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Press Release

Thursday 27 June 2013

OFGEM REPORT HIGHLIGHTS THE IMPORTANCE OF GOVERNMENT REFORMS TO ENCOURAGE MORE INVESTMENT IN GENERATION

- **Tightening electricity margins highlight the need for timely delivery of the capacity market**
- **Without action, risks to electricity supply could increase during the middle of this decade faster than expected**
- **Ofgem to consult on approving additional tools that could help National Grid manage tighter mid-decade electricity supplies**

Ofgem has today published its second report into electricity capacity, which illustrates the need for the timely implementation of the Department for Energy and Climate Change's capacity market. The report shows that electricity supplies are set to tighten faster than previously expected in the middle of this decade.

The risk to electricity supplies is projected to increase from the current near zero levels, although Ofgem does not consider disruption to supplies is imminent or likely, providing the industry manages the problem effectively.

Ofgem also highlights the uncertainty around supply and demand for electricity. National Grid's projections on power demand vary greatly depending on assumptions on economic activity and energy efficiency. There is also uncertainty over the timing and scale of plant closures and mothballing.

Electricity margins could tighten in 2015-2016 to between around 2 and 5 per cent depending on demand. This means that the probability of a supply disruption increases from 1 in 47 years now to around 1 in 12 years for 2015/16 or lower. If the projected decline in demand does not materialise margins could fall to 2 per cent.

Ofgem, DECC and National Grid have been working together to explore options that would provide consumers with additional safeguards against the increased risk to mid-decade security of supply. All three organisations agree that it is prudent to consider the case for additional tools to help National Grid balance the electricity network during the middle of this decade when capacity margins could be tight. These measures would give National Grid the option to buy extra demand-side response and reserve generation to balance the electricity network. Preventive action taken now will help protect consumer supplies.

Andrew Wright, Ofgem's Chief Executive, said: "Ofgem's latest report on electricity security of supply highlights the need for reform to encourage investment in generation. This is why Ofgem welcomes DECC's commitment to introduce a capacity market that will provide a longer term solution to this problem at a time when Britain's energy industry is facing an unprecedented challenge to secure supplies.

"Ofgem's analysis indicates a faster than anticipated tightening of electricity margins toward the middle of this decade. Ofgem, together with DECC and National Grid, think it is prudent to consider giving National Grid additional tools now to procure electricity supplies to protect consumers as the margin between available supply and demand tightens in the mid-decade."

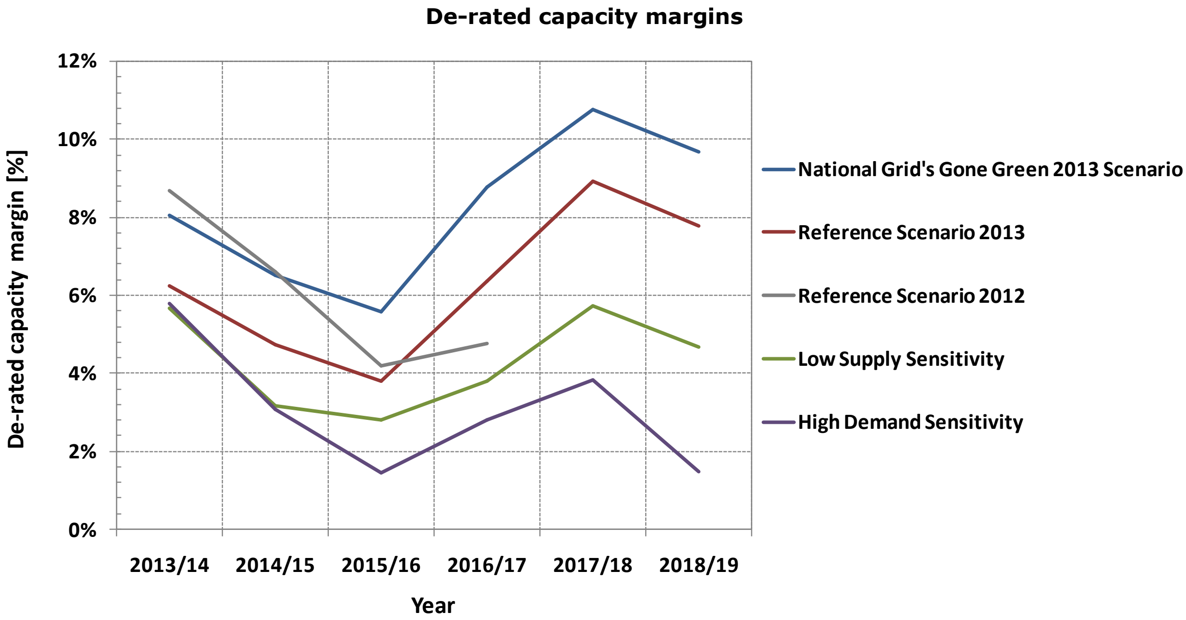
Ofgem's Project Discovery report in 2009, which fed into DECC's review of the electricity market, first identified the issue of tightening capacity margins in the mid-decade. It found that Britain's energy industry faces an unprecedented challenge to secure supplies to consumers due to the global financial crisis, tough environmental targets, increasing gas import dependency and the closure of ageing power stations.

