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Dear Colleague

Recovery of £113m of Black Start contract costs for 2016/17 via the BSUoS invoice.

In order to provide certainty over the recovery of the Black Start contract costs for 2016/17, this letter sets out how National Grid Electricity Transmission (NGET) intends to recover the £113m costs associated with the two Black Start contracts entered into for the period 1st April 2016 to 31st March 2017. The costs associated with these contracts were submitted to Ofgem as an Income Adjusting Event (IAE¹) on 24th May 2016. On the 23rd August 2016 Ofgem issued its IAE determination².

In summary the £113m for the Black Start contract costs will be recovered via the BSUoS³ invoice commencing from 1st October 2016 which will be billed from calendar day 25th October 2016.

The costs incurred for the two Black Start contracts in question for the period 1st October 2016 to 31st March 2017 (£56.3m) will be billed on the BSUoS SF (Initial Settlement) invoice issued for billing dates 1st October 2016 to 31st March 2017. The costs which have already been incurred for the period 1st April 2016 to 30th September 2016 (£56.7m) which until now have been excluded from BSUoS, will be billed on the BSUoS RF (Final Settlement) invoice issued for billing dates 1st April 2016 to 30th September 2016. The BSUoS RF invoice is issued 14 months after the SF (Initial Settlement) invoice, meaning these costs will be billed from June 2017 to November 2017. The table in the body of this letter illustrates the two invoice types and timings.

What is BSUoS (Balancing Services Use of System) charge?

National Grid Electricity Transmission plc (NGET) is the electricity system operator (SO) for Great Britain. We are responsible for balancing the electricity system by ensuring that

¹ https://www.ofgem.gov.uk/system/files/docs/2016/06/notice_of_proposed_iae_submitted_by_nget_on_2015-17_incentive_scheme.pdf

² https://www.ofgem.gov.uk/system/files/docs/2016/08/decision_letter_iae_notice_17_08_2016final.pdf

³ Balancing Services Use of System Charges, for each day on a settlement by settlement period basis there are two BSUoS invoices. The first BSUoS invoice, Initial Settlement (SF), is issued 16 working days after the date in question with the second BSUoS invoice, Final Reconciliation (RF), for the date in question issued 14 months later. The second invoice allows costs to be fully and accurately allocated to days and settlement periods as the final costs and volumes will all be known.

generation on the national electricity grid matches demand on a second by second basis. As SO we buy and sell energy and procure balancing services (also called Ancillary Services) to ensure and maintain operation of the system. Black Start is one of these Ancillary Services; it is the service which would help to recover the National Electricity Transmission System from a total or partial system shutdown. The costs that NGET incurs in carrying out the SO role are passed through to users of the system via balancing services use of system (BSUoS) charges. Ancillary Services are one component that makes up BSUoS charges.

What is BSIS? (Balancing Services Incentive Scheme)

BSIS is an incentive scheme, set by Ofgem, which incentivises NGET to minimise the costs of operating the system and currently runs for a two year period from 1st April 2015 to 31st March 2017. In each year of the scheme if NGET spends less than the target cost we are allowed to keep 30% of that underspend. Conversely, if the spend is more than the target cost, then we incur 30% of that overspend. NGET's performance under the scheme is limited to plus or minus £30 million per year.

As the BSIS target is set in advance, the scheme includes a mechanism to deal with unforeseen events. In those instances, and subject to certain conditions being met, NGET may apply to Ofgem for an Income Adjusting Event (IAE) to amend income under BSIS. When an IAE has been allowed by Ofgem, any costs that are associated with the IAE are effectively removed from the calculation of performance under the incentive scheme, and hence do not affect the profit or loss incurred by NGET under the scheme.

2016/17 Black Start IAE submission

In February 2016, announcements of potential closure or mothballing of thermal power stations led NGET to review its Black Start capability. This revealed that a minimum of two units were required in the North East and / or North West zones to maintain existing capability. Following a competitive process, contracts were signed for one unit at Fiddlers Ferry and one unit at Drax to provide Black Start services only for a 12 month period. The rationale for this decision includes

- A Black Start service at Fiddlers Ferry restores 3.5GW 4-6 hours earlier than would otherwise be the case
- A Black Start service at Drax restores 2-4GW 3-4 hours earlier than would otherwise be the case, provides stability in the establishment of the North East power island and also helps accelerate the restoration of the wider network.
- A simplified cost benefit analysis was carried out using VoLL⁴ to assess the cost to consumers of contracting this service. This indicates that consumers benefit from contracting the service rather than accepting longer restoration times
- Alternative Black Start options were explored but, at this stage, these are not mature enough to provide a viable alternative to the services provided by conventional thermal plant
- NGET's priority will be to continue progressing longer term solutions with these alternative providers.

⁴ Value of Lost Load

On the 25th February 2016, NGET published a letter⁵ requesting final expressions of interest for Black Start services in the North West or North East of England. Following this, we entered into bi-lateral discussions with a number of potential Black Start providers to further explore the options available and signed contracts for the provision of Black Start capability from Drax and Fiddlers Ferry at a combined cost of £113m. As, in our view, both of these contracts met the requirements of an IAE we submitted a Notice of an Income Adjusting Event on 24th May 2016 for Ofgem determination.

The IAE determination was that of the £113m, the Fiddlers Ferry cost of £54m met the criteria of an IAE and the Drax cost of £59m did not meet the IAE definition.

