below takes you to a summary document that is published on the National Grid website, this document contains discussions held as part of this workshop.

http://www.nationalgrid.com/NR/rdonlyres/C97A358F-301C-4930-B33D-34B30EF28DC0/27057/FFRFR_Workshop_Summary.doc

The appendix in the linked document also contains attached presentations highlighting the initial proposed changes prior to the workshop being held. In addition we also have published on our website draft Standard Contract Terms (change marked) for both services highlighting the legal changes made as part of the initial proposals. These can be found under the following links:

Fast Reserve:
http://www.nationalgrid.com/uk/Electricity/Balancing/services/reserveservices/fastreserve/

Firm Frequency Response:
http://www.nationalgrid.com/uk/Electricity/Balancing/services/frequencyresponse/ffr/

Further to Initial Proposed Changes

1. Multi Month Tendering Frequency ('Medium term tenders')

The feedback from the majority of the attendees at the workshop was not supportive of the initial proposed change that limited multi month tenders to twice a year. Feedback received was that the existing timing and frequency of monthly tender submissions for both month ahead and multi-month tenders was more preferable. As a result of this feedback National Grid will not change the existing Standard Terms and Conditions in relation to the frequency of tenders for medium term provision therefore providing potential participants with more opportunities to tender for the multi-month tenders.

Medium term tenders are defined as being no longer than 24 months in duration and tendered for a period no longer than 26 months ahead of the submission date. Our thoughts on longer-term tenders are explained later in the document.

Question Box: Multi Month Tendering Frequency	
Q1.	Do you feel that having more opportunities per year to submit multi-month tenders correctly balances flexibility of the provider to submit tenders against potential inefficiencies of tenders for similar periods not being submitted together?

2. Right to Withdraw a Tender

Question Box: Right to Withdraw a Tender

Q2. Do you feel that by introducing a right to withdraw a tender submission it will lead to more efficient prices?

3. Tender Submission Timescales for single month and medium term tenders

Provider feedback given during the review workshop highlighted that bringing forward the tender submission and shortening the assessment time would provide additional benefit. The current date for notification is deemed too late for providers to consider other market opportunities should the tender be rejected. Below is the existing time table for Fast Reserve and Firm Frequency Response tenders:

Existing Timetable	**Market Information Published**	**Receive Tender**	**Notify Providers of assessment results**
FR Multi Month Tender	BD5	BD10	BD15
FR Single Month Tender	BD5	BD10	BD15
FFR Multi Month Tender	BD1	BD1	BD12
FFR Single Month Tender	BD1	BD5	BD12

Following feedback received as part of this service review we are proposing to amend the tender process timescales to achieve the following;

- Reduce assessment timescales
- Aligning tender submissions across Fast Reserve & Firm Frequency Response
- Bring forward submission dates to beginning of the month

Proposed Timetable	**Market Information Published**	**Receive Tender**	**Notify Providers of assessment results**
FR Multi Month Tender	BD-5	BD1	BD10
FR Single Month Tender	BD-5	BD3	BD10
FFR Multi Month Tender	BD-5	BD1	BD10
FFR Single Month Tender	BD-5	BD3	BD10

The timings of the single month and multi month tender are slightly different with the multi month tender assessment period being 2 business days longer to allow for increased complexity during assessment.

A result of the tender process starting earlier in the month means the market information needs to be published earlier, this means that approximately the last 5 days of data in the market information report will be based on forecast/indicative data.

Question Box: Tendering Process and Timescales

Q3. To what extent do you believe proposed timescale changes reduce the commercial risks to the potential providers of the service?

(please also see Q8.)

4. Long Term Tender Timescales

Whilst it was noted as part of the workshops that there is desire by providers to have tender flexibility, for longer term tender submissions there are specific issues that we feel require further consideration:

- Assessment of a long-term tender (e.g. five years) is likely to need considerably longer than 9 workings days to assess (as currently proposed under this review).
- We feel for longer-term tenders especially, other potential providers should be aware of the fact such a tender has been submitted and be offered the opportunity to submit a tender for that timescale such that National Grid can be sure that all potential proposals are being assessed at the same time.

