

## **Response to Electricity Balancing SCR – Initial Consultation**

### **About GDF SUEZ Energy International**

GDF SUEZ Energy International (formerly known as International Power) is responsible for GDF SUEZ's energy activities in 30 countries across six regions worldwide (Latin America, North America, the Middle East, Turkey & Africa, UK-Europe, Asia, and Australia). Together with power generation, we are also active in closely linked businesses including downstream LNG, gas distribution, desalination and retail. GDF SUEZ Energy International has a strong presence in its markets with 77 GW gross capacity in operation and a significant programme of 10 GW gross capacity of projects under construction as at 30 June 2012.

The UK-Europe region (GDF SUEZ Energy UK-Europe) has 13.9 GW gross capacity in operation, which includes over 9.2 GW of plant in the UK market made up of a mixed portfolio of assets – coal, gas, CHP, wind, a large open cycle diesel plant, and the UK's foremost pumped storage facility. Several of these assets are owned and operated in partnership with Mitsui & Co. Ltd. The generation assets represent just under 9% of the UK's installed capacity, making GDF SUEZ Energy UK-Europe the country's largest independent power producer. The company also has a retail supply business and a significant gas supply business in the UK, both serving the Industrial and Commercial sector.

### **Summary of response**

GDF SUEZ Energy UK-Europe (GDF SUEZ) welcomes the opportunity to respond to Ofgem's consultation on the Significant Code Review of Electricity Cashout. The stakeholder events that Ofgem has held over the last two months have provided industry and Ofgem with the opportunity to explore the various potential reforms of electricity cashout and the wider balancing arrangements.

GDF SUEZ would like to make the following high level comments before providing answers to the detailed consultation questions.

- Currently, the overall objective of cashout reform is unclear. Most of the issues that are being discussed under this SCR have been discussed in earlier reviews. It is not clear what has changed to warrant further discussion of these issues. It would be extremely helpful if Ofgem would state in simple terms what it considers to be the role of cashout as this would set a boundary on the extent of reforms.
- There is a lack of clarity on the respective roles of the capacity mechanism and electricity cashout. GDF SUEZ sees the capacity mechanism's as primarily targeting long term resource adequacy, whereas the energy balancing arrangements should be designed to incentivise efficient delivery of security of supply in operational timescales. At the moment, they each appear to be seeking to resolve both these issues. Identifying the main role of each of these mechanisms might help focus the design scope and reduce overlap.

- In GDF SUEZ's view, cashout prices should achieve the following:
  - they should reflect the costs of the physical actions taken by the SO to ensure the system is in net energy balance;
  - be sufficient to provide incentives on participants to balance in advance of gate closure to minimize the extent of SO balancing;
  - they should be targeted on those out of balance on the difference between meter and contract; and
  - be determined shortly after real time and not subject to ex post adjustment (unless due to errors).
- Other than two areas below where reforms should be considered, we do not see the immediate urgency for such a wholesale review of cashout and balancing arrangements. The interaction with EMR and in particular the detailed design of the capacity mechanism and associated penalty regime are key considerations in any reform of cashout pricing. Care needs to be taken in redesigning cashout in parallel to tackle the same issue.
- GDF SUEZ believes that the scope of this cashout SCR should be limited in the first instance to:
  - pricing demand disconnection and voltage reduction into cashout prices; and
  - allowing contract notifications after gate closure to facilitate trading up to gate closure.
- It is also worth over a longer period exploring the following aspects of cashout:
  - improved allocation of reserve costs;
  - a single cashout price; and
  - single or separate trading accounts.
- GDF SUEZ does not agree with the view held by Ofgem and DECC that more marginal cashout prices will provide incentives to invest. Cashout prices are too variable to be used as an investment basis, and their relationship to wholesale prices is unclear. Generators do not know when the spikes will occur or how long they will last and do not have confidence that the rules will remain constant over time. Investments are based on long term assumptions of spark spreads or, in the case of flexible plant, the ability to secure a long term STOR or other type of reserve contract. More marginal cashout prices will simply provide an incentive to over contract and will also create significant commercial plant trip risks for operators of large generating units.

