EEF response to Ofgem letter on potential requirement for new balancing services

About EEF

1. EEF is the representative voice of manufacturing, engineering and technology-based businesses with a membership of over 2,000 companies covering approximately 6,000 sites.

2. A large part of our representation work focuses on the issues that make a difference to the productivity and competitiveness of UK manufacturing including investment, innovation, and taxation. In this submission, we set out our response to Ofgem's letter dated 27th June 2013 seeking views on the potential requirement for new balancing services.

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

3. Yes, EEF shares the regulators concern that there is a growing risk to security of supply mid-decade. A range of analyses has, for a number of years, consistently pointed to a rapidly declining capacity margin mid-decade driven by a glut of upcoming plant closures and the slow pace of investment in new capacity.

4. Successive iterations of Ofgem's annual 'Electricity Capacity Payment' report have pointed to mid-decade margins significantly below what has historically been considered comfortable. The latest assessment projects the margin narrowing to around 2-5% in winter 2015/16 and that the risk of disruption to supply is likely to increase appreciably as a result.

5. To put the risks posed by this narrowing margin into context, the UK's large coal-fired power stations, with capacities in the region of 2-4GW, each account for around 2-5% of total generating capacity. So an unplanned outage at a major UK power station during this period would put severe pressure on the system's ability to maintain security of supply. Whilst a number of outages at the same time would pose a major threat to energy security.

6. This is a critical issue for manufacturers. Access to secure and affordable energy supplies is a key element of a competitive and attractive business environment for manufacturing. The sector is relatively energy-intensive, with energy costs as a percentage of GVA in manufacturing approximately three times those in the service sector. In a recent EEF survey, a

third of members said that more competitive energy prices would be amongst the top three changes that would make them look more positively on the UK as an investment location[1].

7. A number of manufacturing industries place a premium on security of supply. Reasons include the need to operate continuous processes, the significant costs and delays associated with shutting down and restarting operations and the ability to flex production at short notice in response to 'just in time' orders.

8. The prospect, and perception, of a heightened risk to energy security could act as a major disincentive to the inward investment which plays a key role in the sector. Manufacturing is the second largest recipient of inward 'Foreign Direct Investment (FDI) after financial services and two-thirds of the UK's largest manufacturers, and most significant industrial investors, are foreign-owned.

9. The importance of security of supply for inward investment in the sector cannot be underestimated, especially in energy-intensive industries. UK industrial electricity prices are already uncompetitive, they are approximately 10% above the EU average and double those in the US for instance, and the gap is likely to widen significantly in the coming years with the government estimating that its policies will be adding 46% to business electricity prices by 2020. The combination of increasingly uncompetitive electricity prices and a growing risk of disruption to supplies will significantly weaken the business case for investing in manufacturing operations in the UK.

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?

10. Yes, given the rapidly deteriorating capacity margin and the threat to security of supply this entails, EEF believes it is not only prudent, but essential, that the authorities consider all options for ensuring that the risk of involuntary interruptions is kept to an absolute minimum.

11. Balancing Services are a proven and well-understood part of National Grid's toolkit for maintaining security of supply. Therefore it makes sense to explore whether the scope of this tool can be expanded to encompass mothballed generating plant and broader demand-side response.

12. However, the urgent need to consider additional Balancing Services is an indictment of a national energy policy which has failed over a number of years to provide the right investment framework to deliver sufficient generation capacity to maintain a healthy margin. The

[1] EEF, Invest for Growth (2013)

development of new Balancing Services must not be seen as a substitute for an energy policy that delivers adequate generation in the first place.

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?

13. Yes, value for money for consumers, robust and transparent procurement and minimising unintended consequences to the operation of market are all critical factors in the development of new balancing services.

14. However, value for money for providers, as well consumers, must also be a key consideration. From a manufacturing perspective, this means that participation in any new demand-side service must be voluntary and that adequate financial compensation is provided for any reduction or shift in demand provided by a firm to National Grid.

15. It is also vital that the development of any new service considers business as well as technical issues such as the controllability of industrial processes. For example, consideration must be given to potential non-technical challenges to the provision of demand-side response such as managing a workforce (e.g. changing shifts patterns at short notice) and the need for a production site to retain the flexibility to respond to 'just in time' orders.

16. Since the recession, a noticeable feature of the manufacturing sector has been a shortening of order books and quicker turnaround times – i.e. there's very little forward visibility in order books and orders placed have to be fulfilled quickly at very short notice. For example, it is common for companies in the automotive supply to get 24 hours' notice for next day delivery.

17. To mitigate these issues, and encourage participation from companies operating a broad range of business models, any new service developed must include an option based on payment on delivery only. Companies for whom operational flexibility is key, would be unlikely to enter into an availability-based agreement with National Grid, even for an attractive standing payment, if there are significant penalties for non-delivery. The threat of a financial penalty for failure to deliver demand-side response risks discouraging broad participation in the new service.

18. As a minimum, any service should include an option akin to Flexible STOR where providers have the ability to declare that they are unavailable at certain times. However, an even more flexible approach, where there is complete discretion over actual delivery of demand-side response, would, in our opinion, be most likely to maximise the appeal of the service. A suite of options could be provided within the service, from availability payments coupled with penalties for non-delivery to a completely optional service with payment on delivery only.

19. Marketing will be vital to successfully implementing a new demand-side service targeted at smaller, less energy-intensive, companies than typically operate in this market today. National Grid will be trying to engage with businesses that have little awareness, let alone understanding, of balancing services and how they work. Should the decision be made to develop new services, EEF would be delighted to offer what help we can to facilitate engagement with the broader manufacturing sector.

For further information contact

Roger Salomone

Head of Business Environment

020 7654 1561

rsalomone@eef.org.uk

Gareth Stace

Head of Climate and Environment

020 7654 1506

gstace@eef.org.uk