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System Balancing
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11 July 2016

InterGen UK Ltd. response to Proposed Income Adjusting Event submitted by National Grid Electricity Transmission plc in relation to the 2015-17 Electricity System Operator Incentives Scheme.

Dear Johannes,

About InterGen UK

InterGen welcomes the opportunity to respond to this consultation. We remain the only genuinely independent generator active in the UK market with a track record of developing, constructing and operating large scale thermal power generation projects. We have been active in the market since the 1990s and therefore bring a unique perspective to this consultation. InterGen is owned by two major international investors, representing two key classes of investment which the Government is seeking to attract to UK infrastructure investment, namely, pension funds (Ontario Teachers' Pension Plan) and strategic investors from the People's Republic of China (China Huaneng/Yuedean).

InterGen is one of the UK's largest independent generators, operating a portfolio of three high efficiency, low emissions producing, flexible gas-fired power stations totalling 2,490MW; an investment of some £2.1bn. These stations are located at Rocksavage (Cheshire), Spalding (Lincolnshire) and Coryton (Essex).

InterGen is also ready to build two new CCGT projects and one new OCGT at two sites in Spalding (Spalding Energy Expansion) and Essex (Gateway Energy). The new stations, which are "shovel-ready", will cost around £1billion to construct over their three year build programmes and create around 3,000 jobs.

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

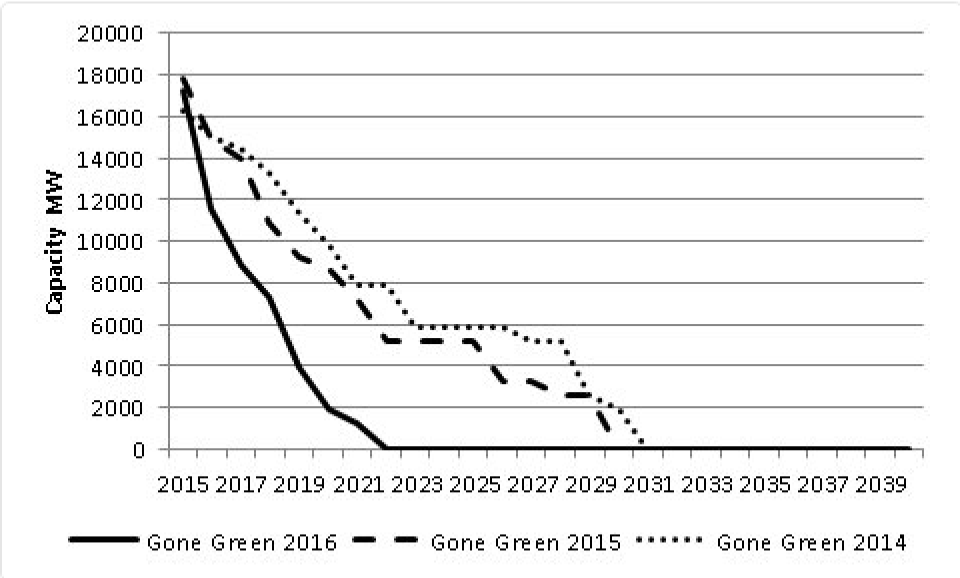
o Do you consider the proposed IAE to constitute force majeure as defined in the BSC or in the CUSC?

No. Neither definition of force majeure is applicable in this instance.

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

No. NGET states that it had not identified this scenario as part of its Future Energy Scenarios modelling for 2016 that concluded in July 2015. The fact that National Grid themselves had not included the accelerated closure of coal plant as part of their scenarios does not mean that this was unforeseen.

On the 09/07/2014, Richard Smith, NGET's Head of Energy Strategy and Policy told reporters in London that all of National Grid's projections show "very aggressive" shutdowns of coal powered stations in 2016 as a result of climate regulations. National Grid's coal closure scenarios published in 2014 and 2015 both had coal plants closing in 2016 (see below).