## Response to consultation questions

### CHAPTER 2: Approach

#### Question 1: Do you agree with the approach and the proposed stakeholder engagement throughout the SCR?

1. GDF SUEZ welcomes the stakeholder events as a chance to explore the various potential reforms of electricity cashout and the wider balancing arrangements.
2. Discussion at these events has been hampered as the overall objective of cashout reform is unclear. This is the fourth review of cashout and most of the issues that are being discussed under this SCR have been discussed in earlier reviews. Other than changes approved as a result of BSC modifications, many of the issues previously explored have not (for good reason) been progressed. It is not clear what has changed to warrant further discussion of these issues.
3. Whilst Table 2 of the consultation tries to set out some indicative criteria for the assessment of potential reform options, it does not set any boundaries to determine whether or not the 'criteria' have been met or the relative ranking of these criteria. Some of these proposals are in conflict with each other. To give a few examples:
  - many of the proposals would increase the current complexity of the cashout calculation whereas Ofgem has concerns about transparency and predictability;
  - one of the SCR objectives is to increase the efficiency of electricity balancing whereas Ofgem is considering introducing marginal cashout prices which will provide an incentive for parties to over contract increasing the requirement for SO balancing and reducing efficiency; and
  - more marginal cashout prices do not sit well with increasing renewables penetration and could create considerable financial distress for market participants
4. It would be extremely helpful if Ofgem would state in simple terms what it considers to be the role of cashout as this would set a boundary on the extent of reforms. In GDF SUEZ's view, cashout prices should achieve the following:
  - they should reflect the costs of the physical actions taken by the SO to ensure the system is in net energy balance;
  - be sufficient to provide incentives on participants to balance in advance of gate closure to minimize the extent of SO balancing;
  - they should be targeted on those out of balance on the difference between meter and contract; and
  - be determined shortly after real time and not subject to ex post adjustment (unless due to errors)
5. It isn't as yet clear what happens after this consultation closes. The next step appears to be that Ofgem will issue an impact assessment alongside its draft decision in Spring 2013 and will seek views on both. The four workshops have raised many issues that need further examination prior to any draft decisions being made. GDF SUEZ believes

that Ofgem should first revisit previous modifications decisions and the minutes of the three previous cashout review groups to understand why proposals were rejected then and look at what has changed to warrant them being re-examined. This could lead to a narrowing down of options that could then be explored further through 'Expert Groups'.

6. We do not however see the immediate urgency to review cashout; the interaction with EMR and in particular the detailed design of the capacity mechanism and associated penalty regime are key considerations in any reform of cashout pricing. At least part of the impetus for the SCR is related to concerns over forecast tightening of reserve margins – however, the capacity mechanism is already being developed to address the issue of potential supply shortages and address the "missing money" concept. Care needs to be taken in redesigning cashout in parallel to tackle the same issue.
7. In addition, there are 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. With a number of significant ongoing developments, it is vital that we get the timing of the SCR right. 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 (FiT CfD). Given all of these other changes, progressing the SCR with the aim of to publishing draft policy decisions in spring 2013 is an unrealistic aspiration for Ofgem.

**Question 2: Do you have any evidence that you would like to submit that may be relevant for any aspect set out in this document?**

No.

**Question 3: What is your view on the interactions between our considerations and aspects of the EU target model?**

8. The design of the EU target model for intra-day balancing is just starting so it would seem premature to consider in any detail what the interactions might be or to try and second guess whether any cashout reforms are likely to be compliant.
9. However, it is worth noting that the Draft Frameworks Guidelines on Electricity Balancing consider that imbalance settlement should incentivise market participants in keeping and/or helping to restore system balance and that 'BRPs shall have the right incentives to manage their own balance'
10. Both of these proposals point towards a cashout mechanism that incentivises overall system balancing. GDF SUEZ does not believe that marginal cashout pricing will achieve this, instead it will incentivise participants to take a long(er) position. We are therefore surprised that the EU target model promotes pay as cleared.

## CHAPTER 4: Primary considerations

### Question 4: Do you feel there are any further alternatives to the reform options presented under our primary considerations?

11. Rather than expanding the scope of the reform, GDF SUEZ considers that the SCR should focus on key areas that align with the overall role of cashout. Using GDF SUEZ view on the role of cashout to bound the problem, we believe that the scope of this cashout SCR should be limited in the first instance to:

- pricing demand disconnection and voltage reduction into cashout prices; and
- allowing contract notifications after gate closure to facilitate trading up to gate closure.

