EP INVEST LTD

# RESPONSE TO OFGEM CONSULTATION ON A PROPOSED INCOME ADJUSTING EVENT SUBMITTED BY NATIONAL GRID ELECTRICITY TRANSMISSION PLC IN RELATION TO THE 2015-17 ELECTRICITY SYSTEM OPERATOR INCENTIVES SCHEME, JULY 2016

EP Invest represents the UK interests of Energetický a Průmyslový Holding ('EPH'), a major energy and utilities group based in the Czech Republic.

EPH owns a large portfolio of energy companies including a major gas shipper from Russia to the EU, the gas industry leader in Slovakia and the electricity supply and heating industry leader in the Czech Republic, as well as generating assets in Germany and Italy as well as Eastern Europe. It has 14.6 GWe of heat and power capacity including coal, lignite and renewables.

In 2015, EPH purchased Eggborough Power Limited, an independent power generator which owns and operates a 2,000 MW coal-fired power station in Yorkshire. This purchase was the Group's initial step into the UK market. In 2016, EPH purchased Lynemouth Power Limited, the owner and operator of a 420 MW coal-fired power station in Northumberland. Lynemouth holds a Contract for Difference for full biomass conversion. EPH is progressing with the biomass conversion project and it is anticipated that this will commission in 2017. EPH is also actively pursuing a number of other acquisition and new build opportunities in the UK electricity market.

**Question 1: Do you believe that the event submitted by NGET as an Income Adjusting Event constitutes an Income Adjusting Event?**

No.

- **Do you consider the proposed IAE to constitute force majeure as defined in the BSC or in the CUSC?**

  No, it does not appear that the proposed IAE is covered by the definition of force majeure.

- **Do you believe that the event submitted by NGET was unforeseen? Please provide evidence to support your view where possible.**

  We do not consider that the event submitted by NGET should be considered 'unforeseen'. Although announcements about the closure of coal-fired power stations have occurred faster than forecast in the Future Energy Scenarios, it should have been clear to National Grid that coal station closures would have been accelerated and running by existing Black Start providers reduced given market conditions. National Grid states that it was aware that increased warming would be required for Black Start, which is why it made a Black Start Mid Scheme Review submission to Ofgem in December 2015, but that it had not expected plant to be closed or mothballed entirely in the summer months. However, the full extent of the problems facing coal-fired power stations should have been clear to National Grid following market announcements such as the announcement in September 2015 of the potential closure of Eggborough power station. We are unclear how National Grid could have assumed that a power station such as Fiddler's Ferry would remain operational to 2026 (as stated in the additional information provided to Ofgem) when the government had clearly signalled its intention that all coal stations would be closed by 2025 with only limited running after 2023. If National Grid had adjusted its analysis at an earlier stage to more realistically reflect the future life of coal stations, steps could have been taken to seek the Black Start service from different providers at a lower cost.

- **Do you believe that the proposed IAE costs were beyond the reasonable control of NGET?**

We do not believe that all the proposed IAE costs were beyond the reasonable control of National Grid. Please see our response to Question 2 for further comments, in particular in relation to the value for money of these contracts and whether they should have been issued to all parties.

**Question 2: Assuming the event is an IAE, do you consider that any or all of the costs set out in NGET's notice were caused by the relevant IAE?**

Due to the amount of information that has been redacted and the lack of public domain information on Black Start in general, we cannot comment fully on whether the costs of these new Black Start contracts are justified. For example, it is unclear whether the £113 million increase in the BSIS target associated with the contracts is net of the reduction in costs associated with the termination or expiry of any existing Black Start contracts at Drax and Fiddler's Ferry which have been replaced with these new contracts.

- **Are there any additional interactions between costs incurred that need to be taken into account?**

  National Grid's current forecast is that BSUoS will rise by £0.38/MWh to recover the cost of these Black Start contracts. However, if the costs are only recovered over six months (as the recovery will not be approved by Ofgem until August) then the BSUoS cost will double. This will impose an additional cost on generators which it is too late to factor into business models and which some generators may not be able to recover. The fact that an Impact Assessment will not be carried out to accompany Ofgem's decision means that the full effect of the BSUoS increase on all parties will not be considered. In general, we consider that such large fluctuations in BSUoS reinforce the rationale for modifications to stabilise BSUoS charges going forward.

- **Do you consider that NGET acted economically and efficiently in procuring Black Start in this event?**

  No.

  There does not appear to have been a compelling case for National Grid to issue this Black Start contract to Drax. National Grid admits that 'Drax did not approach National Grid specifically about their intention to mothball over the summer' and that this was picked up by National Grid from Drax announcements. However, Drax did not take any formal decisions to mothball or close any of its coal units and no clear indication of any intention to do so was given to the market. National Grid's action to issue a Black Start contract to this station on new terms therefore seems to have been premature. It appears that all of Drax's coal units have been running in the market this summer meaning that the units would have been warm and capable for providing the Black Start service as normal. We are therefore not convinced that the additional costs associated with this contract were necessary and we do not consider that National Grid should be allowed to recover them.

  We are also concerned that there was no competitive pressure in the procurement process and that there has been insufficient testing of whether the £113 million incurred through these contracts represents value for money. As stated by National Grid, 'NGET determined that only a provider already capable of providing black start in the relevant zones would be able to submit a proposal... NGET therefore approached all potential providers who were known to meet the requirements to discuss Black Start Services'. This effectively means that, regardless of the Expression of Interest exercise, National Grid had pre-selected Drax and Fiddler's Ferry to provide the service on the basis of their location. Given that National Grid's tender did not require power stations to be Black Start capable and the type of service sought was inferior to the normal Black Start requirements (for example, the contract signed with Fiddler's Ferry is recognised to be an 'inferior technical service...compared to their previous Black Start contract'), it is possible that a number of power stations in these or adjacent zones could have provided the service but that National Grid never intended seriously to consider these options. In future, National Grid should proactively liaise with a wider range of potential providers of such services. Greater market information on the Black Start service and requirements would help in this respect.

*Other issues*

The two Black Start contracts contain claw back and profit sharing provisions. As no details of these mechanisms have been disclosed, it is not possible for the market to have any confidence that they will preserve the natural merit order of the two power stations.

We are also concerned that National Grid's analysis overstates the potential consumer benefit associated with these contracts. National Grid has used the headline VoLL figure of £16,940/MWh from the London Economics report and has then inferred from the results for domestic customers that a four hour outage will lead to a four times increase in VoLL. While London Economics states this explicitly for domestic customers, the correlation is not so clear for SME customers, where London Economics states that 'SMEs prefer shorter electricity outages but there is some evidence that SMEs may adapt to longer outages'. As the headline VoLL figure uses a 74:26 weighting for domestic to SME VoLL and the study shows that value of VoLL is significantly higher for SMEs than domestic customers, the assumption that a four hour outage also leads to a four times increase in VoLL for SMEs has a significant impact. For example, VoLL would be £39,682/MWh assuming that there is no increase in VoLL for a longer duration of outage for SME customers.