

Generators, Suppliers, Traders,
Power Exchanges, Customers and
Other Interested Parties

Email: soincentive@ofgem.gov.uk

Date: 31 March 2014

Dear Colleague

Black Start mid-Scheme target update: Decision Letter

This letter sets out the Authority's approval of an increase to National Grid Electricity Transmission's (NGET's) balancing services incentive scheme (BSIS) target by £14.9 million. This approval follows NGET's formal application for an increase to the Black Start target as part of the mid-scheme update provisions under BSIS. The Authority's approval is conditional on NGET providing clear evidence that it has finalised contracts in line with its proposals and within the period from 1 April 2014 to 31 March 2015. A direction which deems an increase to the value of the Black Start target is published alongside this letter.

Context: The Balancing Services Incentive Scheme and the Black Start target

Black Start is the ability of a generator to start up and provide electricity to the transmission system without an external power supply. Black start power stations would assist in the restoration of electricity supply in the event that all or part of the transmission system becomes de-energised as a result of plant failure or other unexpected occurrences. NGET as system operator (SO) enters into contracts with generators for Black Start services.

The SO is incentivised under a two-year BSIS which commenced on 1 April 2013. The BSIS sets an overall cost target which incentivises the SO to take economic and efficient procurement decisions for balancing services. The overall cost target is comprised of a number of smaller targets, including one for Black Start.

Prior to the current BSIS coming into effect, NGET provided evidence to show that it was likely to incur costs from signing contracts with new Black Start providers within the scheme period. Negotiations between NGET and potential providers were not sufficiently progressed to determine a firm Black Start cost target. We also identified uncertainty surrounding the costs of warming Black Start plant as these requirements are largely driven by relative coal and gas commodity prices.

Our mid-scheme update provisions

In order to cater for these uncertainties, we included provisions for NGET to update a baseline Black Start target at the mid-scheme point as part of our wider mid-scheme update provisions.

Under these provisions, NGET is able to propose mid-scheme updates to variables where the risk of windfall gains or losses to consumers and NGET is high. Included within this are

variables which are used to identify the baseline Black Start cost target. The following table sets out our treatment of the relevant aspects of NGET’s Black Start costs as part of the target. It highlights those variables which qualify for mid-scheme updates:

Table 1: The original Black Start Target Breakdown for 2013-15

Cost area	Description	Treatment	2013-14 target	2014-15 target
Availability fees	Payments to providers for being available to provide a service	Ex ante	£21.05 million	£21.45 million (subject to mid-scheme update of agreed variables)
Testing	Testing to ensure that the plant can provide a black start service if called upon	Ex ante		
Capital contributions for contract re-negotiations	Contributions provided by NGET for existing providers to invest in refurbishments at contract re-negotiation stage	Ex ante		
Warming	Payments to providers to ensure they are available to provide a service when they would otherwise not be	Mid-scheme update		
New provider availability fees	Availability fees for new providers who are not currently providing a service but sign a contract to start providing a service within the scheme period	Mid-scheme update		
Capital contributions for new providers	Contributions provided by NGET to new providers who sign a new contract within scheme to invest in the required capital	Mid-scheme update		
Feasibility studies	Costs of feasibility studies to identify potential providers	Ex post	NA	NA
Total cost target			£21.05 million	£21.45 million

Capital contributions and new provider availability fees

NGET aims to contract with a number of providers in a number of geographical zones across GB to ensure efficient restoration of the GB system following any potential black-out. Recent closure of several Black Start stations has led NGET to consider signing new Black Start contracts to maintain a required level of service availability. However, NGET had not completed contracting negotiations with providers at the time of finalising the BSIS scheme and a lack of robust historical information makes it difficult to set out efficient costs and volume requirements on an ex ante basis. We therefore agreed to factor in any changes to the costs of Black Start which resulted from contracts with new providers through the mid-scheme update provisions. This was based on our intention to provide NGET with the flexibility to continue to negotiate with potential providers to secure economic and efficient contracts.

NGET has now submitted proposals to add £14m for capital contributions to the baseline Black Start target. No submissions have been made for new provider availability fees. Details of NGET’s proposals for updates in relation to capital contributions are set out in the ‘NGET’s proposal’ section of this letter.

