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Julian Roberts  
Wholesale Markets Policy  
Ofgem  
9 Millbank  
London  
SW1P 3GE

5 December 2013

Dear Julian,

### **National Grid's Proposed New Balancing Services: Draft Impact Assessment**

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.

The comments in this letter are restricted to our views on the proposed Supplemental Balancing Reserve (SBR) product. We recognise that there is potentially a gap between now and the first capacity market delivery year (2018/19) where additional measure(s) may be required to ensure security of supply. Therefore we consider that a SBR product may assist National Grid in balancing the transmission system against an anticipated background of narrowing plant margins in the mid-decade period. However, we believe that the SBR product will only be beneficial overall if it meets the following criteria noted below:

- SBR must be a time limited, transitional measure
- SBR must ensure that plant procured is 'additional' to what the market would have delivered in the absence of an SBR product and must only be used as a last resort

We discuss below how these two key criteria can be best met. However, it's important to note that the late publication of National Grid's Supporting Report to the Authority, being so close to Ofgem's deadline for responses to the consultation, will have impaired the ability of interested parties to respond to the Draft Impact Assessment.

### **Ensuring 'additionality'**

To avoid distorting related markets and competition it is essential that plant procured by National Grid is genuinely additional. For example, there seems to be a real risk that the STOR market may be distorted if the additionality principle is not adhered to. This can be observed from the fact that STOR prices have recently cleared at around £6/kW, whereas it can be inferred from the Draft Impact Assessment that SBR plant may be able to command up to £25/kW.

Due to the risk of market distortion, we are concerned by the removal of the requirement for a signed declaration from the board of directors of the company that own the relevant power station. This would declare that the plant(s) will not be participating in the market for energy or other balancing services during the term of the SBR contract (being for the entire year or years and not just the availability windows) for which they are tendering, irrespective of the current status of the plant and whether or not a contract is secured. Without a requirement for a Board Declaration, we believe it will be far more difficult for National Grid to adhere to the additionality principle.

Nevertheless, we understand that National Grid still intends to only provide SBR contracts (if required) to plant which is additional; we welcome this intent. National Grid define additional plant as generation (or

demand) that “would not have been available for despatch had [it] not been contracted to provide SBR”<sup>1</sup>. We agree with this definition. Whilst being far more difficult to achieve without a Board Declaration, National Grid should still strive to only procure plant which is genuinely additional.

However, without a mechanism to ensure that plant procured is genuinely additional, we consider it will be extremely difficult for National Grid to limit its procurement to additional plant. National Grid’s rationale for not requiring an explicit additionality ‘method’<sup>2</sup> does not convince us that the additionality principle can be met. Specifically, we note National Grid’s assumption that only marginal plant which has just exited, or is about to exit the market, will bid for an SBR contract due to it, in effect, being relatively cheaper compared to long-since closed and more efficient plant. We consider this assumption to be wholly unsatisfactory. This is because we believe it is likely that plant, which would otherwise be available to the market, is likely to bid for an SBR contract. We believe this will be the case because:

1. National Grid has placed no restriction on who can bid for an SBR contract; and
2. Most importantly, the potential revenue associated with the SBR product seems likely to be favourable relative to the revenues available from STOR contracts and also the uncertain revenues potentially available from the wholesale market.

As it seems likely that plant available to the market will be withdrawn by National Grid in the event that it tenders for SBR plant, this will result in sending the market short and raising wholesale power prices. We are incredulous as to how National Grid can refer to this as a ‘stimulus’ rather than, as it appears to be, a market distortion. While this action may encourage more plant to re-enter or stay in the market (at least in the short run), we question whether, in the current political environment, rising wholesale prices will be accepted.

Therefore, as it is likely that plant available to the market will be procured by National Grid, we consider there will be an active enforcement role for Ofgem. In our view, additional plant can only be plant that has declared itself unavailable (via OC2/REMIT data) for the year(s) being contracted for. Any plant currently mothballed that is awaiting “changes in market conditions” and has not declared that it is unavailable should be considered to be operating in the market. This plant is therefore not additional plant and thus not eligible for a SBR contract. We believe that plant tendering for an SBR contract which fails to notify its unavailability in its OC2/REMIT submissions should be investigated by Ofgem under its REMIT/wider competition powers. This is because there is a real risk of market distortion and thus consumer harm. Ofgem should also investigate plant which has been in receipt of a SBR contract, but on the expiration of the contract, continues to operate in the market. This approach could represent an alternative to the discarded Board Declaration.

Moreover, we believe that once an SBR contract expires, the holder of the SBR contract should be barred from participating in the Capacity Market. To do otherwise will distort the market and thus competition to the detriment of end consumers.

We also note the change made to the SBR product detailed in National Grid’s Supporting Report to the Authority, that part BMUs may be able to participate in the provision of SBR, e.g. the steam turbine of a CCGT. We do not believe that purchasing a steam turbine in isolation could pass the additionality test. Whilst a steam turbine may be a separate piece of equipment, it can only operate if there is a supply of steam delivered as a result of an operational gas turbine. Therefore to be available to the SO when required, the steam turbine must form part of an operational CCGT package, i.e. both the gas turbine and steam turbine must be available and warm. If both turbines are out of the market (mothballed perhaps), and thus additional, then it is clear that the combination is additional and, thereby, eligible for a SBR contract. However, if the steam turbine is out of the market, but the gas turbine remains operational in the market (operating in OCGT mode; maybe in receipt of a STOR contract), then an element of the BMU remains outside of the control of the SO unless the two turbines are purchased together.

A further consideration is how the operation of a multi-turbine BMU will be monitored / audited to ensure that the “additional” element was only used as instructed by the SO as part of the SBR arrangements. As the turbines will be operated, metered and settled on the basis of a single BMU, what action will National

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<sup>1</sup> Demand Side Balancing Reserve and Supplemental Balancing Reserve: Final Consultations Proposal, National Grid p.42

<sup>2</sup> “Option 1 – Economics Prevail” detailed in the National Grid Transmission – Supporting Report to the Authority on Supplemental Balancing Reserve, p18-19

Grid and/or Ofgem take to guarantee that the unit has only been utilised within the spirit of the SBR proposals?

### **Time limited measure**

We believe that a firm sunset clause, rather than a review of the SBR product by National Grid and Ofgem, is required to provide confidence to the market that the Capacity Market remains the mechanism by which to deliver security of supply in GB in the medium term. It would also better protect against the possibility of market distortions in our view.

However, if there must be a review rather than a sunset clause, we consider that Ofgem (rather than National Grid) should take ultimate responsibility for undertaking the review of the SBR product in 2016, to investigate whether the market has been adversely impacted by the intervention. This is necessary to ensure that the interests of end consumers are protected. The review must not be the responsibility of National Grid as this could represent a conflict of interest. Moreover, National Grid does not have a duty to consider the interests of end consumers, a vital consideration in any review.

### **EBSCR and Cash-Out interactions**

We agree that the pricing of SBR should be consistent with how STOR is priced into the cash-out arrangements and that it is important that it is consistent with any decisions made by Ofgem as part of the EBSCR. However, we caution against a rushed, urgent modification to amend the cash-out arrangements in the event of a SBR tender. A number of industry concerns have been raised regarding the high cash-out prices (ultimately VOLL) that the utilisation of reserves may trigger in the event that a RSP function is introduced. Caution must be exercised when determining what imbalance price SBR utilisation will trigger, as astronomic prices risk placing excessive risk on market participants, which will not necessarily be beneficial with regards to end consumer costs.

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

Yours sincerely,

By email

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