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Dear Andreas,

Consultation on GB Electricity Balancing SCR

Thank you for your invitation to respond to the above consultation. As you are aware, Good Energy is a small, licensed electricity supplier of 100% renewable electricity to over 30,000 customers; sourced from a community of around 40,000 small and decentralised generators across the UK.

Executive Summary

Good Energy does not accept the argument that the development of new peaking plant is being held up by the current cash out arrangements. Building of new plant is a long term investment and decisions are unlikely to be based on the Imbalance price alone. Ofgem's hypothesis therefore needs to be tested and demonstrated.

It also assumes that Suppliers and generators are not already doing all that is reasonably possible to balance their position. Suppliers can balance to their forecast, but actual usage is in the hands of customers. Equally, intermittent generators are in the hands of weather forecasting. Despatchable generators are able to balance their contracted position and therefore have no need of sharper balancing prices.

We are also concerned that this review will take place when several other interlinking market developments are taking place. Having several moving parts makes it difficult to baseline any proposals and increase the risk of unintended consequences, and market players acting in a manner not foreseen to mitigate the additional risk.

If such a review is to take place it should be done after Ofgem has taken a view on smarter settlement reform. This would create opportunities for suppliers to balance their portfolio using demand side aggregation. Currently, there are insufficient options for suppliers and intermittent generators to balance their position

Our responses to your specific questions are listed below:

Q1. Do you agree with the approach and the proposed stakeholder engagement throughout the significant code review?

No. We are concerned that as part of the review there is no proposal to test and provide evidence of the hypothesis that the current imbalance process is hindering the development of new plant and demand side response. The cause and effect need to be demonstrated, and other influences considered such as policy uncertainty caused by EMR are not the root cause. Before any changes are implemented this evidence needs to be presented.

We are concerned that this review is being implemented at a time of significant change. Apart from EMR (Including FIT with CFD arrangements as well as the capacity mechanism) Ofgem's liquidity review, and EU Target Model the Smart Grid forum is reviewing the more fundamental barriers to DSR and smarter settlements work will, if taken forward change the nature of the imbalance calculations. To this end we believe adding more uncertainty and fluidity to the arrangements at this time will in itself inhibit competition and investment. It may also prove to be impossible to baseline any proposed changes to the balancing arrangements as the impact of other changes will require continuous reassessment.

Q2. Do you have any evidence that you would like to submit that may be relevant for any aspect set out in this document?

Good Energy has been trading renewable energy from its inception in 1999 and has developed sophisticated forecasting tools to predict its renewable generation and its customer demand allowing it to balance its position. Balancing intermittent generation as part of a portfolio backed by improving day ahead liquidity means that balancing renewables is not a significant problem and does not need any regulated remedy. We have shared our experience with Ofgem before but are happy to do so again.

Q3. What is your view on the interactions between our considerations and aspects of the EU target model (TM)?

Our view is that Ofgem should be ensuring that the EU target model is compatible in delivering the decarbonisation of the UK energy market in line with the recommendations of the Committee of Climate Change. The UK market is interlinking and complex, with changes to the wholesale market having impact on retail competition and thus current and future customers, and the rate of decarbonisation. The consequences of amending one aspect of the market needs to be considered, just as the implications of the target model need to be fully understood and unintended consequences identified, such as creating barriers to competition. We would prefer Ofgem to channel its limited resources into delivering an EU target model fit for purpose.

Q4. Do you feel there are any further alternatives to the reform options presented under our primary considerations?

We are unable to propose any alternatives until we understand the purpose of the reform. Electricity balancing reform is not an end in itself, but should be undertaken to help deliver the government's trifurcate energy policy of decarbonisation, security and affordability.

Q5. 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.

Changes to existing balancing arrangements

We believe that more marginal main cash out price would run counter to Government policy. Currently only fossil fuelled despatchable plant are capable of delivering precisely to their stated output. Intermittent renewable generation such as wind can forecast reasonably accurately their output, but with a typical margin of error against their installed capacity of around +/- 5 to 10% at gate closure. Equally, suppliers can forecast consumer demand, but again to a margin of error of around +/- 4% of the expected demand.

If the cash out price was made more marginal, then intermittent generators and suppliers would face an increased forecast risk which would need to be passed onto consumers. For intermittent generators, this would be via increased strike prices under EMR proposals, or in the case of suppliers directly into consumer bills. Additionally, single site generators, would face higher financial penalty risk of plant failure or constraints, which could deter investment from independent and community own generation.

