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Dear Colleagues

Determination on National Grid Electricity Transmission's Income Adjusting Event notice related to Black Start costs for 2016/17

This letter sets out the Authority's¹ determination of £54 million as an Income Adjusting Event (IAE) related to Black Start capability for 2016/17. This determination is made in accordance with Special Condition 4C Parts E, E1 and E2 of National Grid Electricity Transmission Plc's Electricity Transmission Licence.²

In summary, the Authority has determined that the costs associated with contracting with Fiddler's Ferry constitute an IAE. The decision against the foreseeability test was finely balanced with market indicators which suggested a decline in the profitability of coal plant having to be offset against the penalties Fiddler's Ferry would incur as a result of closure; the positive statements made by SSE; and the presence of a Supplemental Balancing Reserve (SBR) contract covering some fixed costs. The Authority reached a different view on Drax and Rugeley. In the case of Drax, this was due to the clear difference in circumstances (an intention to review strategy in the case of Drax in contrast to a consultation on closure at Fiddler's Ferry); and also to information indicating that NGET was aware of a credible risk that Drax would not be available during the summer before the alleged IAE. In the case of Rugeley, a different view was reached because of evidence that discussions on closure had been ongoing for some time and also the absence of alternative sources of revenue.

The Authority also considered that there were clear differences in respect of the outcome of the causation test. The announcement of closure at Fiddler's Ferry caused NGET to renegotiate its existing contract to maintain Black Start capability in the region and directly led to the costs being incurred. Conversely, the Authority considered that the costs incurred at Drax, which had a Black Start contract which expired on 31 March 2016, were likely to have been incurred anyway. NGET did not contract with Rugeley.

Background

Black Start is the process used to recover from an event which results in the full or partial shutdown of the transmission system. Isolated power stations are started individually and gradually reconnected in order to re-energise the system.

¹ The terms "the Authority," "Ofgem," and "we" are used interchangeably in this document. Ofgem is the Office of Gas and Electricity Markets.

² Available at

<https://epr.ofgem.gov.uk//Content/Documents/National%20Grid%20Electricity%20Transmission%20Plc%20-%20Special%20Conditions%20-%20Current%20Version.pdf>

National Grid Electricity Transmission plc (NGET), as System Operator (SO) in Great Britain (GB), has an obligation under the Grid Code³ to ensure sufficient Black Start capability is available. NGET also sets Local Joint Restoration Plans with relevant parties including Transmission Owners and Distribution Network Operators. NGET procures its Black Start service in line with a published Black Start policy,⁴ which sets out the minimum requirements for the service as a whole and for service providers. NGET has chosen a zonal policy approach, which divides the country into sub-regions that must all have sufficient Black Start capability in place.

The Balancing Services Incentive Scheme (BSIS)

Black Start is a component of BSIS, the main incentive scheme on the SO.⁵ BSIS sets financial incentives on NGET to encourage it to minimise the costs of operating the transmission system. BSIS includes a single target for all the costs the SO incurs in ensuring that the system is kept in balance, whether these actions are required to balance energy or to manage transmission constraints. If the SO spends less than the target it is allowed to keep 30% of that underspend. Conversely, if the SO spends more than the target it has to incur 30% of that overspend. NGET's financial gain or loss under the scheme is limited to ±£30 million per year.

The current BSIS runs for a two-year period from 2015 to 2017. The assumptions used to set the target (including the agreement of which ones are defined ex-post) are defined at the start of the scheme.⁶

There are a number of mechanisms within BSIS to manage uncertainty. One of them, the Mid-Scheme Review mechanism, gives NGET the opportunity to reset some of the inputs between incentive scheme years subject to GEMA's approval.⁷ This includes Black Start costs.⁸

While the mechanisms described above are in place to account for the expected range of uncertainty, BSIS includes the Income Adjusting Event (IAE) process to deal with unforeseen events. In those instances, and subject to certain conditions being met, NGET may apply for an adjustment to its income under BSIS.

