



**RenewableUK**  
Greencoat House, Francis Street  
London SW1P 1DH, United Kingdom

**Tel:** +44 (0)20 7901 3000  
**Fax:** +44 (0)20 7901 3001

**Web:** [www.renewable-uk.com](http://www.renewable-uk.com)  
**Email:** [Info@renewable-uk.com](mailto:Info@renewable-uk.com)



Andreas Flamm / Jamie Black  
Ofgem  
9 Millbank  
London  
SW1P 3GE

Date: 23<sup>rd</sup> October 2012

[gb.markets@ofgem.gov.uk](mailto:gb.markets@ofgem.gov.uk)

By e-mail: [zoltan.zavody@renewableuk.com](mailto:zoltan.zavody@renewableuk.com)

Dear Andreas and Jamie,

**RenewableUK - Scottish Renewables consultation response REF 108/12  
ELECTRICITY BALANCING SIGNIFICANT CODE REVIEW**

**Summary**

As the trade and professional bodies for the UK wind and marine renewables industries, RenewableUK and Scottish Renewables welcome the opportunity to comment on Ofgem's proposals for a Significant Code Review of Energy Balancing. The consultation paper helpfully sets out a wide range of ideas for improvements in energy balancing, and acknowledges many interlinkages, which we welcome. However, RenewableUK and Scottish Renewables have a number of practical concerns over the proposed approach:

- **There is a need for a timeline for the future development of any proposals on energy balancing, identifying more clearly and with evidence the upcoming challenges and changes to the whole energy market, and the points at which intervention is required.**
- **The required evidence would include a demonstration of significant increases in the amount of energy subject to cash-out, which we have not**

seen to date; and explanations from the System Operator as to why the tools and incentives currently at its disposal are insufficient.

- **In the event that the need for intervention is identified, a more measured process is appropriate, whereby initial thinking is developed with industry engagement, rather than jumping straight to a “draft policy decision” and impact assessment.**
- **In order to be able to input into negotiations on the European Target Model, it is appropriate for Ofgem to consider stakeholder responses to the current consultation, but this does not mean making hasty policy decisions.**
- **In the meantime, there is scope for the development of softer measures to facilitate energy balancing, for instance: better wind forecasting and information provision.**
- **A separate, centrally balanced market for renewables, maintaining some incentive for individual windfarms to be in balance, has its merits, but the market for commercial aggregation should be explored first, encouraged, and monitored in the context of the introduction of EMR policies.**

## **Introduction**

RenewableUK and Scottish Renewables collectively represent the major sectors and technologies within the UK’s renewable energy industry. Our members include supply chain companies both manufacturing and services; renewables developers and generators; and conventional energy companies with renewables portfolios. The associations’ response aims to represent wind, wave and tidal industries, aided by the expertise and knowledge of our members.

Our members include the largest portfolio generators and large independent wind generators, together with smaller wind generators and other players. Some generators sell straight to suppliers, while others sell to aggregators, and they do so according to a range of different contractual arrangements.

Ofgem’s consultation paper sets out a wide range of ideas for improvements in energy balancing, and acknowledges many interlinkages. We welcome this as a helpful thought piece. A lot of work would be needed to understand the implications of each and all of Ofgem’s proposals for each and all aspects of our various members’ activities.

This response is therefore necessarily broad, highlighting issues, concerns and areas for further investigation, in the hope that there will be an opportunity to consider proposals in more robust and comprehensive detail at the appropriate time. We have a number of concerns however about the objectives, timing, and process for development of these ideas, as well as interlinkages, as set out below.

## **Timing**

Within the context of Electricity Market Reform and other on-going review and reform of the market, there is much uncertainty in the electricity market, and in the renewable electricity market in particular. Off-takers are already reluctant to sign Power Purchase Agreements (PPAs)<sup>1</sup>, and investors are cautious about funding renewables projects until there is clarity on future market arrangements and operational detail of Electricity Market Reform, including the strike price for Contracts for Difference (CfD). In this context, adding further uncertainty into the policy arena, through this wide ranging Significant Code Review, is unhelpful.

