The trade association for the energy industry

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Dear Andreas/Jamie

Energy UK Response to the Ofgem Electricity Balancing Significant Code Review

Energy UK Preferred approach

- **An alignment of the Ofgem aspirations for an Electricity Balancing review with the timeline for achieving clarity on the designs of Electricity Market Reform and the implementation of the EU Network Codes;**
- **Ofgem to provide evidence of the areas to be improved, potential fixes and a clear timeline for the introduction of reforms;**
- **Continued transparency around developing thinking as impact on investor confidence cannot be underestimated.**

Energy UK is the trade association for the energy industry. Energy UK has over 70 members covering the broad spectrum of the energy industry, including companies of all sizes working in all forms of electricity generation, energy networks and gas and electricity supply. Our members generate more than 90% of UK electricity, supply some 26 million homes and last year invested £11bn in the economy. In addition, we have a number of associate members that provide equipment and services to the industry.

We welcome a holistic review of electricity cashout and balancing in preparation for the impact of potential changes emanating from the EU Third Package especially around the provisions of the Capacity Allocation and Congestion Management (CACM) code with regard to the Target Model. However it is vital that we get the timing of such an exercise right due to the number of significant ongoing developments. Government, Regulators and the industry need to have clarity on the overall design of Electricity Market Reform (EMR), particularly around the potential introduction of a market wide Capacity Payment design and the introduction of a Feed in Tariff Contract for Difference (FiTCfD). Undertaking such an exercise at this present time is a concern and aiming to publish draft policy decisions in spring 2013 an unrealistic aspiration.

Energy UK members would support an exercise to map out what needs to be done in the future in response to the impact of EMR and the various EU initiatives. Such an exercise should also identify the ‘tipping point’ at which we then initiate development of a process to reform electricity balancing. It would also be helpful if Ofgem could clarify its expectations around the role of cashout, particularly whether we are dealing with the capacity or energy elements of cashout, how we should treat the

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allocation of costs caused by the actions of the System Operator, provide supporting evidence regarding the need for change and outline expectations around the delivery of the CACM code. The criteria for assessing potential reform options appears too broad, with unspecific targets, unclear priorities and objectives and no indication of how the impact of any reforms will be measured.

Widely published analysis has shown that pay-as-cleared generally results in lower overall costs, as the need to bid based on the expected system imbalance is removed and instead parties bid in at their short run marginal cost. However although we believe that pay-as-clear may theoretically be the correct method for costing energy balancing actions within the balancing mechanism, we suggest that there are many practical obstacles to overcome, not least of which is defining a single homogenous product that can be auctioned under the pay-as-cleared methodology.

Additionally, we suggest that as a generator's bid into the balancing mechanism may carry many messages to National Grid, if this mechanism was changed to be pay-as-clear, the bid level calculation may be far more complex than just the short run marginal cost of the station.

We suggest that this area should be discussed with stakeholders in more detail. We believe that a pay-as-cleared concept could work if a homogenous product could be defined and ultimately pay-as-clear would prevent participants from trying to second guess the market in their bidding strategy, however interactions with other primary considerations within the SCR and other obstacles means that this option will need careful consideration and debate within the industry if it is to be taken forward.

We are becoming increasingly concerned about the ability of industry to resource further development groups required to undertake such an exercise at this time. Resource is scarce and spread ever more thinly. That results in an increased reliance on consultants employed by Ofgem and member companies, which incurs significant costs for the industry and ultimately the consumer.
At this time we feel there are important initiatives that require industry attention such as EMR, Transmit and the ongoing European Network Code Development. This consultation process, associated workshops and subsequent responses to the SCR should facilitate the gathering of industry opinion to inform the wider debate particularly around the Balancing Code as part of the European Network Code. It is vitally important that activity needs to be taking place now on this issue at a wider European level. All that said, for industry to commit the right expert resource to this 18 month process is a big ask.

No one in Europe has a market quite like ours and we are aware that the future landscape for the UK may also change significantly because of the outcome of the development of a number of energy related European Network Codes.

This changing framework has the potential to adversely impact investors. At a time when we desperately need to attract investment in terms of both generation capacity and infrastructure we are concerned that the timing of an additional review for electricity balancing might be a step too far.

Should you require any further information then please contact Barbara Vest, Director of Generation on 0207 747 2925.

Yours sincerely

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