

Peter Bingham
National Grid Electricity Transmission

11 November 2013

Dear Peter

Demand Side Balancing Reserve and Supplemental Balancing Reserve Final Proposal Consultation

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

We broadly welcome the changes made to the design of the two new balancing tools since the previous consultation. As mentioned in our previous response, the Supplemental Balancing Reserve (SBR) must only be used to bridge the period until the capacity mechanism is effective. To limit any market distortion, it is imperative that the SBR is withdrawn from the date that the capacity mechanism becomes effective. For the Demand Side Balancing Reserve (DSBR), we still think the expected short-term nature of the tool coupled, with an expectation that it will be used only rarely, will make it challenging to market the product to customers.

In summary:

- To ensure that the SBR is only used as an interim measure, it should be made clear in the C16 Statements, in particular, the Balancing Principles Statement (BPS), that the tool will be withdrawn on the first date that the capacity mechanism becomes effective.
- We support the new requirement for a signed declaration from the board of directors to the effect that the plant will not be participating in the market for energy or other balancing services during the term of the SBR contract for which they are tendering, irrespective of the current status of the plant and whether or not a contract is secured.
- While we welcome the clarification that the SBR service would be called as a last resort after all valid and feasible Bids and Offers (BOAs) have been accepted in the Balancing Mechanism (BM) and any valid and feasible DSBR has been called, we also think that the Maximum Generation (Maxgen) service should be utilised before the SBR service to minimise market distortion.
- It would seem logical that Maxgen would be a cheaper solution than the SBR as it is nominally in the market, and should be despatched ahead of the SBR, but the opposite is currently stated in the revised BPS. If the intention is to despatch SBR in advance of Maxgen, then it would have the effect of undermining existing contractual arrangements with Maxgen service providers which would require redress.

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In the absence of a fully working capacity mechanism before 2018, we acknowledge there could be benefits to short term security of supply in these proposals. However, noting that taking forward the new balancing tools will mean consumer bills will increase, we urge NGET to carefully consider the volume of procurement for both services.

Our detailed responses are set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact Mark Cox on 01452 658415, or me.

I confirm that this letter and its attachment may be published on National Grid's website.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Angela Pearce".

Angela Pearce
Corporate Policy and Regulation Director

Attachment

Demand Side Balancing Reserve and Supplemental Balancing Reserve Final Proposal Consultation

EDF Energy's response to your questions

DSBR Questions

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

The proposed amendments are welcome and we believe customers who do not carry out Triad avoidance may find the DSBR a useful test bed for Capacity Mechanism Demand Side Response (CM DSR). We understand that the current CM design is such that DSBR participation could be used as a qualification for CM DSR.

However, since the DSBR is expected to be a short term programme we, as a supplier and aggregator, suspect that it will be challenging to recruit customers to DSBR. Despite the increase in the set-up fee, we believe it may not be sufficient to cover enablement costs for sites thus limiting participation to sites which can be enabled at low cost. Moreover, with no guarantee of customers actually being called to respond to 'events', and therefore limited opportunity for guaranteed revenue (contrasted with availability payments for STOR committed contracts) the DSBR may not be a particularly attractive service.

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

For the purposes of estimating costs, NGET assumes the recruitment of 1 GW of DSBR resources with a set-up fee of £10/kW and an average utilisation rate of £5/kWh, despatched for an average 4 hours per year, with a 75% availability factor. Against these assumptions, the external costs associated with this service would be around £25m per year, equivalent to 25 pence per year on the average domestic consumer bill. Based on the above, we would agree that the proposed DSBR is worth taking forward.

SBR Questions

Q3. Do you consider that the proposed amendments to the SBR product sufficiently address the issues raised in the consultation? Do you consider that the additionality provisions discussed in Section 5 are sufficiently robust, or whether these should be reinforced?

We believe that the new requirement for a signed declaration from the board of directors to the effect that the plant will not be participating in the market for energy or other balancing services during the term of the SBR contract for which they are tendering, irrespective of the current status of the plant and whether or not a contract is secured, is a pragmatic way of addressing 'additionality'.

We welcome the clarification that the SBR service would be called as a last resort after all valid and feasible Bids and Offers (BOAs) have been accepted in the Balancing Mechanism (BM) and any valid and feasible DSBR has been called. While we note that the SBR would be despatched before emergency measures are invoked, it has not been made explicit in the consultation or public workshop that it would be despatched ahead of Maxgen services. It would seem logical that Maxgen would be a cheaper solution than the SBR as it is nominally in the market, and therefore, despatched ahead of the SBR, but the opposite is currently stated in the revised BPS. If the intention is to despatch SBR in advance of Maxgen, then it will have the effect of undermining existing contractual arrangements with Maxgen service providers which would require redress.

If Maxgen is only utilised after SBR, we are concerned that SBR could effectively displace it. Maxgen, which has an utilisation only payment, is not being treated consistently with products that have fixed payments. Incentives to maintain Maxgen capability would be reduced, which would distort the market and is unlikely to be a good outcome for security of supply. We would, therefore, propose that Maxgen be procured on an availability payment based on cost to maintain capability and probabilistic cost of risk, and utilisation based on marginal operational cost, to ensure more equivalence with other products.

In terms of testing, the summary proposals state that each SBR Unit will be tested on a monthly basis. Whereas, on p.48, it is proposed that that SBR providers are tested monthly over the winter. Monthly testing over the winter months seems reasonable but it does not make sense to test units during the rest of year. Since the availability window is from November to February, we would suggest that testing commences in October and completes in February.

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?

We agree that procurement of larger volumes of STOR could be more expensive in the short term. The Capacity Mechanism is intended to provide the correct incentives for capacity in the long term, and use of additional STOR in the short term could complicate the transition to the Capacity Mechanism.

Q5. 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?

Yes, as insurance against capacity shortfalls in the period before the Capacity Mechanism is operational.

Costs & Funding Questions

Q6. Do you agree that our cost estimates, and the underlying assumptions, are reasonable?

The consultation states that, assuming NGET procures 2 GW of the SBR product, using the cost of STOR as a proxy for the likely level of SBR costs, the cost of 2 GW of SBR might cost around £50m per annum, equivalent to £25/kW. The cost estimates appear reasonable for a CCGT plant but we think they would be much greater for a coal plant because (i) they have higher fixed costs than gas plants; (ii) before closing a coal plant, the operator may well have sought to minimise maintenance costs so there may be a backlog of work needed to meet insurance requirements.

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?

We agree that without knowing the quantity, costs, and utilisation rates of these reserve services, it is not possible to establish a reasonable target within the Balancing Services Incentive Scheme (BSIS) scheme that would provide a meaningful incentive. The consultation further suggests that if a new BSIS scheme is introduced from April 2015, the option of including these costs in any such incentive scheme could be considered at that time, when more is known about prices and volumes for these services. Given the interim nature of the services, we are not certain that they can be included in the BSIS scheme, but agree that they should be considered at that time.

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

We understand that the costs for the development, procurement, etc., were not anticipated and therefore not included in the RIIO-T1 submission for NGET's internal SO activities, and therefore are not funded in its current allowances. We agree that, rather than open up the main RIIO-T1 price control, it would be a more pragmatic solution to include the costs on an ex-post basis within the allowed revenues for external costs, with reporting transparency of the additional costs.

**EDF Energy
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