Income Adjusting Events

IAEs are intended to account for unforeseen events which increase or decrease costs to the SO. Special Condition 4C.13 defines an Income Adjusting Event as any of the following:

- (a) an event or circumstance constituting force majeure under the Balancing and Settlement Code (BSC);
- (b) an event or circumstance constituting force majeure under the Connection and Use of System Code (CUSC);

³ As set out in Grid Code CC6.3.5 and OC9.4.7.12.

⁴ Available at <http://www2.nationalgrid.com/WorkArea/DownloadAsset.aspx?id=7054>

⁵ See Special Condition 4C: Balancing Services Activity Revenue Restriction on External Costs, in National Grid Electricity Transmission plc's Electricity Transmission Licence Special Conditions.

⁶ The methodologies underpinning BSIS are available at <http://www2.nationalgrid.com/UK/Industry-information/Electricity-system-operator-incentives/bsis/>

⁷ Another mechanism is the use of a mixture of forecasts and actual inputs to set the targets for non-Black Start elements of BSIS. See Special Condition 4G: Black Start Cost Incentive, in National Grid Electricity Transmission plc's Electricity Transmission Licence Special Conditions.

⁸ In March 2016, the Authority issued a Mid-Scheme Review decision following NGET's application in December 2015 that increased the Black Start target for 2016-17 from £22.35m to a maximum of £34.74m. This was to address the need to procure additional service providers and due to changing market conditions leading to traditional Black Start service providers running increasingly infrequently in the energy market, in particular during summer.

- (c) a Security Period;⁹
- (d) (where the event or circumstance takes place in Relevant Year t or Relevant Year t-1) an unforeseen event or circumstance other than those listed above which leads to consequences beyond the reasonable control of the licensee which is, in the opinion of the Authority, an income adjusting event and is approved by it as such in accordance with Part E2 of Special Condition 4C; and
- (e) (where the event or circumstance takes place in Period p¹⁰) an event or circumstance other than those listed above which is, in the opinion of the Authority, an income adjusting event and is approved by it as such in accordance with Part E2 of the condition.

Where the income adjusting event or circumstance has:

- (a) Increased or decreased the value of IBCT¹¹ by more than £10,000,000 (the "threshold amount"). This threshold amount does not apply for a Security Period; or
- (b) In the Period p, in which the income adjusting event had occurred, increased or decreased the value of IBCp (bearing the meaning of that term as at 31 March 2013) by more than £2,000,000.

Under Special Condition 4C.22, the Authority shall determine:

- whether any or all of the costs and/or expenses given in a notice pursuant to Special Condition 4C.15 or 4C.16 were caused by an Income Adjusting Event;
- whether the event or circumstance has increased or decreased the value of IBCT by more than the threshold amount; or
- With respect to Period P, whether the event or circumstance increased or decreased the value of IBCp by more than £2,000,000; and
- if so, whether the amount of the proposed income adjustment ensures that the financial position and performance of the licensee are, insofar as is reasonably practicable, the same as if that Income Adjusting Event had not taken place, and if not, what allowed value of income adjustment would secure that effect.

In this instance, Period P is not relevant. The Authority considers that force majeure and a Security Period are also not relevant in this circumstance. The Authority has also determined that this IAE meets the threshold amount because the change in IBCT is more than £10,000,000.

Under the IAE provisions, the Authority has three months from the date of receipt of an IAE notice to make its determination.¹² In this case the deadline is 24 August 2016.¹³ Where the Authority does not make its determination within three months, the full amount of the requested income adjustment would be allowed. If the Authority determines that the information provided is insufficient to determine whether an IAE has occurred, the amount of allowed income adjustment becomes zero.¹⁴

⁹ As defined in the Fuel Security Code.

¹⁰ Period P means the period 1 April 2011 to 31 March 2013.

