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Dear Johannes,

Consultation on a Proposed Income Adjusting Event submitted by National Grid Electricity Transmission plc in relation to the 2015-17 Electricity System Operator Incentive Scheme

Thank you for the opportunity to provide views on behalf of ScottishPower on Ofgem's consultation on National Grid's proposed Income Adjusting Event (IAE).

Views on NGET's application for an Income Adjusting Event

We do not believe this application as currently formulated meets the qualifying criteria for an IAE. As explained below, it is unclear to us whether the circumstances were unforeseen by NGET, but even if they were, we do not believe the consequences were fully beyond NGET's reasonable control. The consequences could have been substantially mitigated had NGET adopted a more robust black start strategy that left it better prepared for the circumstances in question.

In the period during which the GB system was de-carbonising, but prior to Capacity Market agreements being available, it was always going to be difficult to predict and mitigate the precise closure dates of ageing thermal plants that were subject to challenging economics. In particular, it may have been difficult to foresee that one or more operators of plants which had been awarded CM agreements would decide to close and default on those obligations (and we are pleased to see DECC's recent decision on stronger delivery incentives in its reforms to the Capacity Market). Hence it is possible that the precise timing of the events was unforeseen by NGET.

However, we believe the consequences of the events were exacerbated by NGET's failure to have in place an appropriate strategy for maintaining black start capability during the transition. Such a strategy should have included plans to mitigate the risk of the widely-anticipated closure of existing coal and oil-fired black start service providers over the period 2015-2020, and should have been under a process of continuous review. We would have expected that, prior to 2015, the SO would have hosted competitive auctions for longer term black start agreements of 1, 5 and 15 years ahead – rather than rejecting an alternative competing option presented by ScottishPower in respect of its Longannet plant in 2015. This would have maximised competition from existing providers (and potentially new-build projects) ahead of any such closures, in a manner similar to that observed for capacity in the T-4 Capacity Market auctions.

Given the grave circumstances which existed in February 2016 regarding a forecast inability to provide an appropriate black start service, NGET may have had little option but to contract with the most economic service providers available at that time. However, in contracting at the very last minute, competition was minimised, and consumers are now faced with a bill for £113m for a single year, with the potential for similar costs in future years until NGET's new strategy is designed and implemented.

In conclusion, we would support an application from NGET that sought to adjust its incentives target in accordance with the efficient level of cost such as might have been incurred with a more appropriate procurement strategy. However, we believe that consumers should have some protection from unnecessary incremental costs associated with uneconomic and inefficient practices.

Other issues relating to black start service procurement

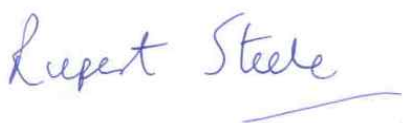
We would like to raise three related points. First, given the magnitude of the costs involved, we request that Ofgem provides guidance on the precise methodology and timeframe for their recovery. It is vital that supplier and generator licensees are able to forecast BSUoS costs well ahead of the costs being levied, in order to efficiently price retail tariffs and economically dispatch plants. Sufficient notice must therefore be given of the period over which these costs will be levied, recognising that licensees may already have traded volumes on a forward basis – and that in doing so, they will have been unaware of the BSUoS cost impact until NGET's application was published on 8 June (despite the agreements having been concluded on 31 March).

Second, as the cost of providing a black start service is socialised equally across consumers, it is reasonable to expect they should benefit from broadly similar restoration times, irrespective of where in GB their homes and businesses are located. We would expect a black start strategy to reflect this principle as a core objective and are concerned that there may be a wide variance in forecast restoration times, with customers in central and southern Scotland in particular facing unacceptable delays for a modern economy. We believe there should be greater transparency around these differences and that Ofgem should review the appropriateness of the arrangements.

Finally, we believe that increased transparency would promote stronger competition between existing (and new-entrant) black start service providers and would better serve consumers' interests in facilitating economic and efficient system management in the longer term. We have long been supportive of the many developments NGET has introduced in this area, but continue to have concerns at the opacity of reporting of services including black start and SBR/DSBR, and non-tendered services including fast reserve and commercial intertrip.

I hope you find these comments useful. Should you wish to discuss any of these points further then please do not hesitate to contact me.

Yours sincerely,



Rupert Steele
Director of Regulation

**CONSULTATION ON A PROPOSED INCOME ADJUSTING EVENT SUBMITTED BY
NGET PLC IN RELATION TO THE 2015-17 ELECTRICITYSO INCENTIVE SCHEME –
SCOTTISHPOWER RESPONSE**

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

We do not believe this application as currently formulated meets the qualifying criteria for an IAE. As explained below, it is unclear to us whether the circumstances were unforeseen by NGET, but even if they were, we do not believe the consequences were fully beyond NGET's reasonable control. The consequences could have been substantially mitigated had NGET adopted a more robust black start strategy that left it better prepared for the circumstances in question.

