

Final Proposals: National Grid Consultation on Demand-Side Balancing Reserve and Supplemental Balancing Reserve

GDF SUEZ Energy UK-Europe Response

(I) About GDF Suez Energy International

GDF SUEZ Energy International (formerly known as International Power) is responsible for GDF SUEZ's energy activities in 30 countries across five regions worldwide (Latin America; North America; South Asia, Middle East & Africa; UK-Europe, Asia-Pacific). Together with power generation, GDF SUEZ also active in closely linked businesses including downstream LNG, gas distribution, desalination and retail. GDF SUEZ Energy International has a strong presence in its markets with 77 GW gross capacity in operation and a significant programme of 8 GW gross capacity of projects under construction as at 31 December 2012.

As at 30 June 2013, the UK-Europe region (GDF SUEZ Energy UK-Europe) has 8.7 GW net ownership capacity in operation, which includes over 5.8 GW of plant in the UK market made up of a mixed portfolio of assets – coal, gas, CHP, wind, a large OCGT diesel plant, and the UK's foremost pumped storage facility. Several of these assets are owned and operated in partnership with Mitsui & Co. The generation assets represent just under 9% of the UK's installed capacity, making GDF SUEZ Energy UK-Europe (expressed as GDF SUEZ in our response below) the country's largest independent power producer. The company also has a retail supply business and a significant gas supply business in the UK, both serving the Industrial and Commercial sector.

(II) Key points

- **GDF SUEZ supports the enduring market wide capacity mechanism as the means of securing system security in the medium to long term.**
- **The position of GDF SUEZ on the appropriateness of SBR has not changed since the last consultation on this subject. GDF SUEZ continues to believe that the energy market should be allowed to function properly and that SBR is unnecessary.**
- **GDF SUEZ believes that the proposed rules to ensure that plant that tenders for SBR is 'additional' to the market will have unintended and expensive consequences.:**
 - **Operators will take a view at the point of the tender on whether to stay in the wholesale market awaiting an improvement in sparkspreads, mothball their plant, or whether SBR could offer a better short term alternative.**

- **National Grid may therefore have to buy capacity significantly in excess of the indicated 1-2GW in order to achieve the required level of security.**
- **This could place the viability of the wholesale market at risk, and compromise the SBR role as “last resort” capacity. Having taken more plant out of the market, it would have to be used more often – the occurrences of ‘last resort’ would become more frequent which would have a large distortionary impact on the functioning of the wholesale market.**
- **If Ofgem does grant National Grid the right to tender then a better solution would be to limit participation in such a way as to avoid this potential scenario. Participation in SBR should be limited to plant that has already made the decision to mothball and already has zero TEC for the targeted periods. Whilst this would favour plant that has made this prior decision to mothball, GDF SUEZ believes that this will help protect the integrity of the wholesale market as far as possible.**
- **GDF SUEZ provides aggregation services to the I&C market and has an interest in the proposals for the DSBR product. Without some suitable financial remuneration paid directly to suppliers and aggregators to cover the costs and resource impact of this activity, GDF SUEZ doubts there will be much uptake in this role.**

(III) Answers to Consultation questions

Demand Side Balancing Reserve Questions

Q1. Do you consider that the proposed amendments to the DSBR product sufficiently address the issues raised in the Consultation?

1. The proposed amendments have dealt with some of the issues raised as a result of the Consultation, and there a number of points that were raised by GDF SUEZ which have been considered and addressed. However, there are a couple of points GDF SUEZ raised in the initial response which GDF SUEZ believes have not yet been thoroughly considered or clarified.
2. GDF SUEZ would like to establish the relationship between the client provider and National Grid’s System Operator, and the involvement of a third party such as supplier or aggregator. The involvement and responsibilities of suppliers/ agents should be clearly stated and should be no more onerous than a directly contracted customer. Furthermore, National Grid must ensure that all operating costs for the service are kept as low as possible for all parties involved (including supplier/ agents and participants).

3. As supplier, GDF SUEZ believes it will be advantageous for National Grid and for the overall cost to consumers if GDF SUEZ actively market and sell the DSBR product to its portfolio to drive uptake. GDF SUEZ does envisage the sale to be difficult and with only limited returns to cover its resource costs. Without some suitable financial remuneration paid directly to suppliers and aggregators to cover the costs and resource impact of this activity, GDF SUEZ doubts there will be much uptake in this role.
4. With regards to the proposed despatch methodology GDF SUEZ would appreciate further clarification on how aggregators and suppliers would be involved in the despatch of DSBR. Does National Grid intend to communicate directly with the providers – in which case GDF SUEZ would request a duplicate signal should DSBR be called; or would National Grid communicate the call-off to the aggregators and expect them to propagate the signal amongst their aggregated providers? If this is the case GDF SUEZ would expect to be provided with the appropriate technology with no additional cost.
5. GDF SUEZ recommends that any customer over 1MW receives direct communication from National Grid, and for those aggregated, GDF SUEZ would propagate the signal, as long as despatch timescales are consistent with the rest of the scheme.
6. Participation in DSBR is entirely voluntary so while GDF SUEZ would support National Grid in taking forward the product in its current state, GDF SUEZ may not necessarily choose to provide the service given the financial impact of marketing and selling such a product to our portfolio, without guarantee or a return on our investment.