¹¹ IBCT is defined in Special Condition 4C.11 as the cost of balancing services on which the licensee is incentivised during Relevant Year t, which is calculated in accordance with the formula given in paragraph 4C.12

¹² See Special Condition 4C.23(b) of National Grid Electricity Transmission's Electricity Transmission Licence Special Conditions.

¹³ The Authority received the notice of an IAE from NGET on 24th May 2016.

¹⁴ See Special Condition 4C.23(c) of National Grid Electricity Transmission's Electricity Transmission Licence Special Conditions.

NGET's IAE notice

On 24 May 2016, the Authority received a notice of an IAE from NGET.¹⁵ In this notice, NGET proposed that its income be adjusted to account for £113 million incurred in contracting for Black Start capability with Drax and Fiddler's Ferry for the period 1 April 2016 to 31 March 2017.

NGET defines the "event" in its notice as: "the announcement of the potential closure or mothballing¹⁶ of a number of thermal generating plant, which has led to balancing service costs being incurred in excess of the current Black Start element of the BSIS target in order to maintain an efficient and economic level of Black Start capability."¹⁷

The announcements referred to in the notice¹⁸ are:

- I. SSE announcing the potential closure of Fiddler's Ferry on 3 February 2016;¹⁹
- II. Engie announcing the potential closure of Rugeley on 8 February 2016;²⁰ and
- III. Drax Power announcing the potential mothballing of the Drax coal units on 23 February 2016.²¹

NGET analysed the potential impact of these closures on the implementation of its Black Start policy and concluded that a minimum of two additional units were required in the northern half of England to maintain a robust Black Start capability.²² In view of this, NGET issued a call for expressions of interest²³ and negotiated bilaterally. This resulted in one year contracts for Black Start being agreed with Drax and Fiddler's Ferry.

NGET has submitted that the closure and mothballing announcements of thermal plant in February 2016 occurred earlier than expected under the Future Energy Scenarios (FES)²⁴ and were unforeseen at the time that adjustments to the target were proposed. It also states that "the extent to which the unfavourable market conditions would lead to plant closure or mothballing decision for 2016/17 was unforeseen." According to NGET, this meant that at the time of the Mid-Scheme Review, which had a deadline of 31 December 2015, and was submitted to the Authority by NGET on 23 December 2015, these announcements were unforeseen.

The notice further outlines that this unforeseen event led to consequences beyond the reasonable control of the licensee because "decisions taken by the boards of power stations on the future of those power stations, taking into account both projected income and expenditure, are outside the control of NGET in its role as GB SO" and that "NGET has an obligation under the Grid code (CC6.3.5) to ensure that the NETS can be re-energised in the event of a total or partial system shutdown and therefore the obligation to contract with such stations for Black Start cannot be avoided."

NGET has outlined that its call for expressions of interest enabled a competitive process resulting in the lowest possible contract value, while reflecting the locational and technical requirements of the Black Start policy. Further, NGET notes that the contracts have been

¹⁵ Redacted notice available at https://www.ofgem.gov.uk/system/files/docs/2016/06/notice_of_proposed_iae_submitted_by_nget_on_2015-17_incentive_scheme.pdf

¹⁶ Mothballing means preserving a generator that is not currently running in the market in a state to allow its future operability. Mothballing between plants can vary significantly depending on the period of mothballing (eg less or more than a year), cost and technique applied.

¹⁷ As set out on p.2 of NGET's IAE notice.

¹⁸ As set out on p.3 of NGET's IAE notice.

¹⁹ Available at <http://sse.com/newsandviews/allarticles/2016/02/consultation-on-future-of-ses-fiddler-s-ferry-power-station/>

²⁰ Available at <http://www.rugeleypower.com/?article=19>

²¹ Available at <http://uk.reuters.com/article/uk-drax-results-idUKKCN0VW0T3>

²² Available at <http://www2.nationalgrid.com/WorkArea/DownloadAsset.aspx?id=7054>

²³ Available at <http://www2.nationalgrid.com/WorkArea/DownloadAsset.aspx?id=45483>

²⁴ Information on the FES available at <http://fes.nationalgrid.com/>

structured to return money to consumers where the service providers generate in excess of the level required for warmth under the Black Start policy. This seeks to minimise potential market distortions.