Warming costs

When developing the Black Start target, we acknowledged that the costs incurred through warming are heavily impacted by a number of external factors such as the plant types available to NGET for Black Start and the economics of the fuel mix¹. Therefore, we took the view that setting the warming target for the full scheme up to two years ahead might result in windfall gains or losses as a result of unpredictable external factors. As a result, we set an initial nominal value of zero for warming costs for 2014-15. Alongside NGET's submission for a change to the target in relation to capital contributions, it has requested £0.9m as the target for warming costs in 2014-15.

NGET's proposal

Under the mid-scheme update provisions, NGET has requested an increase of £14.9m to the Black Start target. This represents an increase from the current target of £21.45m to £36.35m for the 2014-15 scheme year. Of the proposed £14.9 million increase to the target, £14m is for capital contributions in relation to the agreement of new contracts with Black Start providers and £0.9m is for warming costs.

NGET considers making capital contributions for the construction of new black start units and the refurbishment of existing ones where it identifies an economic benefit resulting from the lower availability payments which are required because of the reduced financial capital requirements. NGET is currently approaching the final stages of negotiations with some parties and has formulated its view of amendments to the target from indicative offers.

NGET's proposed target of £0.9m for warming is £0.3m lower than the cost target set for the 2013-14 scheme year. It is also lower than the actual costs which NGET incurred for warming in 2013-14.

The Authority's decision

We consider the procurement of new Black Start contracts to be necessary to reduce the risk of system security issues. NGET has provided us with analysis demonstrating that it has considered a range of options in order to identify the most economic and efficient mix of Black Start service provision to meet Black Start requirements. It has also considered a range of approaches towards the provision of capital contributions and provided value for money assessments for various contract lengths. This analysis has given us confidence that NGET has identified an efficient combination of contracts and shown appropriate judgement in its approach towards making capital contributions which will benefit existing and future electricity consumers.

NGET has presented historical analysis and modelled estimates of warming requirements. We consider that the proposed cost for warming is justified and is in line with historical costs.

The Authority has decided to approve the proposed increase to the target of £14.9 million to reflect the expected costs for capital contributions and warming requirements in the 2014-15 scheme year. The Authority's approval is conditional on NGET providing clear evidence that it has agreed contracts in line with its proposals and within the period from 1 April 2014 to 31 March 2015. As a result of our decision, NGET's BSIS target for 2014-15 will increase by a minimum of £0.9 million to reflect its approved submission of expected warming costs. The target will increase by a maximum of £14.9 million if NGET finalises and incurs the capital contribution costs in relation to all of the contracts which it has

¹ Some plant types require longer periods of warming in order to be available to provide a service. Thus, warming costs are highly related to the type of Black Start providers that NGET has available and whether this plant will already be available or will need to be warmed from a cold start.

presented to us as expecting to sign in 2014-15.

If NGET continues to consider that these contracts will be signed but does not finalise them within the relevant year then the 2014-15 target will not be revised to reflect this expectation. Instead, we will consider the inclusion of these costs into any future scheme target. This consideration will be triggered by the submission of updated analysis and evidence by NGET to demonstrate that its proposed approach continues to be the most economic option.

Special Condition 4G of NGET's Special Licence Conditions sets out the Black Start external costs in Table 1 of paragraph 4G.2:

Relevant Year	Black Start External costs
1 April 2013 to 31 March 2014	£21.05 million
1 April 2014 to 31 March 2015	£21.45 million

Alongside this letter, we have published a direction to revise the target for Black Start costs for 2014-15 as set out above. The direction enacts the revision of the Black Start target which is deemed to be included within Table 1 of paragraph 4G.2.

Next Steps

The changes to the Black Start target will be implemented at the commencement of the second scheme year on 1 April 2014. Any costs incurred by NGET to procure and utilise Black Start services will be recovered through Balancing Services Use of System Charges (BSUoS). NGET's total external balancing services costs will then be compared against the overall scheme target and will be reflected in the incentive payment to or from NGET at the end of the scheme. The costs that NGET incurs in relation to Black Start services and the incentive payment to or from NGET will be passed through to BSUoS customers in line with NGET's usual BSUoS charging processes.