Q2. Do you support us taking forward the DSBR product with these amendments?

7. Participation in DSBR is entirely voluntary so while GDF SUEZ would support National Grid in taking forward the product in its current state, GDF SUEZ may not necessarily choose to provide the service given the financial impact of marketing and selling such a product to our portfolio, without guarantee or a return on our investment.

Supplemental Balancing Reserve

Q3 - Do you consider that the proposed amendments to the SBR product sufficiently address the issues raised in the Consultation?

8. GDF SUEZ recognises that National Grid has taken the responses to the previous Consultation on SBR into consideration and has sought ways to address the concerns that have been raised.

9. Whilst National Grid has tried to provide some comfort that SBR will only be used as a last resort, in most cases this will not be possible due to plant dynamics. Plant that is expected to be utilised very infrequently will need to be warmed and then dispatched to its Stable Export Limit. Other thermal plant will be 'bid down' to accommodate the SBR output. Whilst National Grid has said that this plant will be compensated for lost revenue through constrained off/down payments, more flexible plant participating in the market that does not require early warming, could still lose out. This is because National Grid can expire the bids which provides free reserve. National Grid has not recognised this limitation or proposed a way to remunerate flexible plant for lost earnings.
10. GDF SUEZ continues to believe that SBR plant should be required to short term TEC. National Grid is proposing that TEC will not be needed as if it was, it would push up the tender cost. Since TNUoS charges are a zero sum game, if SBR plant is not paying for TEC, the cost will have to be picked up by the rest of the market. Effectively they will be subsidising this non-TEC SBR plant when it does use the transmission system. Therefore, aligned with our comments at the start of this response, plant that tenders must have already given up its enduring TEC and must then re- apply for short term TEC.

Q3. Do you consider that the additionality provisions discussed in Section 5 are sufficiently robust, or whether these should be reinforced?

11. To ensure that plant is additional to the market, National Grid is proposing that tenderers for SBR contracts must declare that their plant would not otherwise be available in the electricity market or for the provision of balancing services, regardless of whether it is successful in the tender, with this restriction applying for the whole year.
12. GDF SUEZ questions whether this additionality rule will be legally enforceable. Some operational plant are struggling to cover their fixed costs but have remained in the market up to now rather than taking the decision to mothball. These plant operators will take a view at the point of the tender on whether to stay in the wholesale market awaiting an improvement in sparksreads, mothball their plant, or whether SBR could offer a better short term alternative. At the point of tendering they may be able to clearly state that if not successful, the plant would not otherwise be available.
13. However, plant operators have a duty to their shareholders (and to the market in general) such that if market conditions subsequently improved, plant that was unsuccessful in the tender would make their plant available regardless of such a declaration. From a security of supply view, it would not be sensible to deny this plant from participating in the market if margins out-turned even lower than forecast. Whilst GDF SUEZ appreciates the difficulty in trying to define additionality in an objective fashion, GDF SUEZ does not think this proposal is sufficiently robust and may create a challenge for National Grid - to remain objective tenders should be accepted

purely on the basis of cost. This may mean that National Grid has to 'buy through' the plant that they don't need to get to the plant that really is additional to the market.

- Therefore, if SBR is to proceed, GDF SUEZ recommends that participation in SBR should be limited to plant that has already made the decision to mothball and already has zero TEC for the targeted periods. Whilst this would favour plant that has made this prior decision to mothball, GDF SUEZ believes that this will help protect the integrity of the wholesale market as far as possible.

Q4. Do you agree that procuring large volumes of extra STOR would be less economic and cause more distortion to the energy and balancing markets compared to SBR?

14. GDF SUEZ appreciates that the dispatch arrangements around SBR are designed to be different to STOR and therefore procuring larger volumes of STOR as an alternative could cause more distortion to the wholesale markets. National Grid also believes that it may have to buy a lot of STOR that would be taking part in the market anyway in order to access the STOR that was additional.