We would advocate seeing what emerges under EMR, for instance as a CfD strike price. If necessary, a reform of energy imbalance could be undertaken thereafter, leading to a surgical intervention on the strike price. This is preferable to the development of a strike price simultaneously with cash-out reform, which runs the risk of a variety of unintended consequences and the inevitable need for complex remedial action.

## **Justification**

Regardless of the uncertainty, we are not convinced of the need to reform key aspects of energy balancing arrangements at this time. The consultation seems to present no evidence that there has been significant increases in the amount of energy subject to cash out, or that current means and incentives are insufficient to balance the system economically and efficiently.

We accept the theory of sharpening price signals and of the need to promote demand participation, but we question whether these are the most important things to be doing at this time and, indeed, what specific problem they are attempting to solve.

---

<sup>1</sup> Quayle Munro analysis undertaken for Scottish Renewables in August 2012. See annex of [http://www.scottishrenewables.com/static/uploads/consultation\\_responses/sr\\_response\\_ppa\\_call\\_for\\_evidence\\_final.pdf](http://www.scottishrenewables.com/static/uploads/consultation_responses/sr_response_ppa_call_for_evidence_final.pdf)

We would find it helpful if Ofgem were able to draw up a timeline for the future development of proposals, identifying more clearly and with evidence the points at which intervention is required, in the context of market and policy developments. The required evidence would include a demonstration of significant increases in the amount of energy subject to cash-out, and explanations from the System Operator as to why the tools and incentives currently at its disposal are insufficient. It is particularly important to look at the financial and timescale incentives for balancing, and how these relate to what the SO actually needs for balancing the system.

On incentivising flexible generation capacity, cash-out price signals are intended to complement the capacity mechanism. This seems to be confusing, by directing two major policy tools, being developed in parallel, to solve the same issue. There are bound to be unintended interactions and therefore consequences. A simpler alternative would be to develop the capacity mechanism to encourage flexibility, and to keep current arrangements for energy balancing in the main market. The main market already incentivises flexibility to a large extent, as evidenced by the development of OCGTs to replace CCGTs. If current cash-out already provides adequate incentive on generators to balance their position, then a more marginal arrangement would simply add to costs, at no benefit, necessitating an increase in the level of the CfD strike price.

On demand side participation, the DECC “summer paper” stated that variability would not become a serious issue for energy balancing until “towards 2030 and beyond.” Of course it is good to begin innovation early, and we need readiness for higher penetration of renewables than that suggested by DECC, with demand response by, say, the early 2020s. In the meantime, Spain and Ireland have much higher penetration of renewables than GB, and it is more important to learn from them. Distribution level demand response may also be developed under RII0-ED1, and early lessons may be learnt from this. Demand response is a very specific measure and an unconvincing argument for Ofgem to reform energy balancing now.

Regarding the development and implementation of European Network Codes, we welcome Ofgem’s proactivity and agree that it would be helpful for Ofgem (at ACER) and DECC (at the Commission) to be well informed by GB and UK stakeholders when negotiating European Network Codes. However, this does not mean that an SCR should be conducted and policy decisions made in haste.

## Process

Finally, following on from the last point, we are concerned about the proposed process itself. Ofgem's consultation paper contains a number of interesting ideas, and we would be interested in discussing these further in appropriate fora at the appropriate time. We would hope eventually to see, on the back of extensive industry engagement, a further Ofgem paper that sets out potentially viable options in more detail, with a proposed justification. However, we do not believe this should be a "draft policy decision," but rather a "more detailed thoughts" piece, to which industry would be in a position to respond with more concrete views. Given the fundamental nature of the issues being dealt with by the SCR and their interaction with other as yet unresolved major energy market initiatives, stakeholders should be given the opportunity to test emerging thinking, prior to policy positions being determined. Such a piece should also contain an assessment of the range of tools at the SO's disposal to balance the system, together with ideas for softer measures that can be employed to facilitate energy balancing in the meantime, such as better wind forecasting and information provision.

