Andreas Flamm
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Ofgem
9 Millbank
London
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24 October 2012

Dear Andreas,

Electricity Balancing Significant Code Review (SCR) – Initial Consultation

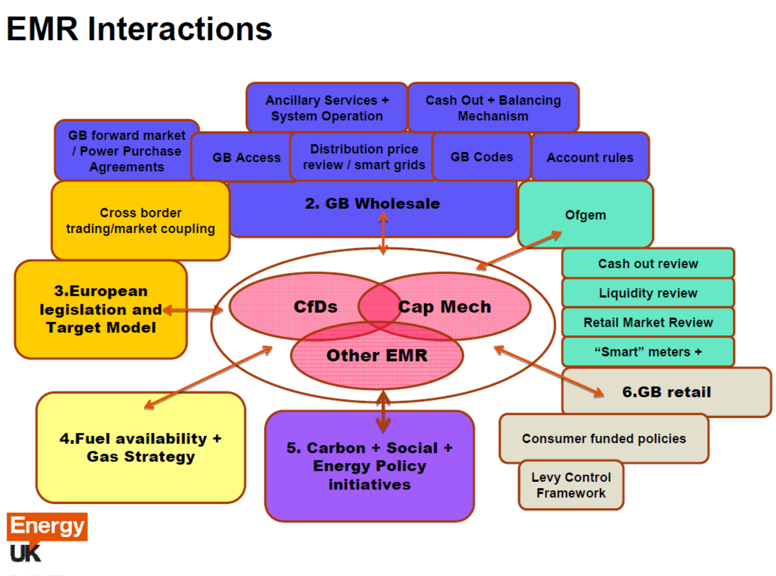
InterGen welcomes the opportunity to respond to this consultation. InterGen is one of the UK's largest independent power producers - providing 5% of the country's average electricity demand through our three gas-fired power stations, which are amongst the cleanest, most technologically advanced and efficient gas-fired power stations in the world. InterGen is also developing two new flexible gas plants in the UK which, once operational, will add a further 1.8GW of generation to the system by 2016, representing an investment of £1.4 billion.

As a thermal generator InterGen is incentivised to balance via the system 'cash-out' prices. Cash-out prices also assist thermal generators assess the risk when forward selling generation – as the penalties under cash-out exposure are almost always more punitive than trading (forward selling) the volume. Intermittent generation is currently not overly incentivised to 'balance', resulting in additional balancing costs to grid operators and ultimately increasing costs to consumers. By sharpening cash-out, intermittent generation will be incentivised to more accurately follow load profiles and contracted shapes. This could being forward more innovation into wind demand forecasting as it will be in generators best interests to more accurately predict output. In this regard, InterGen agree with the sentiment behind this SCR. However, InterGen is concerned about the timing, resourcing and possible unintended consequences of this SCR, discussed in more detail below.

Timing

Drawing your attention to the Energy UK diagram below (Figure 1), EMR and the upcoming Energy Bill are anticipated to signal the biggest change to the electricity markets in the UK for over 10 years, since the introduction of NETA. The Government has stressed (and this has been recently backed-up by Ofgem's Security of Supply Report) that it is essential that the UK attracts the investment required to replace ageing generation and meet low carbon targets, at an estimated cost of £150 billion. Until industry is comfortable with the outcome of EMR, there will likely be an investment hiatus as utilities, shareholders, and lenders (many of whom are based overseas) wait to be able to model the differing risks under the new regime. Therefore adding in a cash-out review on top of this, with all the other EMR interactions highlighted in Figure 1, simply adds more unknown risk to investors in large scale generation projects and will delay construction further.

Figure 1: Energy UK EMR Interactions diagram



InterGen would also stress that sharpening cash-out prices will not incentivise investment in new, flexible generation. We are concerned that Ofgem believe this to be the case. InterGen has traditionally financed its assets using traditional Project Finance; where the cost of capital is a function of the estimated rate of return in addition to the perceived risks. Exposure to cash-out prices is always factored in as a risk – never an opportunity. New plants are financed wholly on returns that are forecast to be achieved from the forward markets, or a long term toll/PPA. In the future this may also include a forecast of Capacity Mechanism (CM) returns. Any benefit a generator can receive from cash-out ('spilling' onto the system when it is short, for example) is uncertain, and therefore un-bankable. Therefore more punitive cash-out will not incentivise new projects. Moreover, it may make financing more difficult as lenders will be factoring in a bigger risk element in exposure to system prices.

Resourcing

InterGen is also concerned that the resource requirement necessary to drive this SCR through to completion in the tight timescale suggested will be severely lacking. As an independent generator, InterGen is struggling to provide resource to fully engage with all the initiatives highlighted in Figure 1. Therefore it may be the case that smaller generators will struggle even more so to dedicate adequate time to this piece of work.

Small, independent generators may also be the market participants most affected by these proposals. InterGen would urge Ofgem to consider the timing of this SCR in light of current resourcing issues.

Interactions

The SCR consultation document states that a review of cash-out is timely in order that new rules can be in place in advance of the introduction of the proposed CM in the UK. InterGen understands this logic but would highlight that if this review is concluded before the design of the CM is complete, there could be many unintended consequences.

The CM Expert Group, consisting of industry experts and representatives from DECC and National Grid, has been working on the detailed design on the CM since the summer. A lot of this work has focussed on ensuring that the CM penalty regime is adequate, giving generators sufficient incentive to provide capacity, without being overly punitive, which may incentivise inefficient plant running regimes. If cash-out redesign resulted in a more penal price at times of system stress, this may result in double counting of the penalty generators face as a result of non-delivery. To this end, it is essential that this SCR understands the detail of the CM penalty regime before it can proceed.

With regard to the issues highlighted above, InterGen urges Ofgem to reconsider the proposed timeline for this review in light of the forthcoming Energy Bill and the need to provide regulatory clarity to investors.

Yours Faithfully,

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