NGET believes the sum of £113 million was the least-cost option for procuring the necessary level of Black Start capability. NGET states that the offers received from Fiddler's Ferry and Drax were the most economic when balanced with technical compatibility.

Our Process

Following receipt of the IAE notice, the Authority issued a public consultation on 8 June 2016.²⁵ All responses received were reviewed and considered in making the determination. In addition, meetings were held with stakeholders and their evidence was incorporated into the analysis.

In conducting its analysis, the Authority requested additional information from NGET and the generators involved and commissioned technical consultants to review the technical underpinnings of the information provided in the IAE notice.

The Authority has considered NGET's IAE notice against the relevant tests set out in the licence. The Authority has assessed whether each of the announcements referred to in the notice is an IAE by considering them against the three tests set out in the licence:

- The event must be unforeseen for a prudent and reasonable System Operator. This test needs to be assessed in the round, taking into account both plant specific and relevant market wide factors;
- To meet the IAE causal threshold, the event must lead to consequences which were caused by the event. This means asking whether 'but for the event, would the consequences have occurred'; and
- The final test is then whether the consequences of the event were beyond the reasonable control of the licensee. The Authority considered whether the consequences were beyond NGET's reasonable control from the time period of the event, which was in this case 3 February 2016. Thus, the relevant time period is from 3 February 2016 to 1 April 2016.

Stakeholder views

We received 21 responses from stakeholders in response to our consultation.²⁶ The view from the majority of respondents was that the event does not meet the IAE tests. In summary:

- Most respondents indicated that NGET should have foreseen the potential closure/mothballing of Rugeley, Fiddler's Ferry, and Drax power plants.
- Several respondents also stated that they do not consider that the costs of the 'event' were caused by the potential closures and arose as a result of insufficient historic action by NGET to ensure sufficient Black Start providers were available.

The three respondents (NGET, SSE and Drax) who believed the IAE tests were met felt that NGET was in no better position than 'the market' to forecast closure/mothballing

²⁵ Available at <https://www.ofgem.gov.uk/publications-and-updates/notice-and-consultation-proposed-income-adjusting-event-submitted-national-grid-electricity-transmission-plc-relation-2015-17-electricity-system-operator-incentives-scheme>

²⁶ Responses to our consultation are available at <https://www.ofgem.gov.uk/publications-and-updates/notice-and-consultation-proposed-income-adjusting-event-submitted-national-grid-electricity-transmission-plc-relation-2015-17-electricity-system-operator-incentives-scheme>

announcements. They also stated that they believed that the costs were caused by the event and that the contracts provided the least-cost solution to ensure Black Start provision.

Analysis and Evidence

Taking all the evidence into consideration, the Authority has determined an IAE adjustment of £54 million. The Authority determined that the remainder of the costs did not meet the IAE criteria. The reasons for the Authority's decision in respect of each plant (presented below alphabetically) and overall decision are described in the following subsections.

Drax

The Authority has determined that the announcement from Drax as set out in the IAE notice was not unforeseen and as such does not constitute an IAE. The reasons for this determination are set out below.

The IAE notice sets out the Drax announcement as:

"[...] Drax Power announced the potential mothball of the Drax coal units on 23rd February 2016."

The direct quote from the Drax CEO Dorothy Thompson was:

"[...] We may choose to mothball them, but what we are keen to do is to work with government and find the right solution,"

This was discussed further in a Reuters article²⁷ dated 23 February 2016 and entitled "Drax says may mothball coal plant amid weak energy markets".²⁸ The article stated that Drax was considering whether to mothball its coal units as part of a strategic review. The article argued that renewables and gas prices had priced coal out of the market and noted that Drax expected conditions for 2016 to remain challenging due to low power prices.