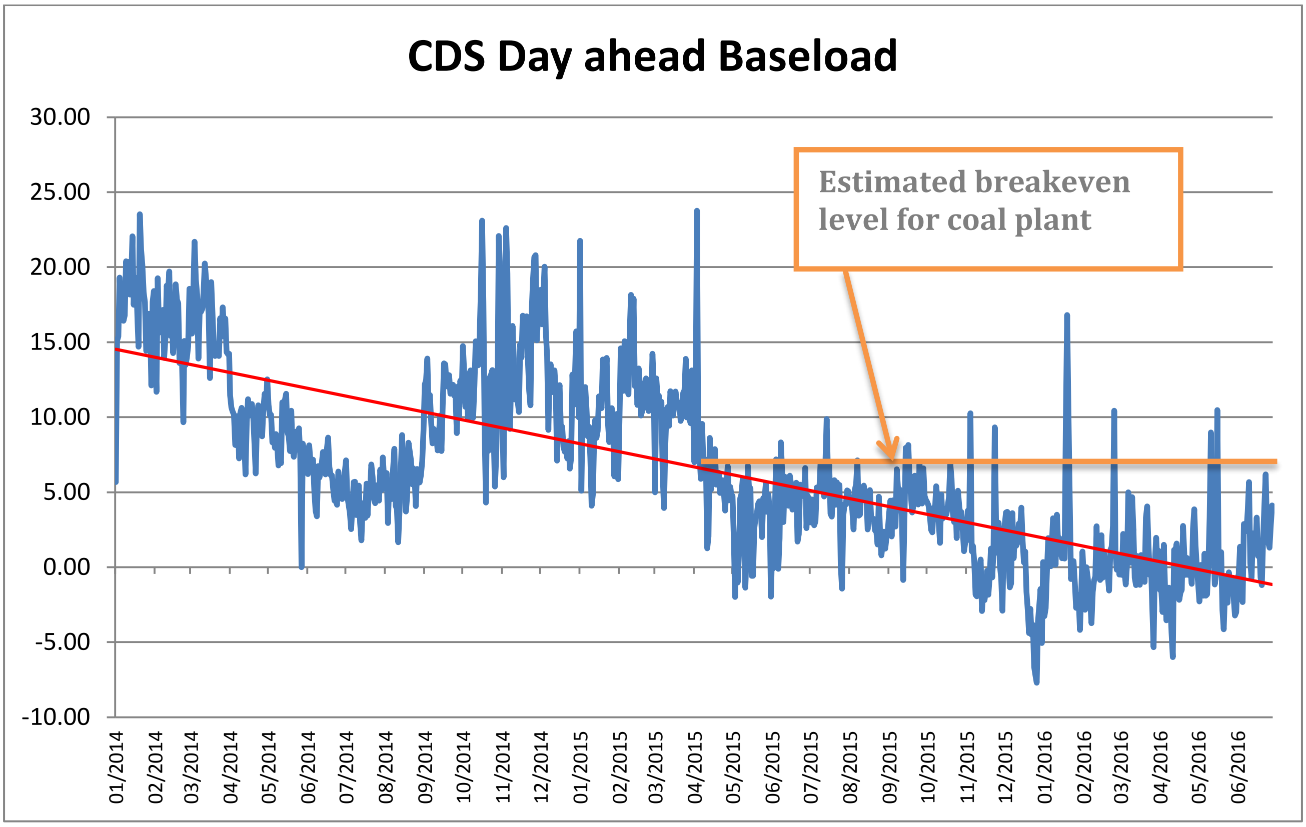


Source: National Grid

As the below chart clearly illustrates, Clean Dark Spreads ("CDS") or the profit realised by a power generator after paying for the cost of coal fuel and carbon allowances, have since 2014 been on a downward trend falling below 0 on many occasions, even during winter months when prices are generally at their highest. Many coal plants, including Fiddlers Ferry, have also been "incurring substantial losses for a number of years"[i] mostly due to the carbon price floor increasing to £18 per ton of CO2 in April 2015. As the orange bar on the chart displays, we estimate that coal plant has not been profitable to run based on Day-Ahead prices since April 2015.

In an economic environment where Cockenzie, Ironbridge, Longannet and Ferrybridge had already closed it is not reasonable to argue that further coal closures were 'unforeseeable'. Clearly, the "unfavourable market conditions", cited as a justification of the IAE, have been prevalent for some time and are not a new or unforeseeable factor.

