



Rachel Fletcher
9 Millbank
London
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26 July 2013

Dear Rachel,

Consultation on the potential requirement for new balancing services by NGET to support an uncertain mid-decade electricity security of supply outlook

Drax Power Limited ("Drax") is the operating subsidiary of Drax Group plc and the owner and operator of Drax Power Station in North Yorkshire. Drax also owns an electricity supply business, Haven Power Limited ("Haven"), which supplies electricity to a range of business customers and provides an alternative route to market for some of Drax's power output.

With regards to the three questions Ofgem raises in its open letter, we make the following comments:

1. We have no comment to make on Ofgem's security of supply assessment.
2. We agree it is prudent to consider the development of additional services. However, the proposals are not developed in sufficient detail at this stage to provide an informed judgement on whether these services are:
 - a. Necessary, and
 - b. Appropriate and efficient.
3. We agree that the three key factors Ofgem suggests to aid its assessment of the new balancing services is appropriate. In particular, consideration of efficiency, value for money and competition are crucial.

In the annex attached to the end of this response, we provide for information our more detailed response to National Grid's informal consultation on the proposed balancing services.

If you would like to discuss any of the views expressed in this response, please feel free to contact me.

Yours sincerely,

By email

Cem Suleyman
Regulatory Analyst
Regulation and Policy

Annex

General comments on the two balancing services

The services, if adopted, should only be a stop gap until the enduring Capacity Market is in place. These new services and the Capacity Market cannot co-exist. The Capacity Market is the primary mechanism to ensure sufficient capacity margins. The additional balancing services should therefore have an expiry date to ensure that what are purported to be temporary measures do not interfere with long term policy.

The decision on how the costs of these services should (or should not) be reflected in imbalance prices should be consistent with the outcomes of Ofgem's Electricity Balancing SCR. An initial assessment of how the costs of these services could affect imbalance prices would be useful to identify any unintended consequences on balancing incentives, operation of the wholesale market etc.

SBR comments

If it is determined by Ofgem and DECC that there is a need to procure this service, holding 'mothballed' plant in reserve is a reasonable way of mitigating declining capacity margins (assuming the design details are robust). The two design elements which need to be defined are the eligibility criterion and the outage rate/penalties methodology. Until the details of these elements are finalised, it is difficult to evaluate the efficacy of the proposal.

Eligibility criterion

The key to ensuring that distortions in other markets (the wholesale market, the BM etc.) are minimised is to enforce the principle of 'additionality'. If plant held in reserve is genuinely additional i.e. would otherwise not exist, then there should be limited impact on the market. However, it is important that the eligibility criterion ensures that only 'additional' plant is procured by National Grid; SBR should not act as a stop gap revenue stream to ensure the long term operation of existing plant i.e. post 2017. We suggest that this could be achieved by employing the following approach.

It should be noted that if a power station is mothballed this does not necessarily mean it has been permanently withdrawn from the market. It is entirely possible that a mothballed plant could re-enter the market in response to changes in market prices in the wholesale market. Please note however that the wholesale market is currently insufficient for procuring new capacity, thus the reason for implementing the Capacity Market. As such, we consider a mothballed plant able to re-enter the market in response to prices signals is not 'additional'. Only plant that will close or is highly likely to close in the short term should be considered additional plant. Thus, if a power station is:

1. Planning to mothball but will stay mothballed for a number of years, this should not be considered additional plant and should be ineligible for the SBR
2. Planning to mothball but will close within a couple of years, this plant may be considered additional plant and should be eligible for the SBR
3. Planning to close almost immediately, this plant should be considered additional and should be eligible for the SBR

In addition to employing the above approach, applicants should also be cross checked by National Grid against their REMIT/OC2 data submissions to ensure they are genuinely planning to close i.e. if this data shows that a plant is available post Winter 2014 this plant should not be considered 'additional'.

Consideration should also be given to ensuring that a power station, once it receives a SBR contract, is barred from future participation in the wholesale market or BM i.e. it must close. This would best ensure that SBR plant does not materially distort the functioning of related markets. However, the legal ramifications of such an approach will need to be carefully considered by National Grid. Alternative approaches may need to be considered if legal difficulties with the above approach become apparent.

Outage rate/penalties methodology

We believe that the methodology discussed in the consultation is, in practice, unlikely to be workable. It is likely to be too complicated to provide a correct assessment of the true technical capability of the relevant power station. As such we suggest that providers should be invited to freely offer the capacity they wish to offer and the level of penalties they wish to be exposed to. National Grid would then be able to rank the different offers received and make a judgement of whether any of the offers represent value for money. We note that plant unwilling to expose themselves to penalties is likely to indicate this plant is fairly unreliable and unlikely to represent value of money. Although this only holds true if the potential penalties are proportionate i.e. are unlikely to cause immediate financial distress. An exorbitant penalty regime is likely to unnecessarily deter the offering of capacity, not for technical reasons, but commercial ones. Finally, a testing regime should be developed to ensure that SBR providers can demonstrate the technical capability of their power station.

Transparency

Finally, notification of all bidders (successful or not) should be revealed immediately as such information will be market sensitive. With this information (prices, quantities offered etc.) in the public domain, market participants will be able to take better informed decisions, thus increasing the efficiency of the wholesale market.

DSBR comments

At the Workshop organised by National Grid, it did not appear that there was a great amount of appetite from the demand side to provide balancing services. This suggests that if National Grid intends to procure a large volume of balancing services from the demand side, there is likely to be a high cost associated with its procurement.

Taking in to account the anticipated high cost of these services, the split in the method of remunerating this service (relatively low start up fees but relatively high utilisation fees) indicates that there is likely to be a major impact on the volatility of BSUoS in periods where these services are called by the SO. The potential for BSUoS to spike dramatically in these periods is a concern for wholesale market participants as there is very little that can be done to hedge these risks. This is because the majority of power will have been sold forward with no opportunity to recoup the additional costs associated with BSUoS volatility.

The current timetable suggests that market participants will only become aware of the DSBR that has been procured in Q1 2014. This represents around six months before DSBR will potentially be utilised by the SO. At six months ahead of time the majority of power is likely to have already been sold into the market. As stated above, market participants will not be able to take account of the BSUoS risk in the already concluded power sales.

To give a worked example of the potential impact on BSUoS, we can assume a utilisation price of £10,000/MWh and utilisation of 1,000/MWh of DSBR. Assuming peak demand of 60GW, G BSUoS would be equal to around £83/MWh, far higher than National Grid's forecast of £1.50/MWh for 2013/14.

Additionally, the lack of penalties faced by DSBR providers places limited incentives on providers to ensure reliability. This is likely to impact on the value for money of this service and adversely impact the costs borne by end consumers.

Finally, notification of all successful bidders should be revealed immediately as such information will be market sensitive. With this information (prices, quantities offered etc.) in the public domain, market participants will be able to take better informed decisions, thus increasing the efficiency of the wholesale market.