

NGC's obligations in relation to securing short-term reserve

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Why is NGC's obligation important for market participants?

- Role of market versus role of NGC in terms of balancing:
 - trading arrangements provide commercial incentives on market participants to balance the system
 - NGC has role as residual balancer
- Important for market participants to understand NGC's obligations as residual balancer in relation to securing short-term reserve:
 - to provide additional transparency in relation to NGC's actions
 - to promote competition in the provision of reserve services
- The recently proposed IAE relates to these obligations – views are invited on this consultation by 18 June 2004

What obligations does NGC operate under as SO?

- NGC, in its role as SO, has a number of obligations under the Electricity Act and its transmission licence

- These include duties to:
 - operate an efficient, economic and co-ordinated system of electricity transmission
 - ensure supply and demand are balanced in real time
 - ensure that the system remains within safe operating limits
 - procure and use balancing services in a non-discriminatory manner

What about an obligation relating to securing short-term reserve?

- An obligation related to securing short-term reserve is not outlined specifically
- NGC's role in relation to securing short-term reserve is instead dependent upon an interpretation of NGC's overall obligations
- The remainder of this presentation outlines Ofgem's interpretation of this obligation

Why did this issue arise?

- In the run up to winter 2003/04, NGC had concerns in relation to forecast plant margin over the winter period:
 - In the June 2003 Operational Forum, NGC outlined a plant margin forecast of 16.2% for winter 2003/04
 - In the October 2003 Operational Forum, NGC outlined a revised plant margin forecast of 16.5% for winter 2003/04
- NGC was concerned over its ability to balance the system under the forecast conditions
- In light of this, NGC requested clarification from Ofgem as to Ofgem's interpretation of NGC's obligations in terms of securing short-term reserve

What has changed?

- Following clarification of Ofgem's interpretation, there has been a subtle but important change in NGC's approach to procuring short-term reserve
- What has actually changed:
 - Prior to winter 2003/04, NGC procured standing reserve based on a narrow economic trade off ('Approach 1')
 - Beginning in October/November 2003 with the Supplemental Standing Reserve Tender, NGC has procured reserve taking into consideration its wider obligations ('Approach 2')
- What is the distinction between the two approaches?

What is Approach 1?

- Short-term reserve procurement is based purely on narrow economic trade-off
- When procuring reserve in advance, the narrow economic trade-off considers the forecast cost versus forecast value
 - Procure short-term reserve in advance if the forecast cost of the service is less than or equal to its forecast value to NGC, vice versa
- No explicit consideration given to wider obligations to balance the system in real time
 - Trade-off does not consider degree of certainty that NGC has in respect of securing its short-term reserve requirement

What is Approach 2?

- Trade-off explicitly considers the degree of certainty that NGC has in respect of securing its short-term reserve requirements, alongside consideration of balancing costs
- NGC is required to ensure that in most circumstances it has sufficient reserve available to carry out residual balancing of the system in an economic, efficient and co-ordinated manner
- Based on this trade-off, if NGC forecasts that there is a significant risk of there being insufficient plant available on the day, it can enter into reserve contracts that might not appear to be economic under Approach 1

Why does Ofgem consider Approach 2 to be appropriate?

- The subtle distinction between Approach 1 and Approach 2 first became apparent in light of low forecast plant margin in the run up to winter 2003/04
- In these circumstances, it became apparent that the trade-off under Approach 1 was too narrow:
 - it did not give explicit consideration to costs associated with not securing sufficient reserve to balance the system
- Approach 2 more appropriately reflects the assessment that NGC makes in its role as residual balancer:
 - it includes consideration of the implications of failing to secure sufficient reserve to balance the system

NGC's assessment under Approach 2

- NGC's assessment of the most efficient and economic method of procurement in light of this trade-off is important - NGC's presentation will go through how this assessment is conducted under Approach 2
- In relation to NGC's assessment, Ofgem considers that it is important for:
 - the assessment to be dynamic and undertaken on an ongoing basis to reflect changes in information over time
 - the methodology used by NGC when making its assessment to be reviewed on an ongoing basis



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