12. It is also worth over a longer period exploring the following aspects of cashout:

- improved allocation of reserve costs;
- a single cashout price; and
- single or separate trading accounts.

### Question 5: What other benefits or drawbacks can you identify for each of our primary considerations? Please provide any evidence you may have to support your position.

### Question 6: Which of the reform options considered under each of our considerations do you believe would provide the most efficient balancing incentives and why?

#### 13. Marginal cashout prices

##### Benefits

- Marginal prices would encourage participants to over contract. In general market participants face asymmetric risk from cashout such that even though lower SSP on a marginal basis might in isolation tend to nudge the system away from a long position, the potential for relatively higher SBP compared with the existing PAR500 methodology means that to manage this risk, parties would be expected to increase length. This creates a slight increase in pre gate closure 'demand' and should have a small impact on wholesale prices and potentially add to liquidity. However, liquidity is more about churn and if balancing risks are high then there may be less market participation overall, especially from financial players.

##### Drawbacks

- Intuitively, a cashout price that incentivises parties to balance leaving the SO to resolve imbalances that arise from plant loss or forecasting errors is more efficient than a cashout price that encourages parties into imbalance through taking a long position. Encouraging everyone to over contract might not therefore be the overall cheapest solution for the consumer society.

- The marginal action cannot always be identified with certainty, is it the last energy action taken in the settlement period, the most expensive one, the one that purely solves energy imbalance (even it also resolves a system imbalance)? In addition, it is unclear how the cost of reserve would be added onto this marginal action (should reserve costs even be added on unless the reserve action is the marginal action?)
- The selection of the marginal action is also affected by the methodology of the SO. Given that the Balancing Mechanism is not an energy auction (minute-by-minute technical balancing actions are required), there is some discretion on the part of the SO in how it resolves energy imbalance. There may be circumstances in which due to a higher risk strategy (i.e. passing up of earlier, cheaper reserve options) it is "forced" to accept a single high-priced offer which sets a high marginal price. PAR500 will tend to mitigate against such events but marginal cashout would potentially expose market participants to changes in the SO's balancing strategy.
- Marginal prices create significant commercial plant trip risks for operators of large generating units. Even highly reliable units will trip from time to time exposing the operator to very large financial payments in the event of a stressed system. These potential losses are already material with PAR500 and a move to a marginal cashout price could result in extreme impacts, the risk of which ultimately may deter new entry into the generation market.

#### Would marginal prices provide efficient balancing incentives?

- GDF SUEZ does not think that a more marginal cashout prices would provide an incentive to balance, it would instead provide an incentive to over contract. This goes against one of Ofgem's objectives for this SCR 'to increase the efficiency of electricity balancing'. At NETA go live, being long was the rational approach to the risk of high cashout prices and this state would become much more prevalent than now if more marginal cashout prices are re-introduced.

#### **14. Single cashout prices**

It is assumed that in referring to a single cashout price, Ofgem means a 'flip-flop' cashout prices where the cashout price is based on sell actions when the system is long and buy actions when the system is short. It is also assumed that the single cashout price is not marginal. If a single marginal prices in introduced, please refer to the comments above that will apply to a marginal price whether based on a single or dual cashout price mechanism.

#### Benefits

- In theory a single cashout price should encourage parties to balance and therefore the system to be balanced. Whilst parties could take a counter view and try to be paid the SBP by going long when the system was short, they would have to hope that other parties weren't also following this approach leading to a long system and payment at the SSP. It should therefore encourage parties to resolve imbalances at the market price in advance of gate closure as this is more profitable than the risk of having an imbalance in the same direction as the Net Imbalance Volume.

- The above logic would not apply if the single cashout price was marginal. This would create a perpetually long system as parties would forego small gains in being long when the system was short and would take a risk averse approach and over contract increasing overall costs for consumers.
- GDF SUEZ does not see the need for the alternative options set out by Ofgem in Workshop 2 (different imbalances for suppliers and generators or moving to a marginal price when imbalance exceeds a certain level). The same cashout price rules should apply to all in the market regardless of system length, direction and type of participant.
- A single cashout price should not be seen as a reference market for CfD FiTs. The Balancing Mechanism is not a market with many buyers and sellers and cannot be accessed other than through System Operator acceptance beyond gate closure. For the same reason it would be unlikely to be used a robust reference price by traders as they cannot trade in and out of this market. Indeed, a key objective of cashout pricing is to improve pre-gate closure balance, and reduce balancing mechanism volumes and costs. This would be inconsistent with the formation of any reliable price index.

