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Your ref. 120/13
Our ref. 131022 EBSCR DE response

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Dear Andreas and Dominic,

RE: Electricity Balancing Significant Code Review – Draft Policy Decision

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 are also the owners of Severn Power, a 824 MW gas fired power station in Wales.

DONG Energy welcomes the opportunity to respond to this consultation on Ofgem's Draft Policy Decision on the Balancing Significant Code Review. The balancing arrangements are extremely important for a well-functioning market and they must also support and facilitate the Government's policy vision of a transformation to a low carbon economy, by enabling less flexible low carbon sources to participate, adapt and trade in the market in the most efficient manner. We recognise Ofgem's concern and the theoretical rationale behind the policy decision to introduce more marginal cash-out prices and include currently non-costed actions, but in the light of other policy developments we remain concerned about the impact these policy decisions could have on particular wind investments.

Executive summary

- DONG Energy believes that the changes proposed in the Balancing SCR Draft Policy Decision process are premature and that there is a high risk they will not be aligned with the outcome of the EMR and the EU Network Codes.

- It remains unclear how the final design of the Capacity Market will work and how it would interact with new balancing arrangements. This interaction needs to be clarified in more details before the suitable balancing considerations can be determined.

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- We believe the main issue around capacity shortages and the 'missing money problem' putting off investment in flexible plant has been addressed through the introduction of the Capacity Market, and that sharper cash-out prices will not have a discernible impact on the short term appetite for investment in flexible plant.

- The case for an abrupt shift to fully marginal price is not definitive and therefore, if decided, a phased approach towards more marginal pricing would be beneficial for market adaptation and in particular for renewables generators leaving them sufficient time to improve forecasting and balancing capabilities incrementally as well as leaving them time to change their business cases accordingly. Introduction of more marginal cash-out prices should in any case be tied to visible improvements in short term market liquidity.

- We are concerned that the development of a deeper and more liquid intraday market and the reduction of the gate closure time is left to the Future Trading Arrangements workstream, which has only just started.

- There is a risk associated with sharper and more volatile balancing costs for projects in receipt of the new CfD FiT, as there is no way for such projects to pass on this increased cost. We do not believe that this risk has been assessed appropriately.

- We can support the principle of pricing VoLL in the cashout arrangement, but we question the high values and the disproportionate risk it would place on wind generators.

Our responses to the detailed questions can be found below.

Yours sincerely,

Jakob Forman
Senior Regulatory Advisor

DONG Energy

Question 1: Do you agree with our proposal to make cash-out prices more marginal?

We understand Ofgem's concerns and the theoretical rationale for proposing more marginal cash-out prices. We do however believe that the current cash-out prices are working to incentivise parties to balance. DONG Energy has invested in significant wind forecasting capacity and operates a 24-7 monitoring system to ensure that our position is as well balanced as can be.

The 'missing money' problem resulting in insufficient investment in flexible capacity has to a large extent been addressed through the introduction of the Capacity Market, and as such, we do not believe the time is right to introduce more marginal cash-out prices before there is full visibility on the design of the Capacity Market as well as on the EU Network Code on Electricity Balancing.

More marginal cash-out prices also increases the incentive for the large Vertically Integrated players to hold their own reserve to avoid penal cash-out charges. This would be inefficient balancing from a system point of view, as each company would use its own resources to balance rather than trading imbalances in the intraday market to find the most efficient solution.

To be able to incorporate large amounts of variable generation and to function efficiently from an economic perspective, the power market needs to be transparent and flexible enough to accommodate the use of short-term forecasts and enable larger churn in the power transactions close to gate closure among commercial generators, suppliers and National Grid.

Enhancing competitive and transparent markets for both balancing energy and system reserves should be a key objective in a holistic approach. Therefore, Ofgem should focus on close monitoring of the intraday market and the balancing mechanism to ensure that these markets are well-functioning.

As such further measures to create more competitive, liquid and transparent short-term markets should be a pre-condition for exposing wind generators and other generators to sharper and spikier balancing prices.

We believe that the issue on integrating wind in the system, getting flexible capacity and the balancing arrangement is all part of making the system fit for purpose. Therefore, we are concerned about the decision to separate decisions on cash-out arrangement, getting a more efficient and liquid intraday market and moving the gate closure time.

Question 2: Do you agree with our rationale for going to PAR1 rather than PAR50? Are you concerned with potential flagging errors, and would you welcome introduction of a process to address them ex-post?