The recovery of costs such as these is not tied into the approval or rejection of an IAE. Rather, the costs will be recovered through BSUoS but the IAE determination outcome will impact NGET's Balancing Services Incentive Scheme (BSIS).

The impact of the IAE on the BSIS outcome will be dependent on the actual outcome of the 2016/17 scheme. The maximum impact that not allowing the £59m Drax costs could have on NGET's performance is a reduction in incentive income of £17.7m (a 30% share of the costs), while the minimum impact could be zero (if NGET still deliver to the capped level of savings).

The actual impact on NGET's incentives within this range will depend on the actual outturn of Balancing Services Use of System (BSUoS) costs versus the target value in 2016/17.

Recovery of £113m Black Start costs

Under the usual billing process, recovery of the £113m should have started from 1st April 2016, at a rate of £309,830/day in the SF (Initial Settlement) invoice. Due to these costs being significantly greater than the Black Start element of the 2016/17 BSIS target, it was decided that it was appropriate to delay recovery in BSUoS until NGET had submitted an IAE to Ofgem and Ofgem had made their determination.

The SF invoice currently being billed for 2016/17 (starting from 1st April 2016) does not yet include any of the £113m black start costs. We have considered a number of options in relation to the billing of the £113m and have engaged with a number of stakeholders to understand impacts. We have come to the conclusion that the most pragmatic and least disruptive way forward is to include Black Start contract costs in BSUoS from billing day 1st October 2016. Billing for the 1st October will start from calendar 25/10/2016.

The costs incurred for the two Black Start contracts in question for the period 1st October 2016 to 31st March 2017 (£56.3m) will be billed on the BSUoS SF (Initial Settlement) invoice issued for billing dates 1st October 2016 to 31st March 2017. The costs which have already been incurred for the period 1st April 2016 to 30th September 2016 (£56.7m) which until now have been excluded from BSUoS, will be billed on the BSUoS RF (Final Settlement) invoice issued for billing dates 1st April 2016 to 30th September 2016. The BSUoS RF invoice is issued 14 months after the SF (Initial Settlement) invoice, meaning these costs will be billed from June 2017 to November 2017.

Although BSUoS invoices are issued on a daily basis, for illustrative purposes, the table below shows on a monthly basis how much and when the charge will be billed.

⁵ <http://www2.nationalgrid.com/WorkArea/DownloadAsset.aspx?id=45483>

~Invoice Issue Period	Billing Period	Invoice Type	£m
Oct-16	Oct-16	SF	9.6
Nov-16	Nov-16	SF	9.3
Dec-16	Dec-16	SF	9.6
Jan-17	Jan-17	SF	9.6
Feb-17	Feb-17	SF	8.7
Mar-17	Mar-17	SF	9.6
		Sub-total	56.3
Jun-17	Apr-16	RF	9.3
Jul-17	May-16	RF	9.6
Aug-17	Jun-16	RF	9.3
Sep-17	Jul-16	RF	9.6
Oct-17	Aug-16	RF	9.6
Nov-17	Sep-16	RF	9.3
		Sub-total	56.7
		Total	113.0

There are a number of CUSC modifications that are currently going through the governance process relating to BSUoS, including CMP267⁶. CMP267 has been raised as an urgent modification by EDF that looks to treat IAE costs (>£30m) separately to other BSUoS costs and to defer the recovery of these costs over the next two financial years rather than the financial year in which they have been incurred. This would give industry a forward view of the costs.

The modification has not yet concluded the governance process but is being progressed to an urgent timetable, and is due to go to Ofgem for decision in early November. Depending on the final CMP267 proposal there may well be licence changes required as well as system changes to allow the BSUoS charge calculations to be modified. Both of these could mean that implementation of CMP267, if approved by Ofgem, could be significantly later than November 2016.

As there is therefore no clarity about how soon the proposal could be implemented, waiting for the outcome of CMP267 risks not being able to recover the Black Start costs via the appropriate SF or RF runs, and also adds to industry uncertainty. We have therefore decided to begin billing these costs ahead of any CMP267 decision.

⁶ <http://www2.nationalgrid.com/UK/Industry-information/Electricity-codes/CUSC/Modifications/CMP267>

Conclusion

The costs incurred for the two Black Start contracts in question for the period 1st October 2016 to 31st March 2017 (£56.3m) will be billed on the BSUoS SF (Initial Settlement) invoice issued for billing dates 1st October 2016 to 31st March 2017. The costs which have already been incurred for the period 1st April 2016 to 30th September 2016 (£56.7m) which until now have been excluded from BSUoS, will be billed on the BSUoS RF (Final Settlement) invoice issued for billing dates 1st April 2016 to 30th September 2016. The BSUoS RF invoice is issued 14 months after the SF (Initial Settlement) invoice, meaning these costs will be billed from June 2017 to November 2017. The table in the body of this letter illustrates the two invoice types and timings.

We hope that this position gives clarity and certainty regarding this issue. If you have any questions, please contact in the first instance Andrew Ford on 01926 654159 (andrew.j.ford@nationalgrid.com) or Rob Smith on 07900 136028 (robert.smith4@nationalgrid.com)

Yours sincerely

A handwritten signature in blue ink, appearing to read 'C McClay', with a long, sweeping underline.

Cathy McClay
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