## Drawbacks

- The suitability of a single cashout price revolves around participants acting logically and recognising that the most efficient action is to try and be balanced. There is perhaps the potential for larger companies who have a better ability to predict system direction to take a advantage of the cashout rules and take a position opposite to market direction.

## Would a single cashout price provide efficient balancing incentives?

- GDF SUEZ is cautiously supportive of introducing a single cashout price as we believe it would create an incentive for parties to balance and hence the system to be overall in balance.

## **15. Single or separate trading accounts**

### Benefits

- Having a single trading account would better facilitate portfolio balancing potentially increasing efficiency of balancing arrangements.
- Larger vertically integrated players already have some tools available to them to help balance their production and consumption accounts (e.g. despatch of embedded generation). Allowing single trading accounts will allow smaller companies to benefit from netting between accounts.

### Drawbacks

- It may encourage more post-gate closure self-despatch behaviour, particularly as the change would allow embedded generation to offset shortfalls in metered generation on the production account.



## 16. Pay as cleared

### Benefits

- Adopting pay as cleared would comply with European Commission preference of pay as clear.
- If all countries within a price zone in the EU target model adopted pay as clear, then there would be imbalance price consistency within a zone.

### Drawbacks

- Ofgem has assumed that if pay as cleared is introduced then generators will price closer to SRMC since they will get the cleared price. However we are not convinced that the decision process that the generator will go through will change if pay as cleared is introduced; generators will be trying to assess the worth of their generation in each period and price accordingly. It would be unlikely that they would price at their SRMC and therefore pay as cleared may cost consumers more overall.
- The BM is designed to allow minute-by-minute balancing utilising a wide range of technologies and dynamic capabilities. Payment on a cleared basis for all energy across a half hour may be unrepresentative of the value of each service. For example a fast reserve short duration offer may be required within a half-hour, in addition to slower ramping offer acceptances. Payment for all offer volume at a higher fast reserve price would not be appropriate. Essentially the BM currently incorporates a mix of balancing services. It will therefore be difficult to define a single homogenous product under pay as clear. GDF SUEZ believes that the GB cashout mechanism is much better suited to a pay-as-bid model.

### Would a pay as cleared provide efficient balancing incentives?

- Pay as cleared would have to sit alongside a marginal price to ensure that the more marginal energy actions paid/received at least their bid or offer price and not a lesser weighted average price. Since GDF SUEZ does not believe that marginal cashout prices will enhance incentives to balance pay as cleared by definition cannot either.

## 17. Attributing a cost to non costed actions

### Benefits

- It is worth exploring how voltage and demand reduction can be incorporated into cashout prices to provide the correct signals at times of system stress as this is a clear omission from the current imbalance calculation. There are some provisos here:
  - The price calculation should be mechanistic rather than arbitrary;
  - There must be sufficient prior warning from the SO that there is a risk that voltage and demand reduction could be included in cashout. Sufficient time should be allowed to give parties the opportunity to trade any imbalance in advance of gate closure; and



- It will be important to distinguish between voltage/demand reduction caused by transmission and distribution failures, or potentially inadequate reserve procured by the SO, and those caused by insufficient market supply.

## Drawbacks

- Each consumer will have a different Value of Lost Load (VOLL), a broadbrush approach such as that used for the gas VOLL may be necessary.
- Whilst a price for demand reduction could be determined (albeit with some difficulty as each consumer will have a different VOLL), it is not clear how a price for voltage reduction can be determined. At low levels, consumers may be unaware that the voltage has been reduced and it is questionable whether they would need compensating. In addition, voltage reduction can be used by distribution companies to manage short term problems that are not related to overall system stress.
- Revenues should flow through to those affected by the demand disconnection. In the absence of smart metering, it will be difficult to identify affected consumers and also determine how much their load has reduced.