15. However, at the point of tender for SBR, more plant operators may take the view at prevailing levels of sparkspreads, that they should participate in SBR. Plant that has already been unsuccessful in STOR may also decide that closure (or SBR) is the preferred option. In other words, the capacity that is currently considered additional may grow at the point of tender. In part, this thinking would be influenced by the SBR process itself.

Q4. Do you support us taking forward the SBR product? If not, what would be your recommended course of action if margin outlook deteriorates over the next 12 months?

16. The position of GDF SUEZ on the appropriateness of SBR has not changed since the last consultation on this subject. GDF SUEZ continues to believe that the energy market should be allowed to properly function and that SBR is an unnecessary intervention.

17. Some plant is currently mothballed in response to low sparkspreads. This is not a failure of the market but an indication that the market is working efficiently. In fact it is possible that this proposed balancing service may already be contributing to the lack of a forward price signal to 'de-mothball'. Ofgem and National Grid should quickly make clear that SBR will not be procured and allow the market to respond to the anticipate tightening of the system.

18. CCGT plant requires a major outage costing tens of millions of pounds once it has run for a certain number of operating hours. The tendered price could be sufficient to pay for the fixed costs including such major outages. Since SBR plant is not expected to operate, it will not be using up any future operating hours following the major outage. Since this cost has already

been paid for, plant that has an SBR contract will have a future competitive cost advantage compared to plant that remains operating in the wholesale market. This important distortionary effect of introducing SBR has not been recognised.

Costs & Funding Questions

Q5. Do you agree that our cost estimates, and the underlying assumptions, are reasonable?

19. The £25/kW/yr estimate of the costs of SBR is probably at the lower end of the range of costs.
20. GDF SUEZ does not consider the most recent contracts agreed for STOR provide a proxy for the likely costs of SBR. STOR at the moment is substantially provided from the demand side sector which can compete much more cheaply because it does not have the same level of infrastructure costs.
21. The higher end of DECC's range of costs estimates might be sufficient for a CCGT plant so long as it does not need to also pay for a major outage in order to be able to participate.
22. In the illustrative example presented by National Grid in the Consultation, 2GW is procured at a cost of £25/kW/yr – giving a total cost of £50m per year. For this to offer value for money compared to a VOLL of £17,000/MWh, 3 hours of lost load would need to take place beyond the proposed reliability standard. Considering Ofgem's June 2013 capacity adequacy report, only the high demand sensitivity scenario would justify this level of procurement. Ofgem has only provided a probability of the reference scenario occurring (1 year in 12) so it is not possible to comment on the likelihood of this high demand scenario but it would appear to be at the extremity of probability.

Q7. Do you agree that it would be inappropriate to include these costs in the Balancing Services Incentive Scheme until such time prices and volumes for these products are better understood?

23. Whilst GDF SUEZ accepts that the costs of SBR and DSBR should be kept out of the incentive scheme until such time as prices and volumes are better understood, GDF SUEZ does believe that National Grid should have an incentive to minimise use of SBR. Firstly, if National Grid is not exposed to the cost of using SBR, it provides a free option that it can use to maximise its incentive payment – particularly since SBR will most likely have to be called ahead of need which will disrupt the functioning of the market and potentially act to reduce incentivised reserve costs.
24. Secondly, National Grid has said that their measure of success will be if SBR is never used. For these reasons, GDF SUEZ believes that a charge should be applied to the incentive scheme

whenever SBR has to be used. This could be a flat rate charge or be based on the costs of the most expensive non-SBR offer taken in the period when SBR was used times the volume of SBR used.

Q8. Do you agree with the proposed approach to the recovery of incremental internal costs we [National Grid] would incur if we were to procure these additional balancing tools?

25. National Grid estimates that development costs for the two products would be around £1m, with implementation costs in the order of £5m for DSBR and £2m for SBR. Annual operating costs associated with tendering, contracting, despatching and settlement of the two products are estimated in the region of £4m per year.
26. If these products are needed for 2 years, this amounts to £16m. GDF SUEZ does not see how this level of expenditure is in anyway justified. For example, it is difficult to see how the costs of tendering for SBR could ever amount to £2m. The £5m estimate of the implementation costs of DSBR costs spread over 500MW of DSBR that provides this service for 2 years would be £5/kW. This is the same level as the proposed option fee that DSBR will be able to charge if they tender for both years. If National Grid considers it will cost this much to implement then thought should be given to the costs that aggregators will incur in trying to sell this service and whether they could also be recompensed.
27. National Grid must provide much more detail on the implementation costs it will incur as without this one might question who is actually benefitting from procuring these services.
28. Once there is more detailed information as to how these estimates have been determined, GDF SUEZ agrees that Ofgem should have the right to veto some or all of the costs incurred where they are regarded these as inefficient.

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