To overcome such issues the proposed process and associated timetable for Longer Term Fast Reserve and Firm Frequency Response tenders is as follows;

	Receive Tender	Notify Industry of tender receipt	Tender extension for further submissions	Notify Providers of tender outcome
FR Longer Term Tender	BD1, Month x	BD5, Month x	BD15, Month x + 1	BD15, Month x + 2
FFR Longer Term Tender	BD1, Month x	BD5, Month x	BD15, Month x + 1	BD15, Month x + 2

The process above is designed to act as a separate process over and above the proposed multi-month and single month tenders – this process could be operated on a rolling month basis process or operated 3 to 4 times per year on preset dates. The process is activated once National Grid receives a tender offer to provide a FFR/FR service that exceeds 24 months in duration. Once a tender is received, National Grid will notify existing and potential providers via email circular, in addition, a website notice will be posted. Once potential and existing providers of the service are notified by National Grid they will have until BD15 of the month after the notification was issued to submit a longer term tender for consideration by National Grid as part of the assessment.

Assessment of all longer term tenders received will commence following BD15 month x + 1. National Grid will notify providers of the results of their longer term tender submissions by BD15 of the following month.

It is not intended to include the right to withdraw a tender in the longer-term process due to the option for indexation to remove some of the market risk and the timescales associated for assessment and notification.

Question Box: Longer Term Tender Submission Process & Timescales

Q4. Do you agree with National Grid's view that longer term procurement should form a separate tender process and if so do you agree with our timescale definitions of medium and long-term tenders?

Q5. Do you think that the longer term tender process should be operated on a rolling monthly basis or restricted to a few pre selected months per year?

Q6. Do you agree with National Grid's view that when longer term tenders are submitted it triggers an industry notification and extension for further longer term tenders to be submitted? If so, do you feel the timescales are suitable?

Q7. Do you agree with National Grid that the right to withdraw a tender should not be included in the longer-term process?

Q8. Do you think that the proposed longer term tender submission process should also be applied to the medium term tender process (Albeit with shortened assessment timescales)?

5. Fast Reserve Market Report

More information will be published as part of the Fast Reserve Market Report, such as the duration of accepted contracts via the tender rounds. This information will provide better market signals to potential and existing market participants.

Question Box: Fast Reserve Market Report

Q9. Do you agree with National Grid's view that publishing further information such as the duration of accepted tenders will provide better market signals to potential and existing market participants?

Q10. What additional information would you like to see in the Fast Reserve Market Report?

6. Firm Frequency Response Flexible Tenders

National Grid proposes as part of this review to amend the Standard Contract Terms to allow providers to submit prices for baseload, extended peak, peak and overnights for the same unit. These options would be overlapping which is currently not permitted under 2.3.3 of the Standard Contract Terms. National Grid would then be able to assess a combination of options that do not overlap. To manage the logistics of this then any options which are mutually exclusive can not be submitted on the same tender sheet and must be submitted as a separate tender sheet. This allows providers to submit more varied tenders thus increasing the probability of having a tender accepted at the same time as giving National Grid more choice and flexibility in their assessment.

Question Box: Firm Frequency Response Flexible Tenders

Q11. Do you feel our proposed additional flexibility in the tender process is of benefit?

7. Price Indexation

It is proposed to introduce an optional mechanism to enable a provider to tender in either a firm price or a price that is linked to indexation in both services. Availability and Utilisation Prices submitted can be indexed on an annual basis for multi month contracts. Indexation could be applied to contracts of 12 months or more in duration. The Availability Price will be able to be linked to RPI with the Utilisation Price linked to a relevant fuel price index or RPI. The indexation methodology will be applied as a percentage adjustment based on a comparison of arithmetic yearly average of the appropriate indices for the financial period preceding the period in question. The Standard Contract Terms will list various fuel price indices for selection from the provider tendering for the service based on their base fuel. Please see *Appendix A* for an example of the optional indexation methodology may look.

The introduction of indexation is designed to remove some of the risks faced by providers of the services when submitting a longer term tenders for assessment, specifically for utilisation where the provider has limited options to hedge the risk as it is unknown when National Grid may utilise the service.

