

Peter Wesslau
Vice President – Finance Renewables
Country Manager UK
1st Floor, 1 Tudor Street
London
EC4Y 0AH

Tel: +44 (0)203 3019 118

Peter.wesslau@vattenfall.com

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Andrew MacFaul

Consultation Co-ordinator
Ofgem
9 Millbank
London
SW1P 3GE
andrew.macfaul@ofgem.gov.uk

Dear Mr MacFaul

Vattenfall response to the Ofgem public consultation on:

“Electricity Balancing Significant Code Review (SCR) – Initial Consultation “

Vattenfall welcomes the opportunity to provide input to the Significant Code Review.

Vattenfall is a Swedish owned energy company with operations in Sweden, Germany, the Netherlands, Denmark, UK, France and Finland. Vattenfall's vision is to create a strong and diversified European energy portfolio and to be among the leaders in developing an environmentally sustainable energy system.

Vattenfall operates three onshore wind farms and three offshore wind farms in the UK and has plans to develop and operate more in the future. As such the SCR is an important consideration for our current and future business.

If you would like to explore any of our points with us we would be pleased to discuss them with you.

Yours sincerely



Peter Wesslau
Country Manager UK

Summary of Vattenfall's views

A superior market design starts in the real time market and ensures that the preceding time frames (i.e. the intra-day, day-ahead and forward market) accurately reflect the real time conditions and thus provide undistorted incentives to trading parties in all market time horizons. That will provide transparency and predictability in cash out prices as well as a signal for entrepreneurs to increase flexibility which will be more and more important as the transition towards a low carbon society continues.

On page 17 of the report it is said that any effects on the capacity mechanism will be considered before any balancing reform proposals are implemented. Vattenfall wants to highlight the importance to first make sure that all time frames are covered with aligned and supportive market arrangements. It is within those that the capacity mechanism shall fit and not the other way around.

The SCR is an opportunity to further visibility and predictability in all time frames relevant for balancing in a concise and coherent manner. To achieve this it is essential to move from pay- as-bid to pay-as-cleared to establish prices used for cash-out that captures the value of balancing power in a particular time period.

Vattenfall urge Ofgem to pay even closer attention to the European Target Model and how it may impact the proposed changes in the SCR. In order to make the final proposal robust over time, each proposal should be assessed against the target model. Otherwise, Vattenfall foresees a risk that additional changes may be required when the target model becomes binding.

Given the current status and direction of the SCR, Vattenfall favours a system with:

1. Marginal pricing
2. Aligned and supportive designs in all time frames
3. Single trading account settled against a single cash-out price

Responses to questions raised in the consultation document

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

Our general impression is that stakeholder engagement on this important is good. It is structured with several opportunities to comment along the way. It is important that the outcome of the SCR will be compatible with the European Target Model.

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?

Vattenfall has extensive experience from the Nordic market that operates with marginal pricing in the Regulating Power Market run by the Nordic TSOs. The TSOs use this market both for balancing measures and grid related measures. The term 'grid related measures' refers to counter trading or special regulations and are settled with pay-as-bid. Grid related measures are close to the term 'system imbalances' used in the SCR and in the P217A Preliminary Analysis.

A methodology to separate between grid related and balance related measures is decisive to reach efficient prices reflecting the prevailing imbalance. In case a grid

related measure is done only by turning up a generation plant on the deficit side of a congestion and no 'down regulation' is done on the surplus side of the congestion it may affect the overall system balance. The potential volume effect may thus cause the TSO to down regulate the system to correct for the grid related measure on the deficit side. From the P217A preliminary analysis it seems like grid related measures are carried out by resolving congestion on one side of it, see e.g. page 48 and page 70. The impression of the analysis is that the price on the grid related measures do not affect the cash-out price directly. But, it is not clear if the P217 captures the potential effect on imbalance volumes from only turning up generation on one side of the congestion. For example, if the system was balanced before the grid related measure it would now turn out long and thus be followed by balance related corrections. If this volume effect is not corrected it could eventually affect the direction used for determining cash-out prices and the volume needed to restore balance. In a strained situation the effect on market actors can be severe. During the winter 2009/2010 the Nordic market experienced several price spikes up to 1400 Euro/MWh. Grid related measures was at the same time ordered to manage congestions. That was done by increasing generation on one side of the congestion. In terms of balancing, the system was found to be long. Consequently, the imbalance was corrected by down regulations at a price considerable below the spot price. The cost for an actor turning out long would then be high. The exact extent the grid related measure affected the direction of the imbalance is not clear but the direction indicates that it at least increased the long position of the overall system.

The above example indicates the importance of accurately separating between grid related and balance related measures. If the volume effect is not already addressed by Ofgem we propose that it be further assessed during the SCR.

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

Vattenfall supports the ongoing implementation of the Target Model and its goal of single European price coupling in 2014. In connection, the ultimate goal for balancing should be a common European market for balancing resources and a harmonised system of imbalance pricing.

Vattenfall is convinced that development towards European wide market coupling and balancing market must be stepwise in respect to geographical extension and depth of harmonisation.

In the context of the SCR, it is important to facilitate this development through supporting a level playing field, transparent and EU harmonised structure of grid and balance related measures and costs. No cross-subsidization between grid services and balance services should be possible.

