Interested parties

Promoting choice and value for
all gas and electricity customers

Our Ref: document ref 11/10
Direct Dial: 020 7901 7009
Email: stuart.cook@ofgem.gov.uk

9 February 2010

Dear colleague

Response to questions raised by industry participant in relation to Ofgem's consultation on CAP170 (ref 11/10)

On 3 February 2010, Ofgem received a request from an industry participant seeking additional information in relation to our 26 January 2010 consultation on CAP170[1]. The request was originally made at the Connection and Use of System Code (CUSC) Panel meeting on 29 January 2010. The party requesting the information has clarified, for the avoidance of doubt, that the information is sought from the perspective of any CUSC Party wishing to respond to Ofgem's 26 January 2010 consultation.

We do not consider that any of the issues raised in the 3 February request would materially affect responses to our January 2010 consultation on CAP170. However, in the interests of transparency, we have published in the appendices to this letter our responses to the questions raised.

Yours sincerely

Stuart Cook
Senior Partner, Transmission and Governance

---

[1] http://www.ofgem.gov.uk/Licensing/ElecCodes/CUSC/Ias/Documents1/100126_CAP170_Competition_consultation_FINAL%20(sig).pdf

Appendix 1 – questions raised and Ofgem's response

	Question	Ofgem's response
	Question *[There are] a number of items where additional information appears (from the letter itself) to be available but was not included in the letter or Appendix; such as:-*	**Ofgem's response**
1)	*Page 1, 2nd paragraph* *"NGET's latest estimate of potential cost savings under CAP170 (if approved) is £35m for the period 2010/11."*	The estimated saving for 2010/11 is calculated in the same manner as cost savings estimated in our May 2009 impact assessment and July 2009 consultation on CAP170 – savings are based on NGET's forecast of constraints costs and volumes pre and post CAP170, using the assumptions set out in appendix 2 of our May 2009 impact assessment.
2)	*Page 4, top of page* *"NGET has since advised Ofgem that it expects savings under CAP170, if approved, of around £35m for the period 2010/11."*	As above.
3)	*Page 5, 3rd paragraph plus footnote 13* *"NGET's latest forecast is for constraint costs of around £86m [footnote 13] on the Cheviot boundary for 2010/11. Against this forecast, and as noted above, NGET estimate potential cost savings under CAP170 (if approved) of around £35m for that period. "*	The £86m figure is based on latest information provided by NGET to Ofgem in the context of the work on SO incentives. That is, of the £322m forecast constraints for the period 2010/11, £86m is attributed to the Cheviot boundary.
4)	*[footnote 13] "Based on latest information NGET has provided to Ofgem."*	We have footnoted the source as 'latest information NGET has provided to Ofgem', as we note that NGET's January publication on SO incentives which quotes its latest constraint forecast of £322m for 2010/11 does not provide a breakdown of the figure.
5)	*Page 11, Paragraph 1.20* *"The tables below summarise the analysis that has been undertaken by Ofgem of the relative price of resolving constraints in England & Wales versus Scotland, via the BM, intertrips, and contracts."* *[(a) there is only one table below this and (b) that table is stated as "Source: NGET" - two questions (i) was there more than one*	(i): There is not more than one table. This is a typographical error, the text at 1.20 should read "The table below summarises . . ." (ii): This is Ofgem analysis based on cost and volume data provided by NGET.

	'table below' and (ii) was there any Ofgem analysis (separate to the NGET analysis shown in Table 2?) if the answer to these questions is 'yes' then can this information also be provided?]	
6)	*Page 12, Paragraph 1.25* *"However, Ofgem has conducted analysis which suggests that this is not a significant factor in explaining the price differential between Scotland and England and Wales."*	We did not consider it necessary to publish this analysis in support of our recent consultation, as we do not consider it material to the arguments we have set out in the appendix to our 26 January letter. However, we are happy to make this analysis available in response to this request, and it is included in appendix 2 to this document. For the avoidance of doubt, we do not consider that the availability of this additional analysis should have a material impact on responses to our consultation.
7)	*Figure 1 (page 13) shows "Accepted BM offers in constrained and non-constrained periods – Scottish coal plant versus E&W coal plant Jan-Dec 2007 ". Where was this information for Scottish gas plant BM Offers over the same time period?*	Figure 1 replicates the analysis published in Ofgem's March 2009 consultation paper on options for addressing market power concerns. The purpose of this analysis was to illustrate our concerns regarding pricing differentials in the BM when constraints are active, rather than to focus on the behaviour of a particular plant type. Equivalent analysis for Scottish gas plant BM offers for the period Jan-Dec 2007 is shown in appendix 3 to this document.
8)	*Figure 2 (page 14) shows "Accepted BM Bids in constrained and non-constrained periods, Scottish gas plant versus E&W gas plant April 2005-August 2008 ". Where was this information for Scottish coal plant BM Bids over the same time period?*	Figure 2 replicates the analysis published in Ofgem's March 2009 consultation paper on options for addressing market power concerns. The purpose of this analysis was to illustrate our concerns regarding pricing differentials in the BM when constraints are active, rather than to focus on the behaviour of a particular plant type. Equivalent analysis for Scottish coal plant BM bids is shown in appendix 3 to this document.
9)	*Table 3 shows "Volume-weighted average spreads and accepted bid prices (£/MWh), Coal, April 2005 to June 2008". Where was this information for Scottish gas plant over the same time period?*	As set out in the *text beneath Table 3, the spreads were calculated assuming a generic coal efficiency of 36%. Given the greater variability of efficiencies between gas plant compared to coal plant, we consider it would be less meaningful to calculate spreads assuming a generic gas efficiency. Ofgem had access to efficiency data for specific plant during the course of the Competition Act investigation, but it would not be appropriate to publish analysis using this data here.
10)	*10) Why are the time frames for Figures 1 and 2 plus Table 3 (i) all different and (ii) do not extend well into 2009 (given that the letter was published in 2010)?*	(i) We consider it appropriate to use differing periods as the periods we have highlighted demonstrate the existence of the issue in certain export constraint and import constraint periods.

