

alena.aliakseyeva@ofgem.gov.uk

Alena Aliakseyeva
Wholesale Markets
Ofgem
9 Millbank
London
SW1P 3GE

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Dear Ms Aliakseyeva,

Impact assessment on CMP201 - proposal to remove balancing charges from generators

Eggborough Power Limited (EPL) is an independent generator which owns and operates Eggborough Power Station (EPS), a 2,000 MW coal-fired power station situated in the Aire Valley in North Yorkshire. EPS was previously owned and operated by British Energy (and latterly EDF) to provide flexible and reliable mid merit support to the "baseload" nuclear portfolio. EPL is now owned by substantial private shareholders and is operating as an essentially merchant power plant in the wholesale market. EPL provides flexible generating capacity to today's challenging electricity market.

Introduction

EPL does not agree with Ofgem that a wait and see approach to this proposal would best fulfil Ofgem's wider duties. At the present time BSUoS adds to generator costs, which are then factored into wholesale power prices and increase costs to customers. By placing the costs more directly onto the customers, via the suppliers, only one part of the supply chain has to forecast and manage the risks and credit costs associated with changes in the BSUoS/RCRC charges. Having only one risk premium in the supply chain will lower costs to customers, as well as lowering wholesale prices.

The charges provide no useful signal, such as where to locate plant, but simply reassign costs between parties, which are ultimately born by customers. EPL recognise that any change in charging structures will result in changes to each party's business risks, but the costs themselves will not alter if the CMP201 and P286 modifications are approved and we believe this should lower costs to customers.

Ofgem's Impact Assessment

EPL has tried to answer Ofgem's questions, below, but feel that the modelling work has not been very robust given its inability to look to the future at a time when we know significant changes in the EU energy markets are occurring.

EPL does not agree with Ofgem's view that generators will see higher profits were Ofgem to approve the modifications. Ofgem rightly points out that BSUoS is a passed through cost, but its removal would not obviously increase export volumes and boost energy demand. Interconnector flows reflect different prices between wholesale markets, which can vary through the year.

GB generation, facing a rising carbon price support fuel tax, may be more expensive over the coming years than power from many of its neighbours. We would observe the most recent Irish interconnector was justified on the back of forecasts of renewable energy flowing from Ireland to GB, which we note NGET did not model. With the introduction next month of market coupling, cross-border energy flows should better align with prices. EPL considers that the modification in fact better aligns costs with generation in other EU states, thus helping efficient cross border trading, but in no way guarantees any increased sales for generators. We do recognise Ofgem's point that there are still many wider factors influencing cross-border trade, but any reduction in distortions should be encouraged.

If the outlook for generator margins was as good as Ofgem seems to suggest then the removal of BSUoS would seem to negate the need for increasing investment signals, such as the capacity mechanism. Marginal generators are not highly profitable; hence we see mothballed plants and EMR. The operation of each plant type is a function of spark and dark spreads, as well as renewable output and GB demand, far more than interconnector flows. The fact that the model did not look at the impact of future generation mix changes means it failed to capture falling profits for marginal plants which will be pushed up the merit order by increasing renewables.

Instead of Ofgem's impact, EPL believes there will be a positive impact on prices as a result of generators not rebilling BSUoS, nor having to add to their sales price the cost of the risk premium associated with having to forecast the charges and provide credit.

While we agree that suppliers will have a risk from the charges, we do not understand the point about different risks. Generators may earn money from constraints, but they also face fuel price risk, carbon, etc. The two are totally different businesses, with different risks, and what is important is that each competitive part of the supply chain faces non-discriminatory treatment; if all suppliers face the same BSUoS/RCRC risk, competition in supply of electricity is not distorted. In terms of volatility, the charge should become no more volatile, but the scale of the charge to suppliers would increase, but as would the RCRC cash flows to them. EPL would support better forecasting of these costs, but who then re-bills them to the customer is a different issue. We agree with Ofgem's view that there is no evidence that this change alters risks in a distortionary manner.

EPL would also be surprised if many suppliers have contracts that do not allow for changes to charges in the event of regulatory decisions. Furthermore, we suspect few contracts are over 1-2 years in length so prices can be altered when contracts are renewed. These are modifications that suppliers have known about since 2011 and may have reworded contracts or already factored in this potential change for the past two years. Ofgem needs to be mindful that ultimately customers pay BSUoS and the most direct means to bill them should be the most efficient and least cost.

Relevant Objectives & Ofgem's Duties

EPL considers that the modification would improve competition between generators across borders. Access to the cheapest supplies, irrelevant of country of origin, is in consumers' interest. The modifications therefore better fulfil the relevant objectives.

The total risk premium will decrease as only one set of parties (the suppliers) are factoring in a risk premium, where currently it is two risk charges added into the supply chain. Given the different charges suppliers face, in a rather complex market, they are better placed to efficiently manage the risks associated with altering charges; creating direct customer pass through where appropriate.

Ofgem's analysis seems to suggest that suppliers, with one exception, would not have to increase credit. Generators would get credit requirements removed. So the customers will only face the costs associated with one set of credit requirements, which would lower costs to them on top of direct cost reductions.

EPL notes Ofgem's suggestion that BSUoS could become locational. However, as transmission charging changes seem to be aiming to reduce locational differences to accommodate significant renewable new build, to introduce a locational BSUoS, when its constituent parts are not obviously locational, would sound like a policy that went against current thinking. Constraint costs could always be removed from BSUoS and charged in a different manner if Ofgem believe that constraints need locational charges.

EPL agrees with Ofgem that the modifications would better meet the relevant objectives. We also agree that the change would be a move in the right direction for better market integration and cross border trading, while recognising the wider EU market distortions that do exist. These modifications are not a total solution to EU integration, but each Member State taking steps in the right direction will help.

EPL does not agree that the benefits to customers will not be realised. The GB generation market is competitive, with a significant number of parties now owning and operating marginal plant. We therefore believe that the wholesale prices will drop and that (along with market coupling) should improve the efficiency of the wholesale market. EPL recognises Ofgem's concerns over competition in the supply market, but the current wider review of competition currently underway should, we hope, result in actions to improve the functioning of the retail market.

The suggestion that interconnector flows will increase enough to have a substantive impact on demand and thus wholesale prices is not likely, with new interconnectors being designed to move energy to the UK. The EMR regime is also aiming to prompt new investment in both conventional and renewable generation, increasing margins and improving security. With increasing intermittent generation there are increasing times when power prices dip very low, but if the costs of wholesale power are not being reflected correctly on customers' bills that is an issue with supply competition, not a reason not to accept these modifications.

Conclusions

EPL agrees with Ofgem that the modifications better facilitate the relevant objectives. However, we disagree that Ofgem's wider duties would not be met. We disagree with the assessment that the interconnector flows will significantly increase to push up demand and

raise wholesale prices. The cost savings associated with the benefits of the modification (reducing credit, improving competition, etc.) should feed through to customers. If the benefits do not feed through to customers that will be due to lack of competition in supply, not the impact of the modifications.

EPL would therefore urge Ofgem to accept the modifications.

If you would like to discuss any of the issues raised in this letter please do not hesitate to contact me.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Michelle Dixon', with a stylized flourish at the end.

Michelle Dixon
Commercial Director