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Dear Charlotte,

23 July 2013

**RE: Integrated Transmission Planning and Regulation (ITPR)  
Project: Emerging Thinking**

Your ref. 83/13  
Our ref. 130723\_ITPR response

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Thank you for the opportunity to respond to this consultation. DONG Energy is one of the leading energy groups in Northern Europe. Headquartered in Denmark, we have an interest in several European markets and cover a wide range of energy sector activities. In the UK, we are the market leading developer and operator of offshore wind farms. Together with our partners we have a current portfolio of 1.6 GW of operational projects, 600 MW of projects under construction, and a strong pipeline of future projects.

We welcome Ofgem's continued engagement with stakeholders on the issues of future network development, and believe that the Integrated Transmission Planning and Regulation project is timely and important. The efficient and economic development of the future network is crucial for the successful integration with European electricity markets, construction of interconnectors that bring socio-economic benefits, and the transformation of the GB into a low-carbon system.

For these reasons, it is important that the appropriate option for system planning and delivery is chosen, even if it means some departure from current arrangements. DONG Energy supports Ofgem's wide ranging scope at this stage, and believe an appropriate range of options for both system planning and delivery have been considered.

We are however concerned that Ofgem's preferred option of an enhanced SO for system planning could result in conflicts of interest between National Grid's SO, TO, and commercial functions. We are also concerned that combined with National Grid's role as the delivery body for the Contracts for Difference and Capacity Mechanism it will, as a privately owned company, hold an unprecedented amount of commercially sensitive data, and as of yet, no information on ring fencing arrangements have been published to reassure the industry that this will not result in conflicts of interest. We do not believe that this

concentration of information is appropriate, and support the introduction of an independent, non-profit system operator with responsibility for system planning and system operation.

Our ref. 130723\_ITPR response

Please find our responses to the specific questions below.

Yours sincerely



**Ebba Phillips John**

**Regulatory Affairs Advisor**

**DONG Energy**

**1. Do you think that we have appropriately characterised the future challenges to network development? Where do you see the main challenges? What are the long term strategic and sustainability implications of these challenges?**

Ofgem have defined the future challenges as:

- obligations and incentives on parties,
- European interactions and frameworks for influence,
- conflicts of interest, and
- overlapping regimes for multipurpose projects.

We agree that these are indeed serious challenges for the future development of the network. In our view, the main challenges are around providing clarity on the roles and responsibilities of network development: ensuring that appropriate and timely needs cases are provided to clearly establish the benefits of coordination to the system, consumers, and generators, and that the process by which coordinated assets and Multi-Purpose Projects will be identified and delivered is clearly set out.

A lesson to be learnt from the on-going review of offshore coordination policy is to ensure that the planning of integrated networks is backed by a strong plan for delivery, with the right commercial and risk sharing incentives in place in order to bring forward the required investment as identified by the relevant body. If this is not in place, or a clear regulatory regime does not emerge in a timely manner, the wider benefits from a coordinated system may be lost. In terms of delivery options, where transmission infrastructure for offshore wind farms are involved, there should be close interaction with possible development of a fit for purpose OFTO build regime, as generator build delivery of coordinated assets is likely to be viewed as too risky by generators.

We believe there is a strong case for an independent system operator, which is clearly separate from a TO or other commercial business interests. This view is consistent with our view that National Grid's EMR delivery body function should be a separate licenced entity.

**2. Are there any review areas under ITPR more relevant than others?**

The most important area for the ITPR project is achieving clarity on system planning responsibility and asset delivery, and who fulfils which roles within the industry. Market participants need to work within a framework where there is no second guessing of interpretation of regulations and Ofgem's intentions. Lack of a clear framework increases the risk and cost of projects. There are projects currently in development that will deliver in the 2020s, and early clarification on the future network arrangements will only be beneficial.

We support the introduction of an independent system operator with responsibility for system planning and operation, and urge Ofgem to spend more time developing the necessary arrangements for this option.