Some brief comments on Ofgem's eight considerations are offered below:

### **New Balancing Arrangements: Considerations 7 and 8 – Balancing Energy Market and Alternative Arrangements for Renewables**

From the perspective of renewables, and particularly wind generation, an alternative market that allows the netting off of imbalance across the country would seem a sensible option to explore. While the net imbalance should lead to lower cash-out payments, a mechanism is still needed to incentivise individual windfarms to be in balance as much as they can be. The netted cash-out payment could be apportioned according to the positions of individual windfarms. More detailed thinking is required here to assess how the mechanism might work.

In the first instance, however, and before introduction of such a drastic change, we would support facilitation of the market for commercial aggregators. The commercial aggregator market has not developed as expected under NETA, but changes are afoot that may help. – DECC is looking at possible powers under the Energy Bill to promote liquidity in the wholesale markets and competition in longer-term contracts, such that suppliers contract less with their generation arms. And under CfD, with

more certainty in the value of renewable electricity, the risk of imbalance for an individual windfarm will be bigger as a proportion of the total risk, thereby encouraging aggregation. It would seem sensible to wait to see how this pans about before introducing further interventions.

If an “alternative renewables market” is to be explored, there needs to be clarity on which renewables this market is proposed for. Wind seems to be the main consideration here, but there would be a need to delineate more clearly what forms of generation qualify. It would also need to be clear whether this is a mandatory or optional market for qualifying technologies.

If a “balancing energy market” is to be looked at seriously, then the timing of gate closure, and whether it should be pushed back closer to real time, should also be considered as an alternative. This would likely benefit the renewables industry, particularly wind, where forecast accuracy improves markedly nearer real-time. However, it does need to be looked at in the round, i.e: taking into account the SO’s ability to take balancing actions within a tighter window. It is important in this context to seek explanations from the System Operator as to why the tools and incentives currently at its disposal are insufficient, and what further tools it needs to develop as alternatives to, or to complement, cash-out reform.

## **Improvements to Price Inputs**

### Consideration 5: Attributing a Cost to Non-Costed Actions

No, we do not agree with this proposal. How can particular generators be held to account or penalised for particular needs, e.g: regional or local voltage issues that will vary across the country? It makes more sense to ensure a mature market in ancillary services, i.e: to pay for additional services from generators and others where these are needed.

### Consideration 6: Improved Allocation of Reserve Costs

Yes, there is merit in this proposal, subject to there being a robust and industry validated methodology for attributing cost of reserve, e.g: for power stations tripping. This will not be easy – for example, what about reserve being carried in Europe, once

we follow European system frequency? The calculations need to be done properly to avoid inadvertent market distortion.

In the case of wind, more accurate wind forecasting by National Grid would be the first and most obvious step to helping reduce the cost of reserve.

## **Existing Balancing Arrangements**

### Consideration 1: More Marginal Cash-out Prices

No, we do not agree with this proposal. The evidence suggests that moving from PAR500 to PAR100 would make a difference only at rare times of system stress, and this needs to be balanced against the costs of disruption.

### Consideration 2: Single Cash-Out Prices

No, we do not agree with this proposal. The regime is working well enough, so we do not advocate change, even if it may be more cost-reflective for wind (where cost of ramping up = cost of ramping down).

### Consideration 3: Single Trading Accounts

Yes, this proposal has merits, but with caution. But note this might change behaviour, for example, less trading in BM leading to higher BM prices.

### Consideration 4: Pay-as-clear for Balancing Services

No, we do not agree with this proposal. You may win some additional players in the BM, but the overall cost of pay-as-clear is likely in practice to work out higher. There is an argument that it may disincentivise investment in more flexible plant as the marginal price of pay-as-clear drops, i.e: counter-productive.

There are also other services that may be bound up within bid prices. Unless these services can be very clearly separated out, then treating all bid prices as if providing exactly the same service may not be appropriate.

We trust the above overview, and brief points on individual issues, are helpful to your deliberations. Please see the attached Annex for answers to the specific questions posed.