Foreseeability

In the Authority's assessment of foreseeability, the Authority considered:

- The nature of the event;
- The economic conditions facing Drax;
- All public consultation submissions; and
- Additional information including from NGET's Black Start Mid-Scheme Review submission.

The nature of the event - The event in the case of Drax, unlike Fiddler's Ferry or Rugeley, is a statement of an intention to consider mothballing. This statement did not lead to a consultation on closure.

The economic conditions facing Drax - There had been deterioration in market conditions for coal units, including Drax, from mid-2015. Profitability from generating electricity from coal fired power stations, as shown by 'Clean Dark Spreads', had been declining and had become negative in some periods (meaning the cost of generating electricity was higher

²⁷ Available at: <http://uk.reuters.com/article/uk-drax-results-idUKKCN0VW0T3>

²⁸ The article was subsequently republished on several other new outlets including the Telegraph, the Independent, and the Yorkshire Post.

than the selling price). The indications from forward markets suggested that these conditions would not change significantly for 2016/17.

In addition, since 2010-11 around 12GW of coal plant had closed in GB. The majority of these closures were because the coal plants were not compliant with the Large Combustion Plant Directive. However, several plants that were compliant also closed because of poor coal plant economics. In general terms, NGET would have been aware of decreasing options for Black Start provision.

All public consultation submissions – A number of stakeholders highlighted the deterioration of clean dark spreads relative to clean spark spreads well in advance of the announcement.

Additional information including from NGET's Black Start Mid-Scheme Review - NGET's Mid-Scheme Review submission to the Authority on 23 December 2015 referred to the possibility of a decline in Drax's profitability leading to it going 'summer cold,' (i.e. suggesting the coal units would not generate over the entire summer). NGET stated in its submission:

"In the central case of warming at £28m no regard was made of Drax [], which as coal, may declare summer cold. Provision of warming for [] Drax coal units to avoid summer cold in North East would increase warming by £12m. This is a credible risk which needs to be covered off in the stated range of warming..."

This indicated in December 2015 that Drax would be unavailable for the provision of Black Start without significant payments for warming over the summer. This indicates that NGET was aware that Drax was considering its options. In turn, this appears to indicate that the possibility of Drax mothballing, which would detrimentally affect Black Start capability and increase costs, was foreseen as a credible risk.

The Authority also took into account the relatively more efficient nature of Drax relative to Fiddler's Ferry and Rugeley and noted the high load factors forecast by NGET in its Mid-Scheme Review submission. It also noted that the submission assessed the risk of Drax closing for 2016/17 and 2017/18 as low and recognised that Drax has a Capacity Market (CM) contract for both 2018/19 and 2019/20.

In summary - The Authority has determined that it was not unforeseen that Drax would announce the potential mothballing of its coal units given the challenging market conditions and in light of evidence presented as part of the Mid-Scheme Review submission. As such the event does not constitute an IAE.

Causation

The Authority also considers that the costs were not caused by the event. Drax had a Black Start contract which ran until 31 March 2016. Had Drax not been expected to mothball, there would still have been a need to renegotiate this contract. There does not appear to have been an alternative to contracting with Drax. This would suggest that the costs associated with re-contracting with Drax, absent their announcement, would have been no different to the costs NGET did actually incur. As such, the Authority does not consider that the event caused the costs for Drax. The Authority notes this is markedly different from Fiddler's Ferry where a Black Start contract was in place until 2020.

Fiddler's Ferry

The Authority has determined that the announcement from SSE on Fiddler's Ferry as set out in the IAE notice constitutes an IAE. The reasons for this determination are set out below.

The IAE notice sets out the Fiddler's Ferry announcement as:

"SSE announced the potential closure of Fiddler's Ferry on 3rd February 2016 [...]"

On 3 February 2016, SSE announced²⁹ that it would enter into consultation with employees and stakeholders at Fiddler's Ferry on a proposal to close three of the four units (maintaining the unit providing SBR).