When the proposals under ITPR are considered together with the new responsibilities being given to National Grid under EMR, DONG Energy are concerned that National Grid SO will have access to considerable commercial data relating to both thermal and low carbon generators as well as system and transmission planning data. This would create a centralisation of functions not seen since privatisation. Without significant ring-fencing and regulatory oversight, there is a high risk of conflicts of interest and perverse incentives being seen. This issue is further addressed in our response to Question 5 on conflicts of interest.

**3. What are your views on the options for system planning discussed in this chapter? Are there other approaches to system planning that you think we should consider within the ITPR project?**

Considering the scale and complexity of the potential future network developments (including a new national grid offshore), an enhanced and coordinated role for system planning will be vital. The current model has attempted to identify coordination opportunities for Round 3 wind farms through the connection application process, but it remains to be seen to what extent the initial coordinated designs presented in grid connection offers will be delivered. We do not believe that the current institutional and associated incentive arrangements are sufficient to deliver an optimal coordinated system offshore and across international borders.

Given the size of the challenge and the potential for conflicts of interest, we support the introduction of an independent system operator model. We have identified the following benefits, and areas for further consideration:

Benefits

- **Synergies**
  - There is a strong argument for keeping system planning and system operation in the same body to ensure that both long and short term costs are taken into account when planning the system.
  - Given the number of potential delivery parties (three existing onshore TOs, OFTOs, potential new entrants) we do not believe that system planning and asset ownership should continue to be associated.
  - If the role of enhanced system planner is given to National Grid, clearer separation of planning and delivery may be required to ensure it does not favour its own TO business.
  
- **Ability to address the scale and complexity of network developments**
  - In order to address the scale and complexity of network developments, and ensuring that the system can be operated in

an optimal way, we believe it would be beneficial for the system planner to also have responsibility for system operation.

- Having both of these functions in one body would also simplify participation in international working groups, for example on integration with the rest of the EU.
- **Improved system analysis**
  - The responsibility for carrying out analysis that is of overall system importance is currently fragmented between several different parties who do not necessarily follow the same standards.
  - It would be beneficial from an economic and efficiency point of view to have a centralised and coordinated approach to system studies and issues such as grid code compliance, harmonics, stability, sub synchronous resonance, and so on.
- **Ownership of codes/single point of contact**
  - The fora mentioned in the consultation (JPC, ENSG, etc.) could be brought under a single function along with ownership of industry codes (such as the CUSC, Grid Code, and the SQSS, etc.).
  - It is important that the GB has a single point of contact for industry and UK/EU stakeholders for overall network matters, and the ISO would be best placed for this.
- **Improved development of needs cases for Ofgem sign-off**
  - As is mentioned in the consultation document, Ofgem are likely to be required to make more frequent and more significant determinations on complex, interconnected projects and their benefit and viability.
  - A stronger, centralised coordinating body (without commercial drivers and regulatory incentives which favour one view over another) would support this and deliver well worked up proposals and investment cases to Ofgem for assessment.

#### **Issues for further consideration:**

- **Asset delivery**
  - Introducing an independent SO model would require close cooperation with the parties responsible for asset delivery to ensure that the recommendations for system coordination are deliverable. We believe this has been a concern for the offshore wind farms receiving coordinated connection offers, as the current framework and risk sharing means that some coordinated solutions may not be taken forward. The ability of enhanced coordination body to work well depends a lot on what the delivery option looks like, and what the commercial and risk terms for delivery are.
  - The system planner must also appropriately weight delivery risk when considering system planning in order to ensure that incremental gains are not pursued at excessive risk to system

users. Our current experience is that small savings from network investment are pursued, at the expense of generation projects of much larger scale. This has the impact of minimising central system cost but not necessarily the overall cost to the consumer.

- **Incentives**

- We would support the non-profit version of an ISO. If it does not have commercial interests, the risk of conflicts of interest is reduced. However, this would require a new approach to incentives and performance drivers.