Thank you again for the opportunity to input.

Yours sincerely,

Zoltan Zavody  
Grid Policy Team  
RenewableUK

Catherine Birkbeck  
Senior Policy Manager, Grid and Markets  
Scottish Renewables



## **Annex: Questions**

The specific questions posed are mostly discussed in our letter, and summary answers are provided below for convenience:

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

No. We welcome stakeholder engagement, but there are a number of additional stages that are required within the process, as follows:

- Justification of the need for energy balancing reform at this time
- A “more detailed thoughts” piece, with fuller justification, rather than a “draft policy decision,” in spring 2013
- A timeline for the future development of proposals, identifying more clearly and with evidence the points at which intervention is required, in the context of market and policy developments

### **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?**

We would ask that Ofgem present the evidence that there is an emerging issue with energy imbalance.

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

It would be helpful for Ofgem (at ACER) and DECC (at the Commission) to be well informed by GB and UK stakeholders when negotiating European Network Codes. However, this does not mean that an SCR should be conducted and policy decisions made in haste.

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

Yes. We see two alternatives:

- One is to begin with softer options, such as encouraging a market for commercial

aggregation, better wind forecasting, more effective information provision; and to monitor their impacts.

- The second is to see what emerges under EMR, for instance as a CfD strike price. If necessary, a reform of energy imbalance could be undertaken thereafter, leading to a surgical intervention on the strike price. This is preferable to the development of a strike price simultaneously with cash-out reform, which runs the risk of a variety of unintended consequences.

**Question 5: What other benefits or drawbacks can you identify for each of our primary considerations?**

Consideration 8, the alternative arrangements for renewables, may have the following detrimental effects:

- Pre-empt the development of a market for commercial aggregators
- Reduce the incentive for accurate forecasts by individual windfarms (where not handled by PPA off-taker)
- Lump all wind locations together (an extreme example: onshore and offshore)
- Portray renewables (however classified) as “different” to other providers<sup>2</sup>
- Prevent aggregation by portfolio of generation

This does not mean that the concept of an alternative market should not be explored, but that this needs to be done with care, and the market for aggregators encouraged and monitored in the meantime.

**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?**

In terms of promoting more flexibility in generation as under considerations 1-2, this should be left to the capacity mechanism rather than a reform of cash-out arrangements. Current arrangements already encourage investment in more flexible plant, as evidenced by the development of OCGTs.

From the perspective of renewables, and particularly wind generation, an alternative market that allows the netting off of imbalance across the country would seem helpful.

---

<sup>2</sup> Different generation types do of course have different characteristics, and market arrangements should be sought to accommodate these.

While the net imbalance should lead to lower cash-out payments, a mechanism is still needed to incentivise individual windfarms to be in balance as much as they can be. The netted cash-out payment could be apportioned according to the positions of individual windfarms.

**Question 7: Do you agree with the initial findings of the preliminary analysis of the last modification to the cash-out arrangements, P217A?**

No comment.

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

We understand that the modification would make a difference only at rare times of scarcity. The benefit of this against the risks and disruption should be assessed.

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

In terms of promoting more flexibility in generation as under considerations 1-2, this should be left to the capacity mechanism rather than a reform of cash-out arrangements.

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

We agree that the secondary considerations should be assessed in the context of wider considerations, but encourage Ofgem to investigate softer measures such as improved information provision before committing to more serious intervention.

**Question 11: Do you have any other comment on the secondary considerations presented?**

Provision of information: Improved wind forecasts should help the market self-balance, as well as reducing imbalance costs for the SO.

Reserve market: We see no need for this.

Amending gate closure: This would likely benefit the renewables industry, particularly wind, where forecast accuracy improves markedly nearer real-time. However, it does need to be looked at in the round, i.e: taking into account the SO's ability to take balancing actions within a tighter window.

RORC: No comment.

Reverse price: Not comment.

Information imbalance charge: We do not support an imbalance charge on the basis of FPNs, which would amount to a penalty on many forms of generation, and particularly on wind.