Providers would have the option to select indexation or alternatively retain a fixed price tender for assessment. It should be noted that National Grid will assess the risk of any proposed indexation as part of the assessment of a tender. National Grid has purposely kept the proposal on indexation fairly simple to remove major IT system impacts.

Question Box: Price Indexation	
Q12.	To what extent do you believe indexation reduces the commercial risks to the potential providers of the service?
Q13.	Do you think National Grid has correctly identified the methodology for applying indexation?
Q14.	Which fuel price indices do you feel National Grid should include?

8. Additional Flexibility for providers who need to invest

Introducing a pre-qualification for investment projects and agreeing a Framework Agreement pre investment will enable potential providers to tender in longer term to secure Fast Reserve or Firm Frequency Response contracts. This will provide the necessary platform to facilitate investment in the assets to deliver the relevant service. This was a proposed change in the initial review and will remain a key change as part of this review.

In addition to the above National Grid are presently working with a potential provider of dynamic demand to draft suitable generic terms for the provision of Firm Frequency Response. We will consult on these proposed terms once complete. Should anyone wish to be involved at this stage of the drafting please contact Hannah Morgan on 01926 653444.

Question Box: Additional Flexibility for providers who need to invest	
Q15.	Do you think the additional flexibility is enough to enable projects to tender for provision of these services prior to investment?
Q16.	Do you think is it appropriate for National Grid to commence payments for Balancing Services prior to projects being completed, with appropriate securities?

9. Review of Fast Reserve optional service parameters

It is proposed to include a payment for Non Balancing Mechanism (NBM) providers where the enhanced service dynamics are provided as part of the service. This aligns the service terms and payments with those of Balancing Mechanism providers.

Question Box: Review of Fast Reserve optional service parameters	
Q17.	Is there anything you feel that National Grid Gas has overlooked, which may impact the ability of NBM's to provide these Balancing Services?

Next Steps

- Feedback to be received from Providers on the above proposed changes by Wednesday 10th October 2008.
- Changes to be incorporated into the Standard Contract Terms (SCTs)
- Publish change marked SCTs for final comments by 31st October 2008
- Final comments due back by 21st November 2008
- New SCTs become effective (subject to review of feedback received) January 2009 and published late December 2008.

Please review these proposed changes, the document poses a number of questions for response over and above any general feedback you may wish to provide

Responses to this document will be published on both the Fast Reserve and Firm Frequency Response web pages and should be sent to:

Sam.Wither@uk.ngrid.com
by 5pm on 10th October 2008

Question Log (Summary of questions posed)

Q1. Do you feel that having more opportunities per year to submit multi-month tenders correctly balances flexibility of the provider to submit tenders against potential inefficiencies of tenders for similar periods not being submitted together?

Q2. Do you feel that by introducing a right to withdraw a tender submission it will lead to more efficient prices?

Q3. To what extent do you believe proposed timescale changes reduce the commercial risks to the potential providers of the service?

Q4. Do you agree with National Grid's view that longer term procurement should form a separate tender process and if so do you agree with our timescale definitions of medium and long-term tenders?

Q5. Do you think that the longer term tender process should be operated on a rolling monthly basis or restricted to a few pre selected months per year?

Q6. Do you agree with National Grid's view that when longer term tenders are submitted it triggers an industry notification and extension for further longer term tenders to be submitted? If so, do you feel the timescales are suitable?

Q7. Do you agree with National Grid that the right to withdraw a tender should not be included in the longer-term process?

Q8. Do you think that the proposed longer term tender submission process should also be applied to the medium term tender process (Albeit with shortened assessment timescales)?

Q9. Do you agree with National Grid's view that publishing further information such as the duration of accepted tenders will provide better market signals to potential and existing market participants?

Q10. What additional information would you like to see in the Fast Reserve Market Report?

Q11. Do you feel our proposed additional flexibility in the tender process is of benefit?

Q12. To what extent do you believe indexation reduces the commercial risks to the potential providers of the service?

Q13. Do you think National Grid has correctly identified the methodology for applying indexation?

Q14. Which fuel price indices do you feel National Grid should include?

Q15. Do you think the additional flexibility is enough to enable projects to tender for provision of these services prior to investment?

Q16. Do you think is it appropriate for National Grid to commence payments for Balancing Services prior to projects being completed, with appropriate securities?