**4. Do you think it would be beneficial to strengthen the role of a coordinating body working with relevant parties to facilitate efficient decision making? In what areas could this coordinating body add most value to the process?**

Yes, it would be beneficial to strengthen this role. For example, there needs to be close cooperation between the system planning body and the delivery bodies to ensure that the network reinforcement plans set out by the system planner are deliverable, as mentioned above. The area which would most benefit from a coordinating body is that of MPPs and onshore/offshore coordination where the need is not driven by a single party and a more holistic planning approach is necessary to realise the value of such integrated investments.

**5. What are your views on the (real or perceived) conflicts of interest that could occur from parties holding dual responsibility in system planning and asset delivery and ownership? What are your views on potential options for institutional arrangements, separation and transparency measures to mitigate this?**

We have serious concerns around the potential for conflicts of interest if the outcome of the ITPR project was to give National Grid as SO increased responsibilities for system planning without complete business separation between the SO and TO function. The main synergy of an ISO model would be between system planning and system operation and we do not believe that these functions should be separated.

DONG Energy has serious concerns over the concentration of commercially confidential data in one private company that will arise through National Grid SO's role as the EMR delivery body. In our response to the DECC/Ofgem consultation on this matter we highlighted possible issues around competition in the generation sector, and the incentive on National Grid to favour its TO business or network solutions over generation. Adding responsibilities for system planning without complete separation of the SO and TO function exacerbates this situation. Unless we have complete sight of transparent

arrangements to avoid any conflict of interest, we cannot be certain that this will not be an issue. Through our engagement with the EMR institutional frameworks export group, and in our consultation response mentioned above, we have called for a ring fenced, separate entity to run the delivery plan obligations. We think the system planning and system operation (ISO) function should be separate from both the EMR delivery body and National Grid's TO function: if there are perceived conflicts of interest, this means that the structures in place are not sufficient to provide confidence in the impartiality of the system planner. We note that the response by Ofgem and DECC to this issue was that sufficient measures would be put in place through licence obligations and industry codes. These have not yet been forthcoming and so we cannot comment on their success.

We also believe that separate ISO (non-profit), TO, and EMR delivery bodies will be simpler and more transparent to incentivise. An incentive structure and appropriate checks and balances for the simpler 'enhanced SO' model where National Grid retains ownership of its TO business would become increasingly complex. This would be a large responsibility for Ofgem, and monitoring and evaluating such incentives and performance drivers would be a considerable task for the regulator. The potential for unintended consequences is also larger the more complex the incentive structure is.

We have already observed behaviour changes in National Grid TO as a result of new incentives through the RIIO-T1 arrangements, which we do not believe were intended outcomes. For example, National Grid TO is very strongly incentivised to deliver at least cost. As a result of this, we have seen a shift in National Grid's approach to which network assets are included in their scope towards the OFTO asset base, as this is regulated in a different manner. Avoiding these works appears as a saving delivered by National Grid, even though the solution will not necessarily be the most efficient one from a whole network perspective.

**6. What are your views on potential future approaches to planning interconnection? Should there be increased central identification of potential interconnection that could benefit GB consumers?**

The current approach for interconnector investments in the UK does not fully account for the benefits to society from increased interconnection. Current incentives encourage investors to go for the most 'low hanging fruits' in terms of interconnection options, but may risk delivering a level of interconnection that is significantly lower than what would be socio-economically optimal. These benefits can both be traced directly to gains of trade and to the benefits arising from diversification and security of supply. With the green transition of the UK energy system, a timely build-out to realise these benefits is even more crucial.