Foreseeability

The Authority has determined that the announcement of the closure of Fiddler's Ferry by SSE was unforeseen.

In its assessment of foreseeability the Authority has considered:

- The nature of the event;
- The economic conditions facing Fiddler's Ferry, including any existing and future contracts that generate revenues outside the normal traded wholesale electricity market;
- All public consultation submissions;
- Additional information including from NGET's Black Start Mid-Scheme Review; and
- Statements from SSE in relation to Fiddler's Ferry during November and December 2015.

The nature of the event – On 3 February 2016, SSE announced that it would enter into a statutory consultation with employees and stakeholders on a proposal to end commercial operations at three of the plant's four units.³⁰

The economic conditions facing Fiddler's Ferry – Market fundamentals had been deteriorating for some time and since 2010-11 around 12GW of coal plant had closed in GB, resulting in an ongoing decline in the number of Black Start service providers. The majority of these closures were because the coal plants were not compliant with the Large Combustion Plant Directive. However, several coal plants that were compliant also closed because of poor coal plant economics. In general terms, NGET would have been aware of decreasing options for Black Start provision.

'Clean Dark Spreads' had been declining since August 2015, becoming negative in some periods (meaning the cost of generating electricity was higher than the selling price). As a relatively less efficient coal plant than, for example Drax, Fiddler's Ferry was likely to have suffered a greater decline in profitability as a result.

All public consultation submissions – Similarly to Drax, industry participants noted the deterioration of clean dark spreads relative to clean spark spreads well in advance of the announcement.

Additional information including from NGET's Black Start Mid-Scheme Review submission – NGET's modelling for the Black Start Mid-Scheme Review indicated a load factor of a maximum of 11% in winter 2016/17, suggesting Fiddler's Ferry was not expected to run often and therefore less likely to be able to cover its fixed costs. In late 2015, NGET indicated in its periodic assessment of plant availability, that there were risks associated with Fiddler's Ferry remaining opening and assigned it an amber rating for being available

²⁹ Available at <http://sse.com/newsandviews/allarticles/2016/02/consultation-on-future-of-sse-fiddler-s-ferry-power-station/>

³⁰ Available at: <http://sse.com/newsandviews/allarticles/2016/02/consultation-on-future-of-sse-fiddler-s-ferry-power-station>

in 2016/17. This evidence suggests that National Grid considered that there was a credible risk of closure.

The Authority considered a range of evidence, such as NGET's FES, which suggested that Fiddler's Ferry was expected to close between 2022 and 2029. Fiddler's Ferry also had a series of ongoing contracts:

- It had a Black Start contract until 31 March 2020;
- It had a Capacity Market obligation for the Delivery Year 2018-19, which carries a non-delivery penalty of £33 million. Fiddler's Ferry did not secure a CM obligation for the Delivery Year 2019-20 in the 2015 T-4 Auction. However, it had the opportunity to bid into a later auction for the same delivery year; and
- The unit for which closure was not announced was allocated a SBR contract for 2016-17, providing it with an additional revenue stream to cover the station's fixed costs.

The Authority noted that there were concerns last winter about whether the CM penalties were sufficient to incentivise contract delivery and that these concerns led the government to consult on changing the CM penalties.³¹

The Authority further noted that a termination clause was inserted into the Black Start contract between Fiddler's Ferry and NGET in 2015. The clause allowed SSE to end the contract subject to a small financial penalty and a notice period of six months.³²

Evidence from SSE statements in November and December 2015 - SSE made public statements in November 2015 indicating that it would continue operating in the market. The below extract is taken from SSE's results statement of 11 November 2015.

"As a consequence of this ongoing review in September 2015 SSE informed National Grid that it would reduce TEC [Transmission Entry Capacity] for Fiddler's Ferry to 1,455MW for 2016/17. This reduction is equivalent to the capacity of one of Fiddler's Ferry's four units and means this capacity will not be available to the market for 2016/17. However the capacity could still be made available to support system security if National Grid requires it during this period. SSE will also explore the viability of submitting this capacity into National Grid's Supplemental Balancing Reserve (SBR) auction for Winter 2016/17.