## Would a costing in non costed actions provide efficient balancing incentives?

- In an ideal world, if the incentive was right and the market had time to respond, costing in the actions would improve incentives to balance. However, there are a number of drawbacks that would have to be overcome as listed above. These have already been examined in previous modifications and it would be worth looking at what has changed to establish whether the problems can now be overcome.

## **18. Improved allocation of reserve costs**

### Benefits

- The current allocation of STOR option fees is based on average historical usage. If a way could be found to better allocate option fees to actual usage, it could provide a better balancing incentive.
- Likewise it may be possible to better target reserve creation actions taken by the SO in the Balancing Mechanism such that any price distortions are minimised.
- In terms of STOR utilisation actions, identifying non-BM STOR utilisation and including these prices in cashout would improve transparency and more fully reflect the SO's incurred balancing costs. If however, this cannot be achieved, its omission should not prevent changes to the allocation of BM STOR costs from being considered

### Drawbacks

- STOR can and is used when the system is both long and short. Since many STOR providers specify less than 5 minutes NDZ and 5 -10 mins minimum running time, STOR can be used for intra half hour balancing even when the system is overall net long but is short for part of a settlement period. If changes to how STOR costs are made, under the

current arrangements where STOR costs are allocated only when the system is short, parties would also only bear the costs when they were also short. STOR would therefore only be better allocated to a subset of periods when it is used.

- It is not obvious how the STOR option fees can be allocated with any accuracy without an ex-post adjustment to cashout prices which is not desirable.
- Other options put forward by Ofgem in their first workshop require an arbitrary judgement on likely STOR utilisation. The tender windows are already National Grid's best estimate of when STOR is likely to be needed. It is not clear how this can be improved upon unless with the benefit of hindsight.
- A further suggestion by Ofgem is to use a replacement price based on the top xMWh of actions. The opportunity cost of the next action that would have been taken had STOR not been accepted does not provide a proxy for the overall cost of STOR.
- Care does need to be taken in reviewing the allocation of STOR option fees as the SO does not consider the option fee when deciding to utilise STOR – the option fee is a sunk cost. STOR is primarily held to resolve short term imbalance which means it often gets used outside of peak periods. It can also be called because having sunk part of the cost, it is a cheaper option than other available offers. Loading onto the STOR offer prices a more targeted adder to reflect actual/expected utilisation could create unrepresentative price spikes (depending on expected utilisation) away from system peaks.

Would an improved allocation of reserve costs provide efficient balancing incentives?

- GDF SUEZ is cautiously supportive of changing how reserve costs are allocated. This is on the proviso that a way can be found to better allocate option fees to actual usage. If this is possible, we believe it could provide a better balancing incentive. However, it is important that the concept of real time pricing is preserved. Arbitrary adjustments that do not reflect the capacity value of STOR should not be introduced. If these conditions cannot be met, GDF SUEZ would rather the current methodology for STOR allocation was retained.

## **19. Balancing Energy Market (BEM)**

### Benefits

- The BEM would provide a clean half hourly value of energy. It would not however be based on the actions taken by the SO to balance the system, it would be based on an unconstrained forecast of actions taken before gate closure. This highlights the need for Ofgem to be clear about the role of the cashout price. If Ofgem does not see the need for the cashout price to be based on the actual actions taken to balance the system then further exploration of the BEM may be warranted.

### Drawbacks

- The BEM is currently insufficiently defined. It is not clear where it sits in the timeline between the day ahead target model, closure of the power exchange, submission of

FPNs, gate closure and the balancing mechanism It is not clear what it would add when there are already all these routes to market. It would be helpful if Ofgem could provide

such a timeline and also clarity on the role of cashout as this would help determine whether a BEM would be of benefit.