In order for the projects with the most benefits to society to be prioritised, we believe there is a need for further development of the regulatory thinking, the institutional set-up and the risk-allocation between developer and consumers. These points are considered in more detail below. The overall aim should be to ensure adequate incentives for the realisation of all interconnector projects with positive regional socioeconomic effects in line with the recently adopted EC Regulation on guidelines for trans-European energy infrastructure.<sup>1</sup>

### Regulatory thinking

We think the inclusion of a project's broader gains remains to be addressed, even with the current development seen in the NEMO approach. A future UK regulatory regime for interconnector projects should:

- explicitly ensure the inclusion of socioeconomic effects in the investment decision in addition to the expected congestion rents, specifically effects on consumer and producer surplus stemming from increased interconnector capacity. Furthermore, the evaluation of a project should also consider effects such as increased security of supply into account.
- take into account the regional socioeconomic effects in the cost-benefit analysis as outlined in article 11 and 12 of the recently adopted Regulation on guidelines for trans-European energy infrastructure referred to above.

These issues can be addressed by incorporating a project-specific socio-economic element when setting the cap-and-floor if a NEMO-like approach is used.

### Institutional set-up

We think that a more centralised approach to system planning will be required for the socio-economic benefits to be realised. This would work well under the independent SO option discussed above, as it would maintain the synergies between system planning and system operation, and would remove real or perceived issues of conflicts of interest between National Grid as SO and its commercial interconnector business. This would maintain the option for third party developers to enter the market.

### Risk allocation

Finally, concerning the risk allocation between project developer and consumers, sharing the risks associated with a new interconnection between those that are expected to benefit, should generally be the preferred option. That means that the developer should have some risk exposure, which at the same time creates incentives for efficient operation of the connection. But some risk should also be held by society to reflect the wider benefits of interconnection. Together, that should provide appropriate economic incentives to projects that are of socioeconomic value, but at the same time exposed to

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<sup>1</sup> EC/347/2013



significantly higher risks than comparable infrastructure projects, as outlined in article 13 of the recently adopted Regulation on guidelines for trans-European energy infrastructure referred to above.

**7. What are your views on the options for delivery of transmission assets discussed in this chapter? Are there other options that you think we should be considering within the ITPR project to address the delivery drivers and challenges identified?**

**Option 1: no flexibility in use of delivery routes**

As identified in the consultation document, there are issues with the current approach for delivering multi-purpose projects. Keeping the current approach to delivery could prevent the delivery of optimal network solutions. We support some flexibility in delivery routes, supported by clear guidance and regulatory arrangements.

From an offshore generator's point of view, it is important that the delivery and subsequent ownership and operations regime do not result in different (and potentially discriminatory) outcomes depending on which delivery option its wind farm is connected through. Issues to be resolved include TNUoS charging for generators connecting through an interconnector (which are exempt), and alignment of availability incentives.

**Option 2: limited flexibility in use of delivery routes**

This option would allow certain projects to be 'carved out' of the existing delivery regimes. For this to work well, clear criteria for allowing 'carve-outs' need to be established, and this should include a clear needs case for e.g. introducing competitive tenders. For offshore transmission assets, generators should be allowed a "first pass" to assess the proposal and decide whether to take it forward as a generator build option or not. It is important that a new delivery mechanism does not prevent offshore wind farms from connecting in a timely manner.

There could be a case for intervention by the coordinating body (the ISO, as referred to above) to recommend the regulatory treatment of certain 'blurred' assets on a case by case basis, but only where they straddle multiple regimes. This could be part of the needs case and the recommended preferred solution presented to Ofgem for sign-off. It is important that uncertainty in the regulatory treatment of projects is not permitted to stifle the delivery of optimised transmission solutions because they appear 'difficult' in a regulatory context, and certainty over the treatment of such projects should be provided as early as possible.

**Option 3: full flexibility in use of delivery routes**

We do not believe that it would be appropriate for all new projects to be assessed for their suitability to be delivered by an incumbent TO or through a competitive approach. This would likely increase complexity and cost, and we do not believe there are likely to be a sufficient number of projects where an alternative delivery approach would be beneficial to justify such a change to the current delivery route.

