RWE
The energy to lead

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26th July 2013

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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 – RWE response

Dear Rachel,

We welcome the opportunity to respond to the 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 (the Consultation Letter). This response is provided on behalf ofRWE npower, RWE Generation SE, RWE Supply and Trading GmbH and the UK subsidiary of RWE Innogy GmbH, RWE npower renewables.

We support initiatives by National Grid to develop ancillary services that meet the future needs of the energy market, particularly in the context of "*significantuncertainties around the outlook for both supply and demand*" (Page 1, the Consultation Letter). However, we do not believe that the case has been made for the procurement of new balancing services by National Grid to meet concerns over security of supply. Rather than introduce a interim short term measures consideration should be given to the early introduction of a market wide capacity mechanism with the first delivery in 2015/16. This should be based on non discminatory terms and open for demand side resources and existing power stations.

We have set out our general views on the proposed balancing services in our response to informal consultation by National Grid on "***Demand Side Balancing Reserve and Supplemental Balancing Reserve***". We reiterate these in the remainder of this letter.

We are concerned that the proposed measures may have a detrimental impact on the functioning of the electricity market. There is a risk that power prices may be distorted as a result of the reservation of demand side capacity as part of the Demand Side Balancing Reserve service and the return to service from mothballs or re commissioning of power stations that are otherwise uneconomic. One of the unintended consequences of the proposals is that existing power stations that are currently present in the electricity market but marginal in terms of despatch over the next few years will themselves be forced off the system. Such an outcome would beneither efficient nor economic for the wider electricity market since generation capacity that would normally retire in response to market signals would be retained and, perversely threaten security of supply and generation adequacy by forcing other

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plant to close prematurely. Decisions of power station operators to retain plant on the system in anticipation of higher electricity prices would also be undermined.

While we recognise that there may be concerns over potential risks to security of supply we believe that the current electricity market combined withexisting ancillary products and services including Short Term OperatingReserve are capable of delivering required margins. Indeed reserve products are a form of capacity mechanism and they reward availability offlexibleplant that is capable ofdespatch in balancing mechanism timescales. Furthermore, existing products arecompatible with current market arrangements. The future requirement for reserve products should be considered in the context of tightening margins and alongside the potential for cash out reform, including a move towards more marginal single cash out prices. The development of a cost reflective methodology for pricing reserve in cash out is an essential requirement to address the so called “missing money” issue.

With regard to Demand Side Balancing Reserve we are concerned that the proposedservice will detrimentallyinteract with the GB electricity market and create a set of incentives on parties that will be difficult to manage and may have unintended outcomes. The proposed service may undermine existing price signals, Triad avoidance, the relationship between suppliers and customers and introduce uncertainty in the industrial and commercial market, jeopardising the update of frequency response and STOR services by customers. We believe that the current incentives in the electricity market are sufficient to deliver a substantial element of demand side response at the peak.

We believe that the Supplemental Balancing Reserve is a “strategic reserve” capacity mechanism which may deliver incremental capacity in the short term while avoiding potential distortions in the energy market. The intention to hold this capacity outside the existing market is consistent with our views on the design of such as strategic reserve. However this product is being introduced as a short term measure in the context “narrowing margins” and prior to the first delivery year of the enduring market wide capacity mechanism. We are concerned that the mechanism has the potential to encourageinefficient existing capacity to remain on the system with consequential impacts on the availability of capacity in the enduring arrangements.

If you have any comments or wish to discuss the contents of this letter then please do not hesitate to contact me.

Yours sincerely

By email

Bill Reed
Market Development Manager

Annex 1: Responses to the specific questions in the consultation letter

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

The capacity adequacy assessment published by Ofgem[1] presents a view of the electricity system based on a number of assumptions including de-rating of capacity to reflect potential reliability, the timing of closure of existing capacity, the opening of new capacity and flows on interconnectors.

Ofgem suggest state that "*the Reference Scenario shows de-rated capacity margins decreasing faster in the next few years than expected in our 2012 report but still bottoming out in 2015/16 at around 4 per cent, before recovering thereafter*[2]". However, the Ofgem analysis is sensitive to the assumptions used and Ofgem note that "*If we look at National Grids' overall Gone Green 2013 scenario, the trends are the same but the margins are consistently around 2 percentage points higher as we make less optimistic assumptions than National Grid with regards to plant investment and retirement and the contribution of interconnectors*[3]". Ofgem also state that "*To illustrate the potential impact on customers, we estimate in the Reference Scenario that the probability of a large shortfall requiring the controlled disconnection of customers increases from around 1 in 47 years in winter 2013/14 to 1 in 12 years in 2015/16*[4]".

Given the uncertainties in predicting the future energy margins we agree with the Ofgem conclusion that"*although it is clear that the risks to security of supply are increasing, it is very difficult to accurately estimate the level of security of supply that will be provided by the market*[5]".

In this context we note that Ofgem have not considered in detail the potential for price signals in the current market to provide indicators to power station operators to retain plant on the system or to return plant form mothballs if system margins were to contract significantly. Consequently we believe that the evidence presented by Ofgem indicates that while margins may tighten under all credible scenarios there will be sufficient capacity to meet demands over "mid decade" period.

2 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?

We do not agree that additional balancing services are required. Existing market signals provide incentives for power stations to remain on the system or to return from mothballs in the period up to the introduction of an enduring capacity mechanism. We also note that DECC are considering introducing some form of demand side management arrangements in the interim period up to the first delivery year of the capacity mechanism (due in 2018/19) and that these may contribute to improving security of supply.

Additional balancing services may undermine the current reserve procurement arrangements, could overhang the electricity market, threaten investment in plant that is otherwise marginal on the system and may create perverse incentives on power stations to mothball in anticipation of balancing services revenues. We believe the wider implications of the procurement of additional balancing services require detailed consideration in the context of the evolving policy landscape. We feel that the introduction of the service would be a "knee jerk" reaction to tightening margins indicated by Ofgem and would foreclose the normal operation of the electricity market.

[1]Electricity Capacity Assessment Report (the Ofgem Capacity Assessment) 2013, Ofgem, June 27th 2013
[2]Ofgem Capacity assessment, Executive Summary Page 4
[3] Ofgem Capacity assessment, Executive Summary Page 4
[4] Ofgem Capacity assessment, Executive Summary Page 4
[5] Ofgem's Capacity Assessment, Overview, Page 1

3 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?

We agreethat if National Grid is to produce an additional "security of supply" (or strategic reserve) balancing service the procurement process must be economic and efficient, the design must avoid unintended consequences and the procurement process must be *"objective and transparent*"[6].

[6] Ofgem letter, Page 3