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

No, we do not consider that the proposed IAE constitutes a force majeure as defined in either the BSC or the CUSC.

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

It is unclear to us to what extent the event submitted by NGET was unforeseen. We recognise that it may have been difficult to foresee that one or more operators of plants which had been awarded CM agreements would seek to close and default on those obligations (and we are pleased to see DECC's recent decision on stronger delivery incentives in its reforms to the Capacity Market).

However, it seems unlikely that the first indication of plant closures which NGET received for its BSIS Formula Year 2016/17 from multiple plant operators acting independently would have been as late as February 2016, as claimed in the IAE application. In support of this view, we would note that ScottishPower held a series of bilateral meetings and discussions with NGET at director level, commencing 23 October 2013, at which we disclosed that it was our intention to close our coal-fired Longannet plant in March 2016, subject to a future board decision. During these discussions, we provided detailed explanations of the unsustainable losses arising from poor market conditions including transmission charging, carbon floor pricing, poor dark spreads and a delay in introducing the Capacity Market until October 2018. We expect that the nature of these bilateral discussions with NGET would have been typical of those that they were having with other large thermal plant operators around that time, therefore giving them early insight into the potential closure or mothballing of thermal plant.

Furthermore, the rapid pace of plant closures and the likely impact of these were widely reported in the press and across industry observers during 2015. NGET would also have been aware that each of the licensees required to publish Consolidated Segmental Statements had reported EBIT losses in their conventional generation businesses for several years and should have concluded that this was unsustainable and likely to result in plant closures.

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

We do not believe that the consequences of the events were fully beyond the reasonable control of NGET. Had NGET anticipated the closure of existing service providers and implemented an appropriate black start strategy (as detailed in response to Question 2(ii) below), the consequences could have been substantially mitigated, resulting in a reduced level of costs.

We would therefore support an application from NGET that sought to adjust its incentives in accordance with the efficient level of cost such as might have been incurred with a more appropriate procurement strategy. However, we believe that consumers should have some protection from unnecessary incremental costs associated with uneconomic and inefficient practices and would suggest that Ofgem is best placed to determine the split between efficient costs and the inefficient costs in this application.

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?

Whilst not accepting that the event is an IAE for the reasons given in response to Question 1, we believe that the consequences of the events were exacerbated by NGET's failure to have in place an appropriate black start strategy and consider that a significant portion of the costs incurred resulted from uneconomic, inefficient and uncoordinated action which was entirely within NGET's direct control.

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

We are not aware of any additional such interactions. However, due to the lack of transparency regarding the two black start agreements concluded by NGET with Drax and SSE, we are unaware of the precise detail regarding the contracted services and their interaction with other elements of the BSIS scheme.

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

We believe that NGET's failure to have in place an appropriate black start strategy left them in the position of a distressed buyer and they were therefore unable to act in an economic and efficient manner. Given the grave circumstances that they found themselves in by February 2016 as respects a forecast inability to provide appropriate black start services, we recognise that they may have had little option but to contract with the most economic service providers at that time. However, in contracting at the very last minute, competition was limited and consumers are now faced with a bill for an additional £113m for a single year, with the potential for similar costs in future years until a robust end efficient black start strategy is implemented.

We are concerned that consumers have been poorly served through a combination of an outdated black start strategy being in place and greater costs having been borne than would otherwise have been necessary. It is not clear to us that NGET's rejection of an alternative competing option presented by ScottishPower in respect of its Longannet plant in 2015 was in the best interests of consumers.

Black start strategy

We believe that an appropriate black start strategy should have had plans in place to mitigate the risk of the widely-anticipated closure of existing coal and oil fired black start service providers over the period 2015-2020 and been under a process of continuous review. We would have expected prior to 2015 that the SO would have hosted competitive auctions for longer term black start agreements of 1, 5 and 15 years ahead, ensuring that an appropriate service was maintained at least cost to consumers. This would have maximised competition from existing providers (and new-build projects) ahead of any such closures in a manner similar to that observed for capacity in the T-4 Capacity Market auctions.

Furthermore, as the cost burden of providing an appropriate black start service is socialised such that consumers make an equal contribution to it, it is reasonable to expect that they should benefit from broadly similar restoration times irrespective of where in GB their homes and businesses are located. We would expect a black start strategy to reflect this principle as a core objective and we are concerned that there may be a wide variance in forecast restoration times, with customers in central and southern Scotland in particular facing unacceptable delays for a modern economy. We believe that there should be greater transparency around the differences in restoration times between parts of Scotland and those of other parts of GB, and would welcome Ofgem reviewing the appropriateness of the black start arrangements across the GB system.

ScottishPower
July 2016