		(ii) We have set out in the appendix to our 26 January letter that the examples provided were from analysis compiled for our Competition Act investigation into SP and SSE, which was closed in 2009.

Appendix 2 – analysis relevant to question 6

We set out in our 26 January letter that there may be an argument that generators are entitled to recover any opportunity cost associated with intertrip arming via the arming fee, which might reasonably include any revenue that may be foregone by a generator in the BM due to use of the intertrip by NGET (this could include both revenue from BM bids in the export-constrained region, as well as BM offers from plant owned by the same generator on the other side of the constraint that would otherwise have been called on to provide replacement energy). We noted that Ofgem has conducted analysis which suggests that this is not a significant factor in explaining the price differential between Scotland and England and Wales. We have been asked to provide this analysis.

We have sought to estimate the "opportunity cost" for inter-trip services provided by a generator in Scotland, using the formula:

Opportunity Cost=
{E&W offers – max(SRMC, MIP)}*(Share of generator in the BM E&W accepted offers)
+ {SRMC-Scottish Bids}*(Share of generator in the BM Scottish accepted bids)

where, E&W offers is the average England and Wales accepted offer price, SRMC is the short-run marginal cost of coal plant, MIP is the market index price and Scottish Bids is the average Scottish accepted bid price. The results are based on a data sample from January 2006 to October 2009. SRMC was calculated using ARA coal and EU ETS carbon prices sourced from Bloomberg assuming a 36% efficiency factor and full pass though of carbon. Generators with SRMCs below MIP had the opportunity to earn a margin in the wholesale market so we exclude this component in the consideration of the replacement offer spread.

Assuming the Scottish bid market is competitive (with bid spreads comparable to similar plant in England and Wales), we obtain an estimated opportunity cost of around £4/MWh:

Scottish bid spread		Scottish BM share		E&W offer spread		E&W BM share			
4	x	50%	+	40	x	5%	=	**4**	£/MWh

This analysis supports our view that opportunity costs are not a significant factor in explaining the price differentials between Scotland and England and Wales, which are set out in Table 2 (page 11) of our January 2010 consultation.

Appendix 3 – analysis relevant to questions 7 and 8

Figure (i): Accepted BM offers in constrained and non-constrained periods – Scottish gas plant versus E&W gas plant Jan-Dec 2007

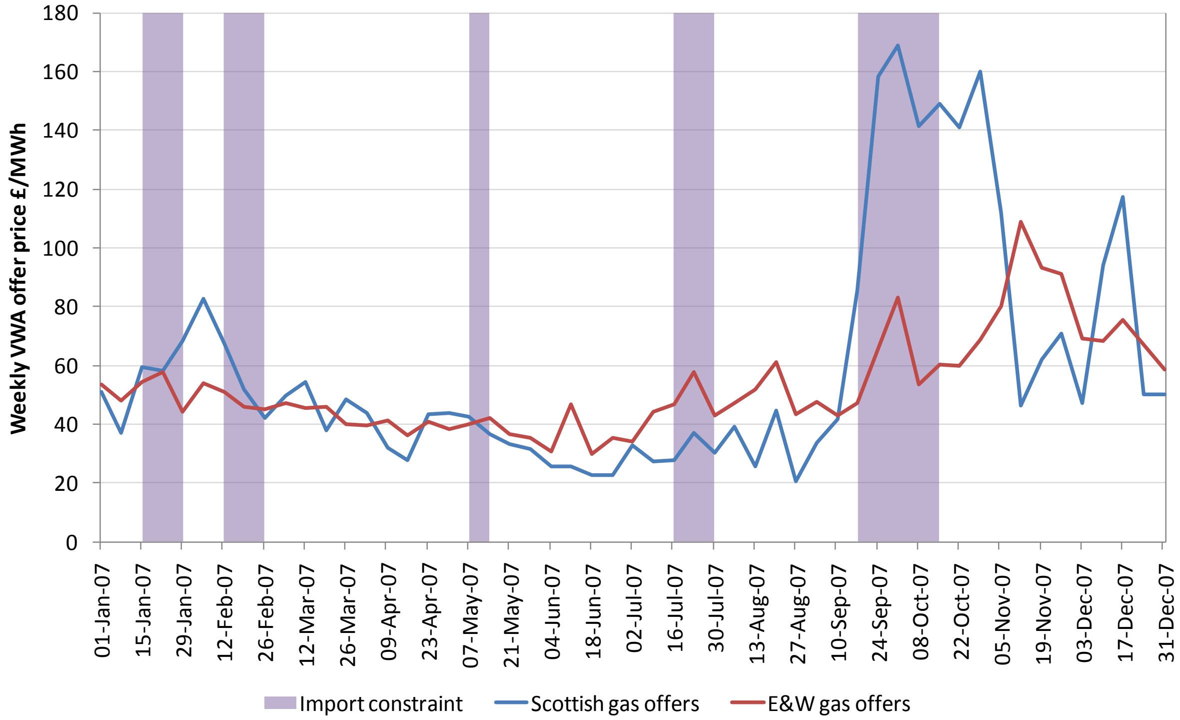

Figure (ii): Accepted BM Bids in constrained and non-constrained periods, Scottish coal plant versus E&W coal plant April 2005-August 2008