INTERGEN

Peter Bingham
Head of Regulatory Frameworks
National Grid
National Grid House
Warwick Technology Park
Gallows Hill
Warwick
CV34 6DA

08 November 2013

Dear Peter,

<u>Supplemental Balancing Reserve Final Proposals Consultation Response</u>

We welcome the opportunity to respond to the above consultation.

InterGen is owned by Ontario Teachers' Pension Fund (one of the world's largest pension fund investors in infrastructure projects) and China Huaneng Group (the world's second largest power generator). As one of the UK's largest independent generators, operating a portfolio of high efficiency gas-fired power stations (totalling 2,490MW; an investment of some £2.1bn in today's money), we actively trade in the prompt and forward wholesale power, carbon and gas markets. InterGen is seeking to invest further in the UK through our two consented development projects, Spalding Energy and Gateway Energy Centre. These CCGT power stations will create around 3,000 direct jobs during construction and up to 60 long term skilled jobs thereafter.

InterGen strongly believes that the Supplemental Balancing Reserve (SBR) should not be required in a properly functioning market, however as the market is distorted at this time we believe it could play an important role in supporting existing power plants through to the introduction of the Capacity Mechanism. InterGen believes that market signals driven by the EBSCR, Ofgem's Secure and Promote proposals and the forecast tightening of capacity margins will help prevent marginal plant from mothballing but these are inherently subject to considerable execution risk. The SBR product is an intervention in the market that will inevitably cause market distortion by removing scarcity rent from times of system stress. It may also encourage the withdrawal of marginal plant from the market at a time when capacity margins are forecast to tighten. Therefore committing any plant to SBR should be done with caution and only in extreme circumstances. The SBR proposals have as currently drafted some design features that some may see as increasing the potential for gaming. There needs to be clear rules, transparency of process and regulatory oversight to ensure this risk is minimised.

InterGen would be happy to meet to discuss further any points raised in our response.

Yours sincerely,

SMiddleton

Stuart Middleton
Public Affairs and Regulation Manager

Question 3: 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?

InterGen does not agree that the proposed amendments to the SBR products sufficiently address the issues raised in the consultation. We believe that STOR remains a more effective, more transparent and cheaper mechanism and do not believe that National Grid has made the case that STOR is an inappropriate measure. The National Grid assertion that the existence of the capacity market proves that the market does not function correctly is correct at this time but there should be some allowance made that this will not be in perpetuity. The capacity market is primarily designed to encourage investment in new build plant which requires a much greater level of financial guarantees than bringing a plant out of mothball which can be achieved through an upturn in forward prices.

The measures to ensure additionality appear fundamentally flawed. A communication from a Board of Directors to mothball a plant can be made if the poor market prices make it uneconomic to run and therefore the decision is made to tender for a SBR contract. However, if that tender is unsuccessful and market prices subsequently recover to a level whereby it is economic to run the plant again, the Board of Directors could reconsider and announce that they can now bring the plant out of mothball as it would be good news to customers and shareholders alike.

The only way to ensure additionality and prevent a large number of marginal units bidding into the SBR service is to ensure that any plant bidding for an SBR contract will have to forfeit their TEC for the period of the contract that they bid. This forfeiture will not be conditional on the award of an SBR contract and should hold for the duration of the contract period. This is the only way of ensuring that the plant concerned will not participate in the market.

Question 4: Do 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?

InterGen disagrees that extra STOR would be less economic and cause more distortion than the SBR. However we accept the STOR may not be a practical commercial alternative for some power plants and as it may not form a robust enough alternative to mothballing. There remains a significant number of plants that could tender for STOR but currently don’t as the prices are too low to justify tendering. It would appear logical to let market forces operate in the STOR market sufficiently before pursuing SBR contracts unless there is a clear basis for excluding the plant from the STOR tendering process.

In addition, STOR is well understood, transparent and is flexible enough to provide the majority of the additional volume that the SBR intends to procure.

Question 5: Do you support us taking forward the SBR product? If not, what would be you recommended course of action if margin deteriorates over the next 12 months?

InterGen strongly believes that the Supplemental Balancing Reserve (SBR) should not be required in a properly functioning market, however as the market is distorted at this time we believe it could play an important role in supporting existing power plants through to the introduction of the Capacity Mechanism. InterGen believes that market signals driven by the EBSCR, Ofgem's Secure and Promote proposals and the forecast tightening of capacity margins will help prevent marginal plant from mothballing but these are inherently subject to considerable execution risk. The SBR product is an intervention in the market that will inevitably cause market distortion by removing scarcity rent from times of system stress. It may also encourage the withdrawal of marginal plant from the market at a time when capacity margins are forecast to tighten. Therefore committing any plant to SBR should be done with caution and only in extreme circumstances. The SBR proposals have as currently drafted some design features that some may see as increasing the potential for gaming. There needs to be clear rules, transparency of process and regulatory oversight to ensure this risk is minimised.

Additional comments

We believe that if SBR is to go ahead, against the vast majority of the industry opinion, that the following additional safeguards be introduced to reduce the market distortions that are inherent in the current proposals:

1. A sunset clause <u>must</u> be introduced that limits the use of SBR to the period until the capacity market is introduced.
2. To ensure additionality and prevent a large number of marginal units bidding into the SBR service, any plant bidding for an SBR contract will forfeit TEC for the period of the contract they specify. This is the only way to ensure additionality.
3. It is essential that National Grid work with Ofgem to bring forward their Electricity Balancing Significant Code Review (EBSCR) conclusions. National Grid proposes that the costs of SBR would be incorporated into the imbalance pricing but this should be considered as part of the EBSCR. However, Ofgem does not plan to implement changes to cashout until winter 2015, a year later than the first anticipated tender round of SBR.