VPI Immingham

Removal of SBR/DSBR Costs from BSUoS into a “Demand Security Charge”

March 2016

Issue: SBR costs for Winter 16/17 are virtually impossible to forecast and will likely result in a distortion of competition between generators

- All SBR/DSBR costs are recovered via BSUoS from both suppliers and generators and are not known until 16 working days after the event
- SBR / DSBR costs are made up of the procurement costs (effectively availability), which are known in advance and utilisation costs, which are not known in advance and are virtually impossible to forecast
  - Market does not have understanding / visibility of how SBR plant will be despatched
  - Lack of transparency in the utilisation price (some include a fuel index, some include fuel and carbon costs)
  - Warming timescales are inconsistent with publication of data
- Given the security of supply concerns, there is a high likelihood of SBR plant being despatched multiple times next Winter and therefore utilisation costs could run into tens of millions of pounds, potentially even higher. These costs are then recovered from BSUoS in the settlement periods they are incurred (whereas procurement costs are spread over total Winter demand)
  - This could drive very high, highly volatile BSUoS costs in periods where SBR is warmed and run in earnest, particularly for coal plant
- In order to mitigate this risk, generators will be forced to add a significant risk premium to their forecasts, driving higher costs for consumers

Impact: Unforecastable and volatile BSUoS costs as a result of SBR will result in inefficient despatch and hence drive unnecessary consumer cost

- Market inefficiency as a result of inefficient despatch of plant (based on a nebulous forecast)
- Perverse incentives for generators in terms of signals to generate (particularly in the shoulder periods – prices should be high enough when used in earnest)
  - SBR may only be required for Block 5b, but could be warmed up to 48 hours ahead of need driving high and volatile BSUoS
  - This could result in generators delaying their start until they are sure that they will recover their costs. This could drive ever higher risk premium and cost consumers more
- Outturn costs in excess of the forecast are irrecoverable by generators as they are recovered ex-post, especially for those that have hedged already
- Highly likely that plant will be despatched uneconomically
- Potential barrier for entry, particularly for independent generators who are not able to offset higher costs against a customer base
- Worst case scenario is that a generator, with independents the most exposed, already struggling with low spreads and low load factors, could go bankrupt, worsening security of supply and exacerbating the very issue that SBR is trying to solve

Solution: Introduction of a “demand security charge”

- Our proposal would move all SBR/DSBR costs into a “demand security charge” that is only charged to demand BMUs
  - Whilst we would expect a workgroup to develop the exact mechanism, our initial views are that the total costs are collected across gross demand across the SBR/DSBR window (i.e. November to February)
- This would more economically charge those parties benefiting from the product
- It would also protect customers from paying for a lack of efficiency as a result of the uncertainty
- Give SBR is really a long term security measure, we would also argue that it is consistent with the capacity mechanism cost recovery framework

- We believe that this would better deliver CUSC charging objectives (a) and (c)
  - The lack of any meaningful signal negatively impacts competitions in the wholesale market
  - Furthermore, the introduction of SBR and continued growth in its size and costs, does not properly take account of developments in the transmission business, specifically the impact of an increasing number of plant closures

- This change would need to be implemented by November 2016 (when SBR window opens), so there is a sense of urgency
- We have serious concerns that without an immediate resolution of this issue, generators will have to consider either charging very high prices on the basis of no robust information, or may go bankrupt over the coming winter turning a tight system into one with negative plant margins
- Whilst CMP250 addresses the issue of BSUoS volatility, it will not be in place for Winter 16/17 when the issue occurs

Questions?

Code Administrator - Proposed Progression

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- The Panel is asked to agree:
  - whether CMP262 should be progressed using either;
    - A Standard timetable
    - An Urgent timetable

Urgency Criteria

- Ofgem's current view is that an urgent modification should be linked to **an imminent issue** or a **current issue** that if not urgently addressed may cause:

  a) **A significant commercial impact** on parties, consumers or other stakeholder(s); or

  b) **A significant impact on the safety and security** of the electricity and/or gas systems; or

  c) A party to be in breach of any **relevant legal requirements.**

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Proposed standard timeline – with Workgroup

10 March 2016	CUSC Modification Proposal and request for Urgency submitted
18 March 2016	CUSC Panel meeting to consider proposal and urgency request
21 March 2016	Panel's view on urgency submitted to Ofgem for consultation
18 March 2016	Request for Workgroup members (7 Working days)
29 March 2016	Ofgem's view on urgency provided
w/c 11 April 2016	Workgroup meeting 1
w/c 25 April 2016	Workgroup meeting 2
16 May 2016	Workgroup Consultation issued (15 Working days)
7 June 2016	Deadline for responses
w/c 13 June 2016	Workgroup meeting 3
21 Jul 2016	Workgroup report issued to CUSC Panel
29 July 2016	Panel meeting to approve WG Report

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Proposed standard timeline – with Workgroup

3 August 2016	Code Administrator Consultation issued (15 Working days)
24 August 2016	Deadline for responses
7 September 2016	Draft FMR published for industry comment (5 Working day)
14 September 2016	Deadline for comments
22 September 2016	Draft FMR circulated to Panel
30 September 2016	Panel meeting for Panel recommendation vote
5 October 2016	FMR circulated for Panel comment (5 Working day)
12 October 2016	Deadline for Panel comment
19 October 2016	Final report sent to Authority for decision
14 December 2016	Indicative Authority Decision due (40 Working days)
30 December 2016	Implementation date

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w/c 6 June 2016	Workgroup meeting 3
16 June 2016	Workgroup report issued to CUSC Panel
24 June 2016	Panel meeting to approve WG Report

Proposed urgent timeline – with Workgroup

5 July 2016	Code Administrator Consultation issued (15 Working days)
26 July 2016	Deadline for responses
4 August 2016	Draft FMR published for industry comment (5 Working day)
11 August 2016	Deadline for comments
18 August 2016	Draft FMR circulated to Panel
26 August 2016	Panel meeting for Panel recommendation vote
7 September 2016	FMR circulated for Panel comment (5 Working day)
14 September 2016	Deadline for Panel comment
20 September 2016	Final report sent to Authority for decision
18 October 2016	Indicative Authority Decision due (20 Working days)
1 November 2016	Implementation date