We believe the move from PAR500 to PAR1 is too drastic, and if sharper cash-out prices are to be introduced, would recommend a more gradual reduction in the PAR, tied to visible improvements in short term liquidity.

Ofgem's analysis shows that the vast majority of the benefit from sharper cash out prices comes in moving to PAR50 from PAR500. We do not understand why the consultation only considers a choice between PAR50 and PAR1 and not also PAR250 or PAR100, for example. If the policy decision to reduce the PAR from 500, we urge Ofgem to consider a gradual reduction (e.g. from 500 to 250, to 100, to 50, and eventually to 1). Independent wind generators would have a

strong incentive to make any possible improvements to forecasting and balancing without being too heavily penalised during that process. The pace of reduction could be determined in advance (e.g. every year), but a preferred option would be to link the reduction in PAR to visible improvements in the short term markets.

We remain concerned about potential flagging errors and a robust process is required to ensure that these are corrected ex-post. We understand that National Grid is in the process of implementing new measures, which need to meet future requirements if marginal pricing is implemented. However, it should be noted that this may have a negative impact on the accuracy of initial cashout prices published by Elexon.

Question 3: Do you agree with our proposals for pricing of voltage reduction and disconnections, including the staggered approach?

From a wind generator's point of view, there is little we can do to control the wind and avoid imbalances, apart from investing in improved forecasting capability. If VoLL pricing for demand disconnections was introduced, there is a risk that wind generators would to a large extent bear the additional risk of the whole system being short due to larger than average imbalance volumes.

We agree that the administrative arrangements required to target this cost onto the suppliers (as discussed in the consultation) are likely to be complex to implement and operate.

Question 4: Do you agree with our assessment of the interactions with the CM and its impact on setting prices for Demand Control actions?

There is a clear interaction between cashout and the CM. However, as this policy is not yet finalised in terms of design, industry participants need the details of the final CM policy design and auction parameters before being able to analyse the impact on setting prices for Demand Control actions.

We agree with much of the industry's concerns around the link between the CM and the level of gas and power VoLL. As there are no Force Majeure provision for gas-related incidents under the current CM design and the power VoLL is significantly higher than the gas VoLL, in the event of a gas shortage, gas-fired power stations would be incentivised to continue running to avoid incurring the high CM penalty and/or the power VoLL. This could inadvertently incur security of supply problems for gas and our members are concerned that DECC and Ofgem have not developed a set of incentives and penalties that will lead to the most appropriate result for the market and consumers.

Question 5: Do you agree that payments of £5/hr of outage for the provision of involuntary DSR services to the SO should be made to non-half-hourly metered (NHH) consumers, and for £10/hr for NNH business consumers?

It seems likely that this policy proposal would be difficult and administratively complex to implement.

Question 6: Do you agree with the introduction of the Reserve Scarcity Pricing function and its high-level design? Explain your answer.

We understand the rationale behind introducing a RSP function, and agree that the proposed design is pragmatic. However, we believe a better option would be to introduce a reserve market, as this would make allocation of reserve costs into the cash-out easier and more transparent. We also believe it would provide more certainty and stronger investment incentives for flexible generation and demand aggregation.

Question 7: Do you agree with our rationale for a move to a single price, and in particular that it could make the system more efficient and help reduce balancing costs? Please explain your answer.

DONG Energy agree with the rationale for moving to a single price.
We believe the move to a single price would make the situation more equal for all players in the market. As such it would contribute to enhance competition in the market. New entrants and smaller players without the backing of a portfolio would more easily be able to navigate under a single price system.
We also agree that in a situation of moving to more marginal prices the single price system would work well for variable generation capacity.

The single price system would to some extend help mitigating the costs imposed on variable generation like wind if more marginal pricing is introduced.

Question 8: Do you have any other comments on this consultation, including on the considerations where we did not propose any changes?

We believe changes to gate closure should be reconsidered as part of the EBSCR. As the rationale behind the EBSCR is to incentivise trading parties to mitigate their imbalances, there should also be greater opportunity, in the provision of tools and information, to do so. A change of gate closure (for some or all parties, reducing it to 30 minutes for physical and contract notifications, or allowing contract notifications after gate closure) would allow for improved forecasting of renewable generation.

The case for leaving this important issue out of the EBSCR has not been made as there is no transparent assessment of benefits and costs of moving the gate closure time. In the consultation document only qualitative statements are presented. For wind generators seeking to balance their portfolio there would be a significant difference in having a forecast half an hour closer to real time.