Demand side response under smart grid would also face difficulties as demand response is by its nature inaccurate. It would also require suppliers to have a clear understanding of when DSR is being undertaken, imposing penalties on consumers who fail to give adequate notice of their intentions. If a distribution network operator constrains an embedded generator without sufficient notice, then the generator or their contracted supplier should be entitled to imbalance compensation. This would need to be factored into Ofgem's current RIIO-ED1 programme.

It is worth noting, that currently NHH suppliers are exposed only to volume forecasting errors as the shape is predetermined by profile for NHH metered customers. As smart metering increases the number of HH metered customers within the settlement system, then suppliers will be increasingly exposed to shape, volume risk and market/cash out price risk. This raises the question as to whether a distribution network failure, resulting in loss of supply or distributed generation should be compensated by the network operator. This should also be considered under RIIO-ED1.

A single cash out price, whilst making sense on the surface, has to take into consideration that the price is not available until after the event. Thus whether the market is long or short is not truly visible to participants before gate closure. Even though the system operator provides an indication as to whether the market is looking long or short at any particular time, it would need to ensure that gaming did not occur by contract notifications occurring at the last possible moment before gate closure. Equally, it would not resolve failure to deliver due to plant failures occurring after gate closure but before delivery. As a generally accepted principle, in order for the cash out price to incentivise behaviour in the half hour concerned it would have to be visible before the event. Visibility after the event cannot drive behaviour unless it is reasonably predictable.

On the question of single or separate trading accounts, we have no strong opinion, but caution against the single trading account principle being rolled into justification for vertical integrated utilities using it as precedence for having a single net account under EMR for counterparty payment and receipts.

We believe that the market should retain the pay as you bid mechanism, and not move to a pay as you clear mechanism. The consultation states "A clearing price could produce the more efficient outcome as participants would be incentivised to bid closer to their short-run marginal cost". We are not convinced this is true, and would like to see evidence presented if Ofgem believe this is the case. We also believe that the consequences of making this change, with a move to single cash out pricing may have unintended consequences as energy traders consider new ways to maximise income.

Improvements to price inputs

Whilst we understand the desire to allocate costs appropriately, we believe that where costs are not easily attributed to a particular half hour, then socialising the cost is a more acceptable position. All parties benefit from availability of reserve, whether used or not because it delivers stability to the system, which in turn provides comfort that customers' will see their requirements delivered. This is particularly relevant as any involuntary disconnections are unlikely to be targeted at the customers of suppliers who have a shortfall in their contracted position.

New Balancing market

At the present moment in time, a supplier only knows his true contracted position at final reconciliation 14 months (28 months if a dispute is raised) after the day in question. Whilst the system in its completeness, could be balanced there would have to be subsequent reconciliation balancing markets to correct any re-adjustment of demand (including distributed generation).

Our view is that this would be overly complex under existing arrangements, but could be revisited once smart settlements has delivered reduced timetables for delivering a suppliers actual position.

With regards to alternative arrangements for renewables, Good Energy has been balancing its 100% renewable portfolio for several years, using a mixture of its own forecasts, dispersed geographic portfolio and technology and working with aggregators. We have therefore created for ourselves the proposals that are being put forward here into a centralised system. This in our view is a restraint on competition, and removes the requirement for parties to manage their portfolio. Independent generators currently have the option to use aggregator services or pass on the risk to suppliers for a discount to the market price.

If this option is to be considered further then it would need to take account of how the renewable market will work under EMR, including vintage RO generators.

We believe in the market the onus is on generators and their counterparties to reasonably manage their position, something we have been successfully doing for several years without centralised assistance. Whilst other reforms to cash out proposed here, such as accentuating the cash out price volatility, may increase the cost of managing the portfolio, and thus increase cost to customers. We do not believe the proposals for separate arrangements are necessary.

If Ofgem is interested in understanding our trading strategy in detail, we would be happy for them to come and see the process in operation.

Q6. Which of the reform options considered under each of our considerations do you believe would provide the most efficient balancing incentives and why?

We do not support any of the changes proposed, but believe that a single cash out price would be the most efficient reform option provided the visibility to the market as to whether the system is long or short and the depth of that position was improved. Without that visibility of the true market position, then the incentive is not visible and thus does not serve purpose.

Actions which increase the volatility of cash out prices will make the process more inefficient, as parties who cannot accurately set their position (all suppliers, several forms of renewable generators and demand side participants) would need to mitigate the risk of volatility by increasing prices to end consumers, or other actions (such as ensuring they are predominantly long in the market, or by purchasing insurance products, etc...).

