Ofgem
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26 July 2013

Consultation on the potential requirement for new balancing services by National Grid Electricity Transmission plc (NGET) to support an uncertain mid-decade electricity security of supply outlook

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

We broadly support the analyses set out in the Electricity Capacity Assessment Report and agree that the mid-decade risks to security of supply could largely be avoided by a well designed capacity market. Such a mechanism would allow existing plant to continue to operate and provide cost effective capacity over the medium term. This would best be achieved by ensuring the design of the capacity mechanism does not discriminate against existing plant or favour new plant. This is in contrast to the Supplemental Balancing Reserve (SBR) which would only support continued operation in the short term and may not, therefore, represent value for money for consumers.

To contextualise the potential risk, we would highlight that the Short Term Operating Reserve (STOR) market is currently indicating the oversupply of short Notice to Deviate from Zero (NDZ) plant and the wholesale market is also signalling overcapacity. The first season of the proposed services is winter of 2014/2015 and we note that the spark spread for this period is very low.

Nonetheless, we understand that it may be pragmatic to consider potential mechanisms that could be deployed in the event that the UK does become exposed to significant short-term security of supply risks.

In the first instance, consideration should be given to bringing forward the capacity market delivery date. This approach will minimise any unintended negative impact described below. Having considered that option, if it is deemed that bringing forward the capacity market delivery date is not possible, at that stage, the SBR or any other potential mechanism should be considered. It must be made clear that the potential mechanisms, in particular the SBR, will only be used to bridge the period until the capacity mechanism is effective.

In general, we are concerned that the inclusion of yet another tool in this developing policy space could potentially create new risks for the design and implementation of the

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proposed capacity market. While we agree with Ofgem that the SBR will be a last resort tool and not within the wholesale market, there is a risk that the detailed design of the proposed mechanisms may be changed without due consideration (owing to the short implementation timescale) which may have unintended negative impact. We also note that the mere consideration of the SBR could, in itself, influence the actions of existing plants which may be contemplating its mid-decade business plans and distort the market. At this stage the volume of capacity to be contracted for the new mechanisms is not clear. If the anticipated volume is high, then we have concerns as it could take volume away from the market.

Our detailed responses are set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact me or Mark Cox on 01452 658415.

I confirm that this letter and its attachment may be published on Ofgem's website.

Yours sincerely,

Angela Piearce
Corporate Policy and Regulation Director

Attachment

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EDF Energy's response to your questions

Q1. Do you agree with our assessment regarding the risk to mid-decade electricity security of supply?

We broadly support the analyses set out in the Electricity Capacity Assessment Report and agree that the mid-decade risks to security of supply could largely be avoided by a well designed capacity market. Such a mechanism would allow existing plant to continue to operate and provide cost effective capacity over the medium term. This would best be achieved by ensuring the design of the capacity mechanism does not discriminate against existing plant or favour new plant. This is in contrast to the Supplemental Balancing Reserve (SBR) which would only support continued operation in the short term and may not, therefore, represent value for money for consumers.

To contextualise the potential risk, we would highlight that the Short Term Operating Reserve (STOR) market is currently indicating the oversupply of short Notice to Deviate from Zero (NDZ) plant and the wholesale market is also signalling overcapacity. The first season of the proposed services is winter of 2014/2015 and we note that the spark spread for this period is very low.

Q2. If so, do you agree with our view that it is prudent to consider the development by NGET of additional balancing services, which NGET would procure and use if there is a need for them?

In our view, there is no need for additional support to security of supply in the short-term if existing plant continues to operate. This would best be achieved by ensuring the design of the capacity mechanism does not discriminate against existing plant or favour new plant. Nonetheless, we understand that it may be pragmatic to consider potential mechanisms that could be deployed in the event that the UK does become exposed to significant security of supply risks.

In the first instance, consideration should be given to bringing forward the capacity market delivery date. This approach will minimise any unintended negative impact described below. Having considered that option, if it is deemed that bringing forward the capacity market delivery date is not possible, at that stage, the SBR or any other potential mechanism should be considered. It must be made clear that the potential mechanisms, in particular the SBR, will only be used to bridge the period until the capacity mechanism is effective.

Q3. Do you agree with our assessment of the key factors we should have regard to when considering whether to approve any changes to NGET's Balancing Services Procurement Guidelines and associated documents?

Yes. In addition to Ofgem's power and duties as set out in The Electricity Act 1989, we agree the three key factors that Ofgem should consider are:

a) NGET's procurement must be economic and efficient and the products must represent value for money to electricity consumers.
b) NGET's product design and proposed use of the new products must minimise unintended consequences to market participants and the operation of the market.
c) NGET's procurement process must be objective and transparent.

It is imperative that NGET's procurement is economic and efficient and the products represent value for money to electricity consumers. In assessing NGET's proposals, we found this factor most challenging because at this stage the volume of capacity to be contracted for the new mechanisms is not clear. If the anticipated volume is high, then we have concerns as it could take volume away from the market.

With regard to (b), we note that NGET is currently proposing that until Ofgem's review of cash-out pricing is completed, contract costs will not be reflected in imbalance prices. While we believe the SBR should be outside of the wholesale market, it is not clear whether cash-out can be immune from the service. For example, would cash-out prices be allowed to rise to a very high level, perhaps to Value of Lost Load (VoLL), or could SBR end up setting a lower cap? There is an argument to suggest that there should be no interaction at all. There is a risk that the SBR will dampen prices, the 'slippery slope' risk is introduced; it will take money away from existing plants in the market and may worsen the capacity shortfall risk.

Although we agree that these issues need to be resolved in the realm of Ofgem's EBSCR rather than NGET's consultation, it is worth emphasising that the objective of the cash-out review is to focus on what is required to deliver effective and enduring arrangements for the long term. The need to accommodate a short term measure, which may or may not be needed, should not compromise that objective.

EDF Energy
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