

Leonardo Costa  
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Dear Leonardo

### **Funding arrangements for new balancing services: Initial Proposals**

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.

In summary, we consider Ofgem's proposed funding approach to be proportionate. We agree that the internal costs of the two new balancing services should be recovered via the RIIO-T1 re-opener and the external costs via the 'targeted efficiency check'. We also support the inclusion of a volume cap and a volume procurement methodology to ensure that consumers do not have to pay more than what is needed. Based on NGET's current view, an additional 400 MW in 2014/15 and 1200 MW in 2015/16 would achieve 3 hours LOLE in most scenarios. If the final volume procured is closer to those figures (than the 3GW figure outlined in NGET's Final Proposals), then we would expect costs to be lower than the £75m set out in NGET's Final Proposals.

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 Mari Toda on 07875 116520, or me.

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

Yours sincerely,



**Mark Cox**  
**Head of Transmission and Trading Arrangements**

## Attachment

### Funding arrangements for new balancing services: Initial Proposals

#### EDF Energy's response to your questions

##### CHAPTER: One

**Q1: Do the draft licence conditions published alongside this document appropriately reflect our initial proposals?**

We have not sought legal input but the draft licence conditions appear to reflect the initial proposals in the consultation.

**Q2: Do you agree with our assessment that a financial incentive would not be fit-for-purpose at this time?**

Yes. Given that there is no relevant historical data (e.g. previous tender or cost information on which to base any analysis on expected costs) relating to the two new services, we agree with Ofgem that a financial incentive would not be appropriate at this time.

##### CHAPTER: Two

**Q1: Do you agree with our approach towards funding for the internal costs associated with the services?**

We agree that the RIIO-T1 mid scheme re-opener should be used to scrutinise and to recover the internal costs associated with the services.

NGET provides an indicative estimate of £8m in development and implementation costs plus an additional £4m per annum in annual operating costs. These costs seem a high proportion of the value of the scheme; there may be a need to re-examine NGET's internal administrative processes.

Given that these figures are only an indicative estimate and the RIIO-T1 mid scheme re-opener is not expected for another four years, we would want National Grid to communicate annually the amount it has spent on internal costs to ensure the industry is prepared on the level of any funding application.

**Q2: Do you agree with our view that the targeted efficiency check protects consumers and increases transparency to industry?**

For external costs, the 'targeted efficiency check' approach should, theoretically, protect consumers and increase transparency to industry. The ex-ante principles and the methodologies that NGET must develop in advance should facilitate this.

It is, however, not clear to what extent the approach would protect consumers because NGET is effectively being assessed against methodologies that they are going to develop themselves. We would suggest that the methodologies are subject to consultation to ensure industry input are factored in to the final set of methodologies (i.e. a volume cap and volume procurement methodology; a procurement methodology including principles

for availability payments; a testing methodology; and an operational methodology for pre-utilisation warming and utilisation of these services). To ensure full transparency, the final methodologies and costs should also be published, and anyone, not just Ofgem, should be able to challenge them, if they wish.

**Q3: Do you agree with how we have proposed to fund each of the cost components of SBR and DSBR?**

Yes. The internal costs should be recovered via the RIIO-T1 re-opener and the external costs should be subject to the 'targeted efficiency check'.

Additionally, the volume procurement methodology is designed to ensure that NGET procures an efficient volume of SBR and DSBR taking into account the Government's reliability standard. The volume cap methodology is designed to set out the maximum volume (MW) of SBR and DSBR procured that will be funded by consumers. The combined effect of the two methodologies should ensure that consumers fund only what is necessary, and no more.

**Q4: Do you have any views on NGET's proposed approach towards identifying a volume cap and volume requirement?**

NGET proposes the inclusion of a volume cap of 5% of average cold spell peak demand. While we do not have a strong view on the 5% figure, since the volume cap would represent the maximum volume of service provision that NGET would be funded for through BSUoS charges at any time of the duration the services, we are supportive of having a cap.

It also seems sensible to define a reference case (demand and generation) with a three-year horizon and define a number of credible and internally consistent sensitivities around the reference case to determine the volume requirement. We understand that NGET proposes to, for each case and year, estimate additional de-rated capacity required (if any) to achieve 3 hours LOLE. It would then choose volume to procure in each year to achieve 3 hours LOLE in a reasonable proportion of cases (proportion yet to be determined). At the workshop, NGET stated that, based on data from Ofgem's 2013 Capacity Assessment Report, an additional ~400 MW in 2014/15 and ~1200 MW in 2015/16 would achieve 3 hours LOLE in all but two cases. These volumes appear reasonable.

**Q5: Do you agree with the principles behind each of the ex ante methodologies and any proposed details that we or NGET have suggested should be included within the methodologies?**

Yes.

**Q6: Are there any other principles or details that should be included within our targeted efficiency check approach?**

No, everything appears to be captured.

**EDF Energy**  
**January 2014**