- It is not clear how the costs of resolving the forecast NIV in the BEM and post gate closure balancing costs would be allocated to those out of balance and also to the market in general.
- The SO would have to forecast NIV. This would probably require an information imbalance charge to encourage accurate submission of FPNs from both the generation and demand side. Such a charge would impose additional costs on participants and in particular those less able to forecast their generation output with a good degree of accuracy (for example wind and perhaps smaller suppliers).
- The addition of a BEM would add significant complexity to existing market arrangements

#### Would a BEM provide efficient balancing incentives?

- It is difficult to say as it is unclear how parties would be charged for the costs of the BEM and also any post gate closure balancing actions. At a high level, since the BEM does not reflect actual balancing costs it is unlikely to provide as good a balancing incentive as the current arrangements. In fact it could detract from current efficiencies in balancing if the SO is effectively required to unwind positions from the BEM in order to balance a more constrained system.
- Ofgem should first explore either shortening gate closure or allowing contract notification after gate closure as many of the aims of the BEM could be achieved through these measures as well.

## **20. Alternative arrangements for renewables**

### Benefits

- There are clear benefits to renewable generators of having alternative imbalance arrangements where output is less predictable. However, the GDF SUEZ position is that all participants in the market should be subject to the same level of imbalance costs regardless of generation type. To reduce risks for renewable generators, GDF SUEZ preference is for commercial aggregation services to be allowed to innovate in this area and take on balancing risk from subscribers.

### Drawbacks

- GDF SUEZ's position is that all participants in the market should be subject to the same level of imbalance costs regardless of generation type. It would seem perverse to exclude generators that create more imbalance from the contributing towards imbalance costs that they create.

- This approach is reinforced by DECC's decision to implement CfD FiTs for low carbon generation. This decision was founded on a desire to maintain the central role of the Energy market, including balancing signals, for all market participants. Exempting renewable generators from imbalance prices would undermine this approach and is not compatible with the CfD FiT model.
- It is difficult to define who should be allowed to participate in this alternative market. Should for example tidal power be allowed or small scale storage, both of which will be generating intermittently but predictably? Low load factor plant could also fall within this definition given that in the future it will also be generating more intermittently than it does now. Defining who can participate would need to be robustly addressed.
- Under the central aggregator role (option 2 in Ofgem's slides from the 3<sup>rd</sup> workshop), the aggregator would be forecasting output, centrally aggregating and taking responsibility for any imbalance. Since cashout is based on the difference between meter and contract, this proposal would incentivise renewable generators to contract as much as they wanted to in the wholesale energy market as they would have no penalty applied for the imbalance costs incurred. Under Ofgem's description, this would seem to be a major drawback.
- Under option 3 in Ofgem's slides from the 3<sup>rd</sup> workshop, Ofgem is proposing that the SO provides forecasting services to generators and takes on the risk of fluctuations to generation that deviate from these forecasts in the period between gate closure and real time. Ofgem proposed that generators would have to trade their power and would be responsible for deviation of their contracted position from the SO's forecasts up to gate closure.
- It is not clear who would bear the risk of within gate closure deviations. Ultimately it would fall on consumers if the SO took this risk, if it was smeared via BSUOs it would still fall on consumers. If the imbalance risk is left with the renewable generator, they would require a higher subsidy level which would fall on consumers. It is not clear why separate treatment is needed. GDF SUEZ's preference is that all participants in the market should be exposed to imbalance risk.
- A potential solution that should be explored in greater detail is to reduce gate closure (although it is accepted that this would create challenges in balancing the system). More preferably, contract notifications (but not trading) could be submitted after gate closure to allow trading on exchanges closer to real time. This would seem a much simpler solution than introducing separate balancing arrangements for renewables.

**Question 7: Alongside this initial consultation we have published preliminary analysis of the last modification to the cash-out arrangements, P217A. Do stakeholders agree with the initial findings of this analysis?**

21. As a simple analysis of the impact that P217A has had on cashout prices compared to the pre P217A cashout calculation, we agree with the findings. It is disappointing that the analysis has not looked at the extent to which P217A has removed system pollution (para 2.17 of the P217A analysis report). Having confidence that P217A can do this accurately is a precursor to any changes that move to more marginal cashout prices as it becomes increasingly important that the marginal energy action is identified as prices move towards PAR1.

**Question 8: What additional analysis could be done as part of the SCR around Modification P217A and the flagging methodology it introduced?**

22. Other than that highlighted in Q7 (which we accept is difficult for Ofgem), GDF SUEZ cannot think of any further analysis.

**Question 9: Do you agree with our rationale for considering making cash-out prices "more marginal"?**

23. This question specifically addresses marginal cashout prices and has already been addressed in questions 5 and 6. It is unclear why Ofgem is singling out marginal cashout prices for special attention.

