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Sent via email to soincentive@ofgem.gov.uk

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Dear Mr Costa

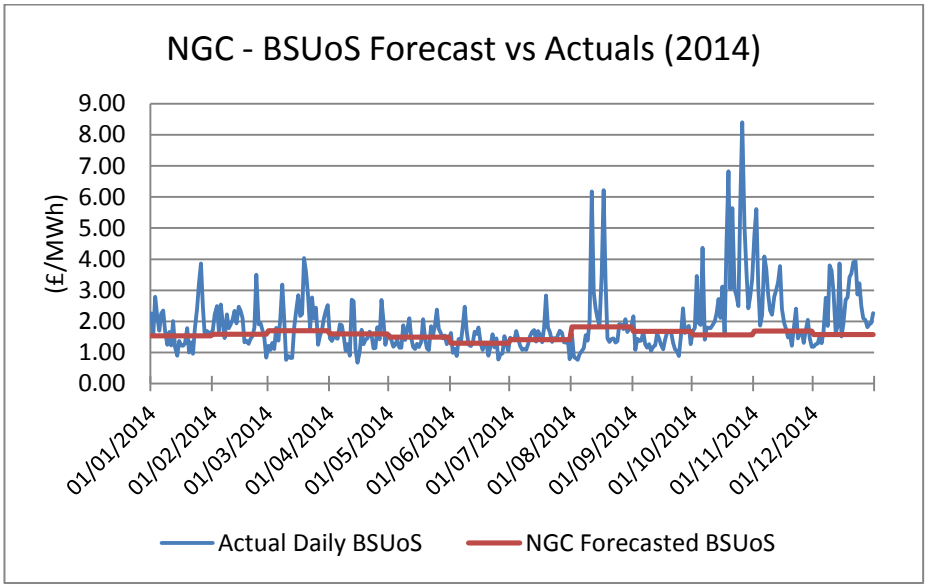
Haven Power Limited's response to the Consultation on the Final Proposals for Electricity System Operator incentives 2015-17

I am writing in response to the consultation issued on the 19th March 2015 to set out Haven Power Limited's position on the Final Proposals for Electricity System Operator incentives for 2015 – 17.

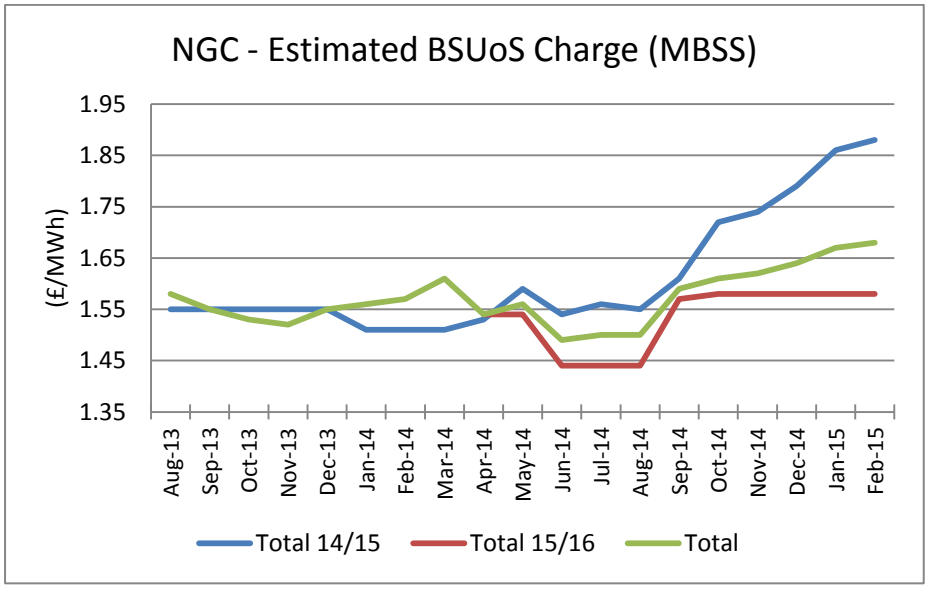
Whilst we have no specific comments on the Draft Licence conditions we would like to make some comments around the proposed incentives in general.