- 8. Do you think that it would be beneficial to introduce some flexibility in the existing regimes to provide for alternative delivery routes, where this is in the interest of consumers? If so, what criteria should be used to determine the delivery route for an investment?**

Ofgem should be clear about what it means by "in the interest of the consumer". This could be interpreted as the cheapest solution for the particular asset in question, but could also cover wider criteria such as opportunities to deploy innovative technological solutions that could bring future benefits, or ensuring that a wide range of generation can connect in a timely and cost effective manner. As we mentioned in our response to question 5, there are issues with the incentive regime to deliver savings for consumers.

We do not think that there are sufficient numbers of projects which would benefit from a truly flexible delivery approach to warrant establishment of a separate process and the uncertainty that that brings to the industry. Alternative delivery models could be appropriate if applied in a merit order principle of 'first refusal': e.g. an offshore wind developer has first refusal on whether to build their radial connection (or any coordinated asset associated) after which it goes to competitive tender for an OFTO build, then to an onshore TO, and so on. The same process could apply for onshore assets, except the existing TO is given the option of first refusal. However, in practice this is likely to result in maintaining the status quo with incumbent delivery and ownership of onshore assets.

Where flexible solutions and competitive tendering can bring absolute cost savings it should be welcomed. Ofgem needs to ascertain for that a competitive process would result in an absolute cost saving, rather than a reallocation of costs and risk.

- 9. If we pursued additional flexibility in application of the regimes, what role should discretion play in identifying the delivery route for a particular investment?**

As mentioned above, we do not believe that there is a large number of investment opportunities where there is scope for, or clear benefit from introducing additional flexibility.

- 10. Do you think that the case for change to current arrangements to enable more integration and coordination is material now, or may become so in the future? If the latter, when?**

We believe it is critical that these issues are addressed now, and that Ofgem continue to develop the regulatory regime before the first projects which require more integration are delayed or fail to realise full benefit because of uncertainty in their treatment. Ofgem should learn from the offshore coordination process, which we believe unfortunately has taken too long for developers to be able to accept coordinated connection offers from National Grid resulting in some early opportunities for offshore coordination to be lost.

There are some specific areas where a more holistic system planning would be beneficial:

- Opportunities for Round 3 projects to connect to different countries
- The planned wind interconnectors from Ireland to the GB market
- Difficulty in getting planning permission for onshore reinforcements of the National Grid could justify offshore coordination

We believe that Ofgem's commitment to ITPR sends the right signals: a commitment to coordination, and hopefully a resolving of issues that will enable coordination to go ahead when the need arises in the future.

**11. What are your views on our emerging thinking to consider further an enhancement of NGET's role as the SO in system planning for a more coordinated and holistic approach across the GB system?**

We believe there is likely to be benefits from a more coordinated and holistic approach to system planning (indeed this is likely a pre-requisite for all but the simplest elements of coordination), although simple enhancement of NGET's role may be insufficient to provide a suitable independent and transparent system planning function. However, Ofgem needs to be mindful of the need for stakeholder input into the process to ensure system user's needs are met, and that plant can connect in a timely manner, and that any coordination must be underpinned by a strong needs case.

**12. What are your views on the emerging thinking that introducing further flexibility and applying criteria to designate whether an investment should be delivered by incumbent delivery or competitive selection could address many of the challenges and drivers identified?**

We believe that there is currently limited scope for introducing further flexibility in delivery. Ofgem must ensure that a competitive regime for delivery of assets is fit for purpose, and that cost reductions are absolute rather than reallocating costs and risks to other parties that are not necessarily better placed at handling them.

**13. What other options should we take forward for consideration in the next stage of our work in ITPR?**

We believe the ITPR project needs to have a stronger focus on the commercial and risk sharing aspects of delivering coordinated network solutions, as outlined above.

**14. Do you have any views on our approach and timetable for our work on ITPR, or on interactions with related areas?**

We encourage Ofgem to publish a timetable for Stage 4 as soon as possible. This would enable projects that are looking to deliver in the early 2020s to consider coordinated solutions given consent and equipment lead times.