The remaining capacity (1,455MW) - which has capacity obligations for Winter 2018/19 - will continue to be made available to the market. SSE intends to enter it into the 2015 Capacity Market auction (for delivery in Winter 2019/20) and will consider the options for the future operation of the station after the auction has been completed. All of the capacity at Fiddler's Ferry is compliant with the Large Combustion Plant Directive (LCPD); and has been opted into the Transitional National Plan (TNP) for emissions and dust under the Industrial Emissions Directive (IED). Generators will not have visibility of the final TNP rules until December 2015, at which point SSE will be able to consider how Fiddler's Ferry should comply with the IED."

In summary - The Authority considered that the evidence in respect of foreseeability for Fiddler's Ferry was finely balanced. However, it concluded that because of: the existing Black Start contract; the CM penalties the plant would incur if it closed; the public statements made by SSE in November 2015; and the likelihood that the SBR contract was

³¹ Consultation from government to change penalties available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/468173/Autumn_Consultation_Document.pdf

³² Fiddler's Ferry did not invoke this clause in February and instead indicated that it would close by 1 April.

covering some fixed costs, it was reasonable for the SO to assume that Fiddler's Ferry would honour its contract and remain available to provide Black Start services in 2016/17. As a result, the Authority has determined that the announcement of closure was an unforeseen event.

Causation

In the case of Fiddler's Ferry, the unforeseen proposed closure of the plant caused a gap in Black Start capability and increased the costs of Black Start.

The Authority is satisfied that all of the costs of the new contract with Fiddler's Ferry were attributable to the proposed closure of the plant. The costs of the new contract therefore meet the test for causation as they would not have occurred without the event. The Authority has determined that to put NGET back into the financial position prior to the event an income adjustment of £54 million is appropriate.

Reasonable control

The Authority has determined that NGET could not reasonably have controlled the consequences³³ arising from the event, in the relevant time period, for the following reasons:

- NGET was aware of the proposed closure from 3 February 2016 and was limited in the possible actions it could take to procure Black Start between 3 February 2016 and 1 April 2016.
- The Transmission Entry Capacity (TEC) deadline (5 business days before 1 April) limited the time available to NGET to ensure Black Start capability.
- To improve liquidity and provide competitive pressure on market participants, NGET opted to conduct a call for expressions of interest which resulted in bids from multiple participants. Additional actions would have been beyond the reasonable control of NGET.
- NGET negotiated bilaterally with providers and clawback mechanisms were included to limit costs and protect consumers.
- NGET used a technical scoring matrix to determine Fiddler's Ferry as the most appropriate option for the Black Start zone.

Determining the Amount of the Income adjustment

In the case that an event meets the above criteria and qualifies as an IAE, Special Licence Condition 4C.15D requires the Authority to determine "the amount of the proposed income adjustment" which "ensures that the financial position and performance of the licensee are, insofar as is reasonably practicable, the same as if that income adjusting event had not taken place, and if not, what allowed value of income adjustment would secure that effect."

The Authority has determined that an income adjustment of £54 million secures this effect.

Rugeley

The Authority has determined that Engie's announcement on Rugeley³⁴ as set out in the IAE notice was not unforeseen and as such does not constitute an IAE. The reasons for this determination are set out below.

³³ The consequences of the event are both the need to enter into a Black Start contract and the cost of that contract.

The IAE notice sets out the Rugeley announcement as:

"[...] Engie announced the potential closure of Rugeley on 8th February 2016[...]"

Engie's announcement of 8 February 2016 stated that the 1,000 MW Rugeley Power Station in Staffordshire was expected to cease market operations in early summer 2016, due to the deterioration in market conditions for UK coal-fired power generation. Engie commenced a formal staff consultation.