Vattenfall thinks the consultation document should elaborate more on where and how the target model has influenced proposals and how the transition to the target model will take place. The SCR should aim at the target model.

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

No.

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.

Consideration 6 - Improved allocation of reserve costs; new balancing arrangements

The cash out price should reflect the price of the marginal balancing energy bid and be kept separate from all other costs the TSO incurs to provide system stability. Any additional costs connected to balancing could be recouped by a separate fee on imbalance volumes. The costs covered by the fee must be transparently presented and justified.

Consideration 7 - Balancing Energy Market (BEM)

Vattenfall interpret the proposal as a way to compensate for lack of predictability and in cash out prices placing too much risk on market actors. In that case it should instead be addressed in actions to increase the liquidity in wholesale prices and thereby reducing the uncertainty in the outcome of the cash out prices.

Consideration 8 - Alternative arrangements for renewables

Aggregation would indeed smooth out imbalances. The decision to aggregate or not should be with aggregators or ordinary Trading Parties and not with the System Operator. Central aggregation by the System Operator could counteract innovations in respect to forecasting. In this context it is worth noting that Denmark and Spain have moved away from similar systems with the motivation that the benefits do not outweigh the costs for the system. The market should drive any arrangements and not be forced by regulation - of paramount importance is that clear price signals are ensured.

Having said that, one central issue is to ensure a level playing field e.g. between different generation technologies. This is, in our opinion, addressed through the proposal of a single cash-out price. All generation types should face the same rules. In that sense, the dual price system treats intermittent generation and demand unfairly. With increasing amounts of wind power in the system it is thus reasonable to adapt a one single price system for balance settlement of all imbalances.

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?

Consideration 1 - More marginal main cash-out price

Vattenfall considers the SCR as an action to support the overarching goal of a transition to a low carbon economy. This is best achieved with providing clear price signals in the (Balancing) Markets, complemented with proportionate cost reflective charges and fees. Marginal pricing or market pricing will incentivise market actors to improve forecasting and in the long run will steer the electricity generation sector towards a more cost efficient system. Furthermore, the demand side is incentivised to increase predictability (or reduce imbalances) through marginal cash out prices. Thus, ensuring proper incentives to invest in forecasting methodologies and/or flexibility on the demand side is best achieved by marginal pricing.

Consideration 3 - Single or separate trading accounts

The consideration seems feasible and directly targets the purpose with balancing. To keep the arrangement as transparent and simple as possible a combined balance per Trading Party would be preferred. Vattenfall thus agrees with Ofgem that a change to single accounts is reasonable to consider.

Consideration 4 - Pay-as-bid or pay-as-clear for energy balancing services Improvements to price inputs

On page 20 the report refers to investment incentives and the detrimental effects from averaging cash-out prices. Here, it is important to distinguish between how the resources called for balancing energy is settled compared to the settlement of imbalances. In respect to investment incentives for generators or large consumers (or aggregators) the relevant signal is found on the market for balancing energy. Thus, ensuring proper incentives to invest is best achieved by pay-as-cleared pricing.

Consideration 5 - Attributing a cost to non-costed actions

If consumers are involuntarily disconnected as a consequent of supply failing to meet demand, the price on balancing energy and cash out prices should accurately reflect the scarcity. Actions attributed to balancing but not part of the market for balancing energy, such as automatic reserves, could be subject to a separate fee. It should be further analysed how this fee should be designed to properly reflect the costs.

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?

Vattenfall strongly supports the ambition to reduce the 'pollution' from system service related actions on the cash out prices. A transparent and harmonised structure for balance and system/grid related costs is crucial for efficient balancing mechanisms. No cross-subsidization between balance services and system or grid services should be possible. Grid related measures must not affect the price on balancing energy or the cash-out price. If there is not a clear distinction between the measures taken the cash out prices may be distorted. The distortion may decrease the incentives for market actors to plan and stay in balance.

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

See, question 2.

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

Vattenfall supports the initiative to evaluate moves towards marginal pricing regarding both balancing energy and cash-out prices.

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

a. Improved provision of information

Timing of providing information is relevant. In principle all balance responsible parties should plan to balance and all additional information should be collected and interpreted by those responsible for imbalances. This could be achieved through transparent provision of information but this need not mean that the System Operator shall provide the analysis through their forecast or foreseen reserve requirements.

b. Creating a Reserve Market

Vattenfall is somewhat surprised that this is regarded as a secondary consideration. When considering clear price signals, transparent contracting of Reserve Capacity should be paramount. We believe it would be helpful if Ofgem explained why predictable and structured framework for reserve procurement needs was not considered a primary consideration.

c. Amending gate closure

No objections to move gate closure closer to real time, but any consideration must take the ongoing harmonisations under the framework of implementation of European network codes and target model into account.

d. Residual cashflow reallocation cashflow (RCRC)

No comments

e. Reverse price

In the case that dual-price settlement is applied, the reverse price should be the relevant market price established in a liquid market place.

f. Setting an information imbalance charge

A strict deadline for providing the SO with binding plans should be sufficient. It should be in the balance responsible parties' interest to provide accurate submissions to the SO before real time. This would be the case if the actor is financially responsible for any deviation from its binding plan sent to the SO before real time.

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.