Ends

Notes to editors

Ofgem's Capacity Assessment Report is available here:
http://www.ofgem.gov.uk/Markets/WhlMkts/monitoring-energy-security/elec-capacity-assessment/Documents1/Electricity%20Capacity%20Assessment%20Report%202013.pdf

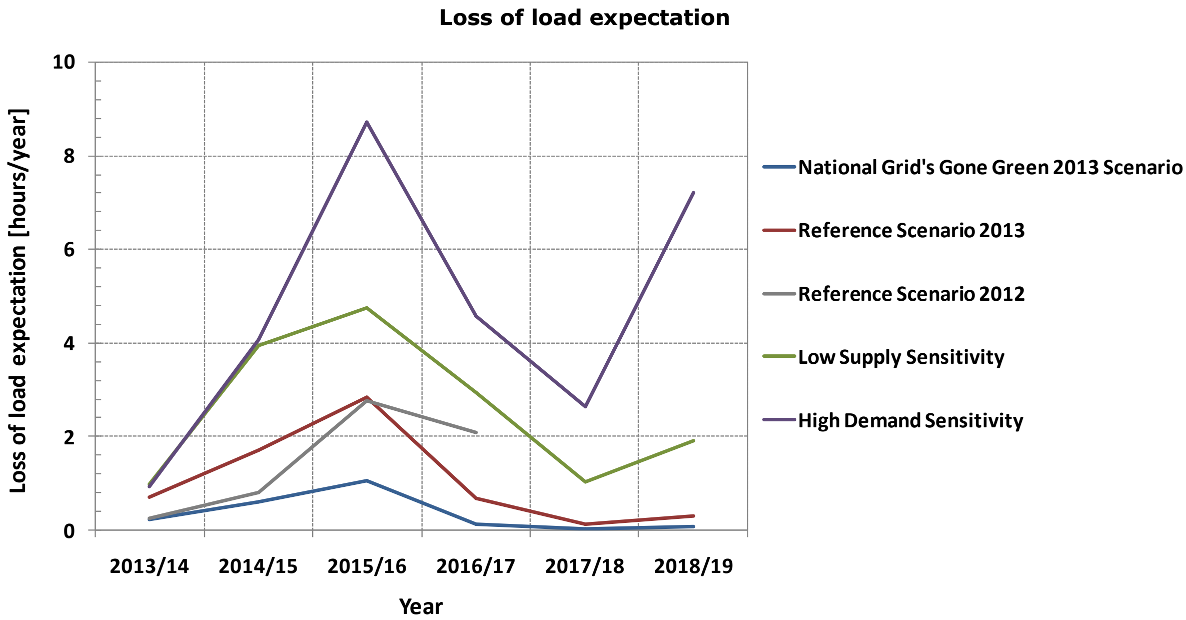
1. De-rated capacity margins



The above graph from Ofgem's Electricity Capacity Assessment Report shows the degree of uncertainty involved in estimating levels of security of supply going forward. It is difficult to provide a firm view given the significant uncertainties around both supply and demand in the analysis. Therefore, the Reference Scenario should not be solely relied upon to assess the risks to security of supply in the coming years. This is why Ofgem has presented a range of sensitivities looking at the impacts of low supply and also the impact of demand reductions not materialising – ie demand remaining flat (High Demand Sensitivity).

Loss of load expectation – a measurement of the risk to consumers' power supplies

While margins illustrate trends in the market, they are not a measure of the risk of supply not meeting demand**.** Ofgem uses loss of load expectation (LOLE) to present this risk. This does not however mean that customers will be disconnected or that there will be blackouts for that number of hours a year. Most of the time, when available supply is not high enough to meet demand, National Grid may implement mitigation actions to solve the problem without disconnecting any customers. The graph below shows the range of risk to electricity security of supply as represented by LOLE.



In the Reference Scenario 2013 we estimate an increase in loss of load expectation from less than 1 hour per year now to around 3 hours per year in 2015/16 as margins decrease. This is within the maximum level of risk accepted by other European countries, including France, Ireland and Belgium. However, if demand were to remain broadly flat then the risks to security of supply would be markedly higher than in the Reference Scenario, reaching up to 9 hours in 2015/16. The risks are also higher in the low supply sensitivity.

To illustrate the potential impact on customers, we estimate in the Reference Scenario 2013 that the probability of a large shortfall requiring the controlled disconnection of customers increases from around 1 in 47 years now to 1 in 12 years in 2015/16. This increases significantly to around 1 in 4 years if the demand reductions fail to materialise as outlined in the high demand sensitivity. Aside from the potential of controlled disconnections, any tightening in margins could impact customers through an increase in wholesale prices.

2. Additional tools for National Grid

While we consider the imminent risk of outages is low, in light of the uncertainty facing electricity margins Ofgem, DECC and National Grid think it prudent to consider the need for National Grid to design, procure and dispatch two new balancing services to help them secure additional sources of power.

These are:

1. Demand Side Balancing Reserve: This allows large energy users to sell back the energy they would have used at times when the electricity system needs additional power.

2. Supplementary Balancing Reserve. This is aimed at generators and large energy users making more power available. It allows National Grid to competitively tender to ensure they have extra reserve margins to balance the system.

National Grid could then draw on these products after exhausting its usual balancing tools in order to preserve supplies to consumers.

Ofgem has published an open letter asking for stakeholder views on the need for these measures. Our open letter can be found here: http://www.ofgem.gov.uk/Markets/WhlMkts/EffSystemOps/Documents1/Consultation%20on%20the%20potential%20requirement%20for%20new%20balancing%20services%20to%20support%20an%20uncertain%20mid.pdf

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