We support the idea of incentivising National Grid to increase the efficiency of its system balancing operation and improve the quality of the information it provides to the market. The increase in the sharing factor as well as cap and floor from 25% and £25m per annum to 30% and £30m per annum is encouraging; although we believe it should go further and be 50% and £50m.

BSUoS charges have recently been highly volatile, please see graph below. The graph shows the volatility of BSUoS, particularly between August and December 2014, and illustrates how it differs from National Grid's initial 2014/15 monthly balancing services summary (MBSS) forecast. The majority of our customers require fixed price, fixed term contracts, typically of 12 and 24 months duration, so they have certainty on their electricity charges. Additionally, customers on flexible contracts where BSUoS is a pass-through cost find it difficult to set budgets with the high degree of volatility. The degree of volatility combined with the unreliability of the BSUoS costs forecasts makes it extremely difficult to determine an appropriate price for this element of direct cost into fixed price contracts for customers. If we express the uncertainty as a high risk premium then our overall price will be uncompetitive. If we take the SO forecast at face value we lose money on the contract and this is not sustainable. We believe this distorts competition as larger suppliers with greater financial resources are more able to withstand BSUoS cost escalations than smaller suppliers and new entrants.



We recognise that the advent of significant volumes of intermittent generation sources has made the forecasting of balancing charges even more challenging. However, the SO is best placed to provide the best forecast based on the information it has on the system together with the control of the actions taken to balance the system. Even so recent BSUoS cost forecasts have been unreliable as the figure below demonstrates.



The graph shows the forecasts at a particular time from the MBSS with the blue line showing the overall 2014/15 forecast BSUoS cost, the red line the overall 2015/16 forecast BSUoS cost and the green line the total forecast cost over the two year period. It clearly demonstrates the problem we face as a small supplier with National Grid's own 2014/15 forecast increasing significantly over the 2nd half of the year. The SO has underestimated BSUoS annual costs for the last 4 years and is unable to take actions to stem the inexorable rise in balancing charges. This uncertainty is a concern and whilst we note the wind forecasting incentives in the proposals, we would like to see further incentives

for National Grid to accurately forecast BSUoS and to minimise forecast divergence from outturn. We believe the SO should be incentivised to produce a good quality annual average cost forecast which suppliers can rely on in pricing contracts to provide customers the benefit of fixed electricity prices and budget certainty.

In the longer term the industry needs to work towards the introduction of fixed-price system balancing costs together with advanced notice of future cost levels. We would suggest the costs are fixed for 12 months with a 15 month notice period as in the recently approved DCP178 change for distribution use of system charges. This provides the SO with certainty on future revenues and suppliers and customers with certainty on future BSUoS costs. The levels would need to be determined within a price control regime given the natural monopoly of the SO. The design of such an approach ought to be considered in the forthcoming substantive review of the SO incentives to take effect from 2017.

Further, we support the proposed extension of the Black Start mid-scheme update to include existing providers. This will ensure the Black Start procurement options available to National Grid are not unduly limited. However, we believe maintaining the Black Start target at £22.35m is short-sighted. The use of a target based on historic numbers could lead to undesired effects, particularly at a time when the generation base of the system is rapidly changing. The generation outlook, transmission and generation technologies, stability and reliability of the system, as well as the system risk as a whole is changing so it cannot be reasonable to assume that costs stay constant. Imposing an artificial target on National Grid would force them to buy Black Start contracts to optimise for cost and not for security.

It is our view that the SO should already be predicting wind generation as a way of reducing the instability in their BSUoS forecast and we do not believe that they should be incentivised for business as usual activity.

We would be happy to discuss our response further.

Yours sincerely,

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