Q7. 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?

Yes. We support the view that the implementation of P217A has made prices less spikey and volatile. What is missing from the analysis is whether P217A has improved or otherwise the imbalance position of market participants. In theory, if prices are less volatile and more predictable then if anything the market imbalance should have worsened as parties become less afraid of unforeseen price spikes.

In particular we support the view expressed that:

“A more marginal cash-out price would make prices sharper, increasing the incentive for parties to balance. However, there would be wider considerations around such a change, for example, that it could also increase the cash-out risk faced by market participants”.

We also reiterate that the findings do not show any change in behaviour by parties to improve or otherwise their imbalance. We believe this is because parties continue to take all reasonable steps to balance as best they can, and there are no further cost effective actions they would take in response to sharper prices to improve their position.

Q8. What additional analysis could be done as part of the SCR around modification P217A and the flagging methodology it introduced?

Further analysis should be taken to see what the impact of this change had on parties' imbalance position. As a result of P217A, did parties introduce actions to improve their imbalance position, continue as was, or allow their imbalance position to grow in response to more stable prices?

Q9. Do you agree with our rationale for considering making cash-out prices ‘more marginal’?

No. The rationale is based on the assumption that it will lead to parties being more incentivised to balance is flawed on two points. Firstly, only certain classes of generator such as fossil and nuclear plant can accurately meet their contracted position. Suppliers, whilst they can forecast consumer demand reasonably accurately have no control on their consumer’s consumption especially in the half hourly market. Equally, intermitted generators, both transmission and embedded can forecast their output, based on weather information, but will always have a reasonable margin of error has this error increases markedly beyond 1-2 days ahead of delivery. These proposals could also significantly curtail the demand response market development. The question that should be asked is what additional actions could these parties take to improve their position, which they do not because of the dampened imbalance signal?

As a supplier, and aggregator of renewable output we believe we have taken all reasonable actions to balance our position, and any increase in marginality in cash out prices, would lead to no other actions other than to be fed through to consumers in the form of higher prices, either directly by suppliers or indirectly via increased strike prices under the FIT with CFD regime. It may be that once smart metering with a smarter settlement process is in place, other tools will be available to manage imbalance, and thus a review of cash out at that point would be more appropriate.

Secondly, for a price incentive to be effective the price needs to be known at the time an action is required, or at the very least reasonably foreseeable 1-2 days ahead. Currently, market participants do not know the cash out price until it is too late to take corrective actions, and the pollution of the stacking price makes predicting the price difficult. Parties therefore attempt to balance is driven by the perceived risk of a price spike which leads to the system as a whole being predominantly long, as being long is usually less risky than being short. More marginal cash out will increase the risk of price spikes.

It is our view that the lack of capacity has little to do with the marginality of cash out prices, but more to do with generation projects being held up by the lack of clarity around government policy, including support mechanisms through EMR, the need of industry to adjust to EU emission performance standard and permitting, and decarbonisation targets. We find it difficult to believe that decisions on building additional generation capacity could rest on something as fickle as cash out prices.

That said, a more marginal cash out price will increase the financial cost of parties being out of balance, which would be fed to consumers either directly by suppliers, or indirectly by higher strike prices in the FIT with CFD arrangements.

We believe the current level of marginality is the best balance at the present time.

Q10. Do you agree with the circumstances we have identified in which the secondary considerations are important?

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Q11. Do you have any other comments on the secondary considerations presented here

We would always support improving information and transparency, but not if it leads to data overload. There may be scope for the system operator reviewing the data it publishes, and the timeliness of that data and whether there is scope for some element of predicting imbalance which leads to spikes similar to the Notice of insufficient margin (NISM) mechanism that operates for capacity.

We would also support the creation of a reserve market if it was done in such a way that it allows demand side participation based on a day ahead market. Currently, Demand side can only operate in STOR by giving contractual undertakings to deliver demand reduction over the contractual period. A day ahead market would allow greater

participation by I&C customers unwilling to make long term commitments to demand reduction but who could do on a day by day basis, and to aggregators.

We believe other secondary proposals only come into play if other options are considered the way forward.

I hope you find these responses useful, if you would like to discuss any of the points we have raised further, please contact me.

Kind regards,

A handwritten signature in black ink that reads "Chris Welby". The signature is written in a cursive, slightly slanted style.

Chris Welby
Policy & Regulatory Affairs Director