Foreseeability

The Authority's assessment of foreseeability considered:

- The nature of the event;
- The economic conditions facing Rugeley, including any additional contracts;
- Additional information including from NGET's Black Start Mid-Scheme Review submission; and
- All public consultation submissions.

The nature of the event - Engie's announcement was similar to Fiddler's Ferry announcement, but unlike the announcement by Drax, Engie initiated a formal consultation with staff on the closure of the station.

The economic conditions facing Rugeley - Rugeley was affected by deteriorating economic conditions in a similar way to Drax and Fiddler's Ferry.

Additional information including from NGET's Black Start Mid-Scheme Review and consultation responses - the Authority received information from Engie that it had been in discussions with NGET since early 2015 on the possibility of closure. However NGET did receive market intelligence that Rugeley would invest in becoming IED compliant which would indicate it would remain available going forward.³⁵ NGET's FES had Rugeley closing as early as 2017 and NGET's November 2015 analysis of plant availability put the risk of closure for Rugeley for 2016/17 and 2017/18 as amber.

This risk was identified due to NGET's estimation of low profitability for Rugeley in 2014/15 and, its IED opted-out status. In addition, Rugeley was rated as relatively low in terms of efficiency (which makes it more expensive than a significant number of competitors). NGET's Mid-Scheme Review modelling also forecast low running hours for 2016/17. Rugeley did not have a Capacity Market contract for 2018/19 or 2019/20 or any additional ancillary services contracts, such as SBR.

In summary - Having considered all of the information available, the Authority considers that the announcement of closure of Rugeley was not unforeseen and as such does not constitute an IAE.

The Decision

The Authority has considered NGET's proposed income adjusting event in the round, having considered all available information, including market fundamentals and evidence from stakeholders. The Authority has taken into account the extent to which various risks

³⁴ Available at: <http://www.rugeleypower.com/?article=19>

³⁵ Making the station IED compliant would have indicated that plant owners expected to keep the station open for a number of years given the investment needed.

surrounding the specifics of each plant could have been unforeseen, or were unforeseen in practice. In addition, the Authority has considered whether the scale and nature of the event was unforeseen.

The Authority has concluded, particularly in light of evidence from the Mid-Scheme Review, that the announcement of possible mothballing by Drax was not unforeseen by NGET. In contrast, and on balance, the proposed closure of Fiddler's Ferry was unforeseen by NGET.

In respect of Drax, the Authority has considered causation, and determined that the cost consequences were not caused by the announcement from Drax to consider its options on mothballing. But for the event, Black Start capability would have still been required in the North East region, with NGET incurring an equivalent sum for the contract to that which it eventually incurred. Conversely, for Fiddler's Ferry, the Authority determined that the full amount of the contract for Fiddler's Ferry was caused by the event and that NGET could not reasonably have controlled the consequences arising from the closure.

The Authority has sought to place NGET back in the financial position and performance as if the event had not occurred. Overall, the Authority has determined an income adjustment for NGET, according to a reasonable and rational application of the IAE test.

Next steps

The Authority has determined that a share of the costs for the provision of Black Start have met the IAE criteria and as such has determined an adjustment to NGET's income of £54 million less any funds recovered through the clawback mechanisms.

During the process of assessing the IAE request several issues were brought to our attention. These relate to, among others, compliance with REMIT; potential competition law issues; alleged deficiencies in the long term Black Start policy; and national and regional security of supply concerns. The Authority also notes that industry code modifications have been raised in relation to IAEs.

The Authority's focus has been on assessing the IAE as thoroughly as possible in the three month period available and the Authority has not yet made any decisions on these other issues. The Authority will fully explore these issues and take any appropriate action. We are also consulting on future SO incentives, including how the Authority continues to regulate and incentivise Black Start.³⁶

Yours faithfully

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³⁶ Available at <https://www.ofgem.gov.uk/publications-and-updates/electricity-system-operator-incentives-april-2017>