Potential coal closures could and should therefore have been anticipated.



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

In the letter sent to Ofgem on the 24th May 2016, National Grid claim that due to a number of thermal power stations 'unexpectedly' announcing their intentions to close or mothball in February 2016 resulted in it having to procure additional Black Start Capability at a cost of £113 million.

In February 2016, three coal generators announced consultations:

- SSE announced a consultation on the future of Fiddlers Ferry on the 03/02
- Engie announced potential closure of Rugeley power station on 08/02.
- Drax announced potential mothballing of coal units on 13/02

None of these announcements amount to the closure of a plant they are merely consultations with closure being a possible outcome.

Before SSE or Drax closed their consultations on possible closure or mothball NGET had negotiated highly expensive bilateral contracts to influence the outcome of these consultations. It is questionable as to whether or not the NGET negotiations were appropriately timed.

Black Start capability is a requirement under the grid code. National Grid's policy is to have to have 3 black start capable units in each zone, therefore, with the clear projection that coal would close, industry would have expected NG to already have engaged with industry providers on how to resolve the Black Start issue.

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

We do not believe that the event is an IAE.

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

No. The requirement for NGET to have black start capability is a licence condition and an essential requirement as per Grid Code CC6.3.5. As such, there is clear visibility that in this instance, NGET were a distressed buyer of a service from a limited number of providers that they had no choice but to procure. NGET were not negotiating from a position of strength and have failed to act economically or efficiently.

Given that National Grid had forecast an aggressive reduction in coal fuelled thermal plant in 2016, it would be reasonable to expect National Grid as a responsible and prudent system operator to have planned accordingly to mitigate this problem. National Grid should have also have been able to identify that black start capability in the North East and North West England was limited should certain ageing coal plants close. Instead, National Grid left themselves exposed.

The EBSCR has resulted in reforms to electricity cash out pricing. The highest price National Grid can pay to a generator to help balance the system is currently capped at £3,000/MWh. However, National Grid have attempted to justify procurement of black start services against a VOLL of £67,780/MWh. There is a clear disconnect here. Fiddlers Ferry and Drax are being paid well above the returns that they could expect to make in the market.

The System Operator is financially motivated to keep its spending within the BSIS budget and is entitled to retain 30% of any underspend. If NGET overspends on this budget it will only incur 30% of this overspend. The basis of this consultation is that NGET wishes to avoid paying for 30% of overspend related to the payments made to Fiddlers Ferry and Drax and to pass this cost through to market participants and ultimately consumers. Ofgem should be aware that InterGen will be subject to an approximate additional daily BSUoS cost of £2000 for each of the three power plants that it operates due to the additional £113m of NGET spending to procure black start capability.

If InterGen's three power plants ran at baseload for the duration of the charging year we would incur an additional £2.19M of BSUoS costs as a result of NGET's contract with Fiddlers Ferry and Drax.

This increase in BSUoS costs could not have been foreseen by the market as it was the result of bilateral negotiations. SSE and Drax would have had prior knowledge of their own impact on BSUoS and thus had an advantage over the rest of industry. Parties will have hedged significant volume in the forward market prior to this procurement activity by NGET, pushing their spending well over their original permitted maximum, which now means that some of these positions hedged in advance may be uneconomic.

Due to the extensive redactions in the Supplementary Information to NGET's letter to Ofgem it is very difficult to definitively assess whether or not NGET has acted economically or efficiently. However, the headline figures are clearly excessive and make payments to these coal plants well in excess of what they could, or others will, receive through participation in the wholesale energy market where they would be loss making based on dark-spreads alone.

The parties awarded the black start contract have therefore had an advantage in hedging the forward market and NGET should be aware that the information was market sensitive. The contracted parties also continue to have an advantage as market cannot fully understand the implications/costs of the rebate referred to in the redacted document therefore cannot price this accordingly.

InterGen assert that NGET have procured these contracts in neither an efficient nor an economic fashion.

Yours sincerely,

L Mackay

Lisa Mackay

Commercial Director
InterGen UK Ltd.

i http://sse.com/newsandviews/allarticles/2016/02/consultation-on-future-of-sses-fiddlers-ferry-power-station/