24. To expand upon the answers to Questions 5 and 6, we do not see a link between cashout prices and incentives to invest. Cashout prices are too variable to be used as an investment basis. Generators do not know when the spikes will occur and how long they will last and do not have confidence that the rules will remain constant over time. Investments are based on long term assumptions of sparksreads or, in the case of flexible plant, the ability to secure a long term STOR or other type of reserve contract. CfDs and the capacity mechanism (dependent on the detailed design) should offer investment incentives and provide the longer term signal, cashout is not the place to create this signal.

25. More marginal cashout prices could actually increase the cost of capital for investments due to the cost of a plant trip. The CfD strike price will also have to take into account the strength of the cashout price.

26. Cashout prices do provide a signal to maintain plant and this signal would be enhanced if cashout prices became more marginal. However, the impact of a plant trip would be far greater under marginal cashout pricing perhaps leading to the closure of generators that only operate sporadically.

27. Given that the flagging methodology is subjective, it will also be difficult to identify the marginal energy action taken by the SO.

**CHAPTER 5: Secondary considerations**

**Question 10: Do you agree with the circumstances we have identified in which the secondary considerations are important?**

**Improved provision of information and information imbalance charge**

28. It would be helpful if the SO could publish a more accurate forecast of system imbalance but we are not sure what additional information could be gleaned as generators are already required to provide their best estimate of FPNs as generating positions change.

29. Generators already have a strong incentive to adhere to Final Physical Notifications. It is a Grid Code requirement and failure to comply with the Grid Code can lead to fines of up

to 10% of licensee turnover. At the fourth workshop, Ofgem indicated that the deterioration in information is largely being caused by the increase in intermittent generation. An information imbalance charge would therefore impact on larger intermittent generators who are less able to adhere to FPNs (it may not affect those below 50MW since they are not required to submit FPNs).

30. Any attempts to improve information provision should not discourage trading close to gate closure.

### **Creating a reserve market**

31. We can envisage that a day ahead reserve market may well be required at some point in the future to supplement STOR and BM activity. Increasing amounts of capacity will be held in reserve day-to-day, perhaps putting existing pre-gate closure balancing structures under some stress. In these circumstances a market solution to helping manage intermittency would be welcome. There is a question however as to whether this needs to form part of this SCR, or, more likely, whether this is something that the SO will naturally identify at the appropriate time and implement (with or without prompting) from Ofgem.

### **Amending gate closure**

32. The current gate closure duration seems to provide a sufficient level of time to allow the SO to dispatch plant in the BM.
33. Whilst there is sense in shortening gate closure as it would allow for more accurate generating positions to be nominated and allow the market to resolve imbalances closer to real time, there may be challenges that would need further investigation.
34. If gate closure was reduced from one hour to, for example, 30 minutes, most CCGTs would be unable to be operational in the shorter timescales creating a reduced 'pool' of plant that could participate in the Balancing Mechanism. To access CCGTs, the SO would have to issue warming style contracts in advance of gate closure, increasing the degree to which the SO participates in the market and moving away from one of the aims of encouraging parties to balance their own contract positions. In addition, unless these contracts were awarded through a competitive and open process, it would raise issues of transparency.

### **RCRC**

35. RCRC is a by product of the imbalance calculation. To make changes that set RCRC at an 'appropriate level' would be akin to the tail wagging the dog.

### **Reverse price**

36. The Imbalance Settlement Group (ISG) takes an annual look at the reverse price calculation and through this, the reverse price is now based on exchange trades taking place in the 12 hours before gate closure. Whilst the reverse price could be based on

trades closer to gate closure, there may not be sufficient liquidity leading to more default prices being calculated. GDF SUEZ believes that the ISG should continue with its regular check on whether the reverse price is being calculated appropriately and does not see the need for a review of the the reverse price to form part of this SCR.

## **Contract notifications**

37. GDF SUEZ supports moving contract notifications to after gate closure as this would allow imbalance to be resolved right up until gate closure. Trades could be time stamped to ensure that ex-post trading did not occur.

**Question 11: Do you have any other comment on the secondary considerations presented here? Please provide any evidence you may have to support your position**

No

**End of consultation response**





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