By E-mail

Lesley Nugent
Ofgem
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Dear Ms Nugent

CAP170 Consultation 26 January 2010

DONG Energy welcomes the opportunity to respond to this consultation. We share Ofgem's concerns about the level of constraint costs. However, we remain of the view that the solution offered by CAP170 is not an appropriate solution and would not better facilitate the relevant objectives of the CUSC. DONG Energy does not support implementation of CAP170.

We note the additional analysis provided by Ofgem, but without the data underlying the tables it is difficult to in anyway comment meaningfully upon the work Ofgem has done. We are aware that it is not always possible to attribute specific balancing actions to one issue and the debate about system verses energy actions remains ongoing. However, we can see no evidence that Ofgem has considered the wider costs associated with the proposal, rather than the costs to NGC, and ultimately born by customers.

DONG Energy remains extremely concerned that CAP170:

- Will force plants to accept, in some cases retrospectively, major and commercially material changes to their contracts;
- As defined, it would remove a generator's right to refuse to accept changes to a Bilateral Connection Agreement (BCA), which are already difficult to negotiate given the generator is negotiating with a monopoly;
- The regulatory risk associated with building new plant in the UK will rise significantly (for example our Severn Power development never envisaged providing such services at the proposed prices);
- The modification is meant to be an "interim measure", but will be hard wired into CUSC with no drop dead date; and
- No operational process has been developed so there is no way for a generator to understand or challenge the process and the risk of undue discrimination in operation of the inter-trips further increases risks.

Issues raised in to Ofgem's letter

As a market participant we have no way to judge the probability of inter-trips as there are no forecasts or historic data on fault levels and the use of inter-trips. We also do not know how long, even on average, plants are off line following these inter-trips. Ofgem says that faults are "rare", but does not quantify this. We are therefore unable to judge what the potential costs to participants are if they are caught in the scheme. We note Ofgem's comments that the administered prices may be "broadly appropriate", but cannot believe given the range of plants, with differing costs, and the variety of times that inter-trips could occur that this can be right. We understand that the work on CAP076 did not look at the costs to wind farms.

Ofgem must undertake a more rigorous cost benefit analysis rather than focusing on the reduced constraint costs.

For our plant we do not believe that the administered price is at a level to cover the expected costs. There are potentially considerable costs around the wear and tear that could occur and possible renegotiations of the operations and maintenance contracts that we have in place. Reduced running will reduce revenue streams and increasing starts in a year may impact our maintenance schedules. These are not insurmountable pricing problems, but simply reflect the way that this modification has been progressed without the valuable input of expert industry working groups.

In our response to the original urgent consultation, DONG Energy raised the issue of breakers being opened on operational inter-trips at wind farms. The changes under F/08 of the Grid Code allowed operations to change so that they reduce the mechanical stress on the turbines, but the breakers being opened would not keep the wind farm's voltage control facility in operation, which benefits the reactive power balance in the grid, and stop rapid up-regulation of active power if recovered. This issue is relevant under the Category 5 proposals and needs to be addressed. For wind farms the inter-trip payment must still be made if the breakers are not opened for reasonable operational reasons. We do not believe that this issue has been considered. Intertrip payments must also include compensation for any loss of income from ROC's, LEC's and other forms of variable subsidies.

DONG Energy remains firmly of the view that in competitive, liberalised markets ad hoc administered pricing is not a substitute for competitive tendering. DONG's not inconsiderable investments in the UK have been based on the understanding that this is an open market where commercial, bi-laterally negotiated arrangements are the norm. To undermine the principle of markets in this way adds to the regulatory risk for new build. This is of even greater importance now the DECC has clearly stated that the "connect and manage" transmission access regime will be introduced and the likelihood of non-complaint boundaries will increase.

Ofgem does not seem to have considered that if it a plant has rising costs associated with CAP170 then they will seek to recoup those costs via prices more generally. So while inter-trip costs go down other balancing costs may go up. While it is difficult to forecast how generators will behave, it is a reasonable assumption that if marginal plants see costs rising they will increase their prices and the forward curve as a whole will shift up. Pricing difference between the markets in Ofgem's analysis may be skewed if it is not taking account of the type of plant that exists in each market. It has also not considered the impact of the wider market prices which could be significant.

It would also appear that the forecasts of constraint costs are falling significantly, though there is limited information on why forecasts have gone from £322m when the modification was raised to now be at £86m for the specific boundary for 2010/11. Of this £86m we believe it is reasonable to expect some costs due to the non-complaint nature of the boundary (as agreed by Ofgem at BETTA). While a saving £35m would be welcome, we are not convinced that this benefit would not be outweighed by the costs associated with the scheme.

It would appear that NGC has made some progress in reducing constraint costs. We would welcome some detail on how this has been achieved so that the industry can consider whether further actions should be looked at. For example, have NGC ensured that operational solutions are being fully utilised, such as timing outage works to minimise costs.

Ofgem's competition analysis may be correct depending on the definition of the market used, contract prices, weighting of plant type available, etc... However, as noted above there is not enough data to comment. We share Ofgem's concerns about the level of competition, but do not believe that this modification addressed competition issues without placing considerable additional cost on the industry more widely. We are extremely disappointed that Ofgem did not try to use its powers under the Competition Act 1998 to test the competition concerns that it has with regard to SSE and SPL in 2009. Without testing those powers we do not believe it will be easy to define any new generation licence conditions to address the issues that Ofgem has identified. The CAP170 arrangements do not address competition either, it simply regulates the plants impacted, but with too many side effects to be economic.

DONG Energy believes that Ofgem should use its additional analysis, combined with the work it undertook last year, to take action under the Competition Act if it believes that there are players with market power who are abusing that power. We appreciate that this is a substantial piece of work, but in the longer term establishing a competitive market should remain Ofgem's top priority, in line with its statutory duties. It should also continue to keep pressure on all TOs to deliver the investment needed to remove constraints. Ofgem must not however approve CAP170 given the wider costs that we believe it will impose on the market.

If you would like to discuss any of the points raised in this letter please do not hesitate to contact me.

Yours sincerely

Thomas Dalsgaard
Vice President – Regulatory Affairs