Q17. Is there anything you feel that National Grid Gas has overlooked, which may impact the ability of NBM's to provide these Balancing Services?

Appendix A

Indexation Formulae example (Gas Index for Utilisation base fuel)

Availability Price

The **Availability Prices** specified in Schedule [x], Section [x], Part [x] are specified at April 2008 value and will be adjusted annually (commencing on 1st April 2010) to take account of general price inflation. The index used will be the Retail Prices Index (RPI) with 1987 = 100 base. For the purposes of this Part IV, a financial year shall be a 12 month period ending 31st March.

The source of the RPI index is to be the monthly Office for National Statistics "Focus On Consumer Price Indices" http://www.statistics.gov.uk/statbase/Product.asp?vlnk=867

The **Availability Price** will therefore be increased (or reduced as appropriate) for the period April 2010 to March 2011 by the following factor:-

$$\frac{RPI_2}{RPI_1}$$

Where

RPI_2 is the arithmetic monthly average of RPI for the financial year 2009/2010
RPI_1 is the arithmetic monthly average of RPI for the financial year 2008/2009

The **Availability Price** will then be increased (or reduced as appropriate) for the period April 2011 to March 2012 by the following factor:-

$$\frac{RPI_3}{RPI_1}$$

Where

RPI3 is the arithmetic monthly average of RPI for the financial year 2010/2011
RPI_1 is the arithmetic monthly average of RPI for the financial year 2008/2009

In subsequent years indexation will continue in accordance with the above, with always the numerator of the factor representing the arithmetic monthly average of RPI for the financial year preceding the period in question and the denominator of the factor being the arithmetic monthly average of RPI for the financial year 2008/2009.

In the event that RPI ceases to be published or is not published in respect of any relevant month or it is not practicable to use RPI because of a change in the method of compilation or some other reason, indexation for the purpose of this Part IV shall be calculated by **National Grid** using an index agreed by the **Parties** with a view to determining the relevant price after indexation that would be closest to the relevant price after indexation if RPI had continued to be available.

***Exercise Prices** - Gas*

The gas exercise prices being the **Standard Exercise Price** and the prices for **Reserve** (gas only) in Schedule [?], Section [?], Part [?] are specified at April 2008 rates and will be adjusted annually (commencing on 1st April 2010) to take account of fuel price inflation. The index used will be the Gas Index for Large Consumers (GI).

The Source of the Gas Index for Large Consumers is to be the monthly Department of Trade and Industry "Energy Trends" report - "Fuel used in electricity generation by major producers"
http://www.berr.gov.uk/energy/statistics/source/electricity/page18527.html

The gas exercise prices will therefore be increased (or reduced as appropriate) for the period April 2010 to March 2011 by the following factor:-

$$\frac{GI_2}{GI_1}$$

Where

GI_2 is the arithmetic average of GI for the 4 quarters in the immediately preceding calendar year
GI_1 is the arithmetic average of GI for the 4 quarters in the calendar year 2008

The gas exercise prices will then be increased (or reduced as appropriate) for the period April 2010 to March 2011 by the following factor:-

$$\frac{GI_3}{GI_1}$$

Where

GI_3 is the arithmetic average of GI for the 4 quarters in the immediately preceding calendar year
GI_1 is the arithmetic average of GI for the 4 quarters in the calendar year 2008

In subsequent years indexation will continue in accordance with the above, with always the numerator of the factor representing the arithmetic average of GI for the 4 quarters in the immediately preceding calendar year and the denominator of the factor being the arithmetic average of GI for the 4 quarters in the calendar year 2008.

In the event that any changes in gas costs, directly resulting from a change in taxes, are not fully reflected in the Gas Index for Large Consumers in Energy Trends, the **Parties** shall agree an appropriate adjustment to the gas exercise prices (such agreement not to be unreasonably withheld or delayed).

In the event that GI ceases to be published or is not published in respect of any relevant quarter or it is not practicable to use GI because of a change in the method or compilation or some other reason, indexation for the purpose of this Part IV shall be calculated by **National Grid** using an index agreed between the **Parties** with a view to determining the relevant prices after indexation that would be closest to the relevant prices after indexation if GI had continued to be available.