

Ofgem
Wholesale Markets
Attention: Andreas Flamm
9 Millbank
London
SW1P 3GE

Dear Andreas

APX response to Ofgem's Electricity Balancing Significant Code Review Draft Policy Decision

APX welcomes the opportunity to respond to this consultation on Ofgem's Draft Policy Decision for the Electricity Balancing Significant Code Review.

APX operate day-ahead auction and intraday continuous markets in the Netherlands, Belgium and the United Kingdom. APX have been at the forefront of power market innovation since we launched the first European power exchange in 1999. We are heavily involved in current regulatory initiatives to improve GB market liquidity and to integrate GB with neighbouring markets.

APX has 67 members, significantly more than any other GB power exchange and approximately 95 per cent of GB intraday trading is facilitated by APX. We anticipate that any change to GB cash-out arrangements will impact on our members, their trading strategies and our business.

As Ofgem's proposals become clearer, we intend to consult our members on new products and services that APX can introduce to help our members manage any changes in their risk profile and to support Ofgem's overall policy objectives. Whether or not Ofgem is successful in meeting its stated objectives depends on whether the industry has the necessary tools to respond efficiently to the proposed reforms.

We are happy to work with our members and Ofgem to provide appropriate tools. For example, we are launching smart orders for our day-ahead auction which, when NWE market coupling goes live on 26 November, will enable market participants to reflect the physical nature of their assets or demand profiles into the day-ahead auction.

To ensure that Ofgem keep abreast of the developments taking place in wholesale market trading we welcome your continued participation as an observer in our Market Development Advisory Board.

Key messages

The GB electricity balancing arrangements are fundamental to the efficient functioning of NETA. We share Ofgem's concern that current balancing arrangements may not provide a sufficiently strong signal for market participants to invest in capacity and flexibility and ensure security of supply.

We support Ofgem's intent to reform GB cash-out arrangements so that "the market does the heavy lifting" to ensure GB security of supply. We believe that efficient wholesale markets provide the most appropriate signal for investment in an efficient level of capacity and flexibility, and are concerned by the proliferation of non-market measures.

We fully support Ofgem's three high-level objectives to reform GB cash-out arrangements to (i) incentivise an efficient level of security of supply (ii) increase the efficiency of electricity balancing (iii) ensure balancing arrangements are compatible with the European target model and EMR.

However, given the high-level nature of Ofgem's draft policy decision, there are many open design questions, which may have a fundamental impact on market participants incentives and result in behaviour that is contrary to Ofgem's objectives. We would recommend that Ofgem engage with industry to work up more detailed proposals ahead of publishing its final decision.

We would also welcome more clarity from Ofgem regarding the anticipated timing to develop and implement the proposals. As highlighted by Ofgem's own "Electricity Capacity Assessment Report 2013" it is anticipated that GB margins will be tightest in 2014-15.

It may be worthwhile considering a staggered approach to implementation, fast-tracking the proposals with the greatest degree of support and the lowest barriers to implementation.

APX products and services

APX is working to develop and implement new products and services that we believe will support the market in meeting Ofgem's three primary objectives with the Electricity Balancing Significant Code Review. Below we provide an explanation of two initiatives.

Smart Orders

To coincide with the expected launch of North West European market coupling, APX has developed and will introduce "smart orders" as a new product offering for our members. This will be the first time that smart orders are available to GB market participants in a market coupled day-ahead auction.

Smart orders enable our members to reflect more accurately the physical constraints of their generation portfolio or demand profile into their bids in the day-ahead auction. This is important as the day-ahead auction is a one shot process where members' bids are accepted or rejected at a price determined by the auction algorithm. The introduction of smart orders facilitates the participation of demand, storage or aggregators in our day-ahead market.

Two particular types of smart order are linked block orders and exclusive block orders. Linked block orders, are orders where the execution of a (set of) order(s) is subject to the execution of another block order. These can, for example, be used for storage optimisation – orders can be submitted such that a storage facility will run only during peak hours if the off-peak purchase order has been accepted and the buy/sell combination is in the money.

Exclusive block orders are orders where at most one block can be accepted within a set of profile block orders. These can, for example, be used for demand management with a programme of load shedding entered into the day-ahead market on the most expensive hours when a threshold is reached.

We are also working on developing equivalent smarter functionality for our intraday market. For example, to meet the requirements in the capacity allocation and congestion management network code.

Demand side participation

More active participation of demand in the wholesale market is an important reason given by Ofgem for proposing more marginal cash-out prices. APX has been working to develop a service to reduce the barriers to demand side participation in our intraday and day-ahead markets.

Our proposed demand side participation service would enable industrial and commercial customers to trade directly on our intraday markets, via their suppliers' account, at minimal cost and without having to post additional collateral.

This has significantly lower implementation costs than many alternative proposals that are currently under consideration, and we believe it would be effective at facilitating demand side response.

To take this proposal forward we would like to explore the possibility of launching a GB pilot project with a group of interested parties and would be interested in discussing how this could fit with other ideas. Such initiatives to develop our day-ahead and intraday markets, are important to provide industry with appropriate tools to respond efficiently to Ofgem's proposed reforms.

Conclusion

Please contact myself or my colleague Olaf Islei, if you would like to discuss any aspect of this consultation response further.

Sincerely yours,



Andrew Claxton
Director of Business Development

Question for the Draft Policy Decision:

More marginal cash-out prices

We agree that PAR500 is too wide a margin to determine the main price for GB cash-out arrangements. As demonstrated by Ofgem's own analysis, on a day when National Grid instigated demand control, the main cash-out price did not rise above £500/MWh.

Related to this, the Power Exchanges implementing North West European market coupling (APX, Nord Pool Spot and Epex Spot) have agreed to harmonise the price limits for their respective day-ahead auctions to +€3000/MWh and -€500MWh. Ofgem should note that these price limits will apply to APX's day-ahead auction, and not APX's intraday market.

The agreed limit has been set at a level which Power Exchanges believe will not be reached in the day-ahead market. However, the level of the limits does reflect the anticipated price volatility in the participating markets, which seems to be easily in excess of that experienced in GB to date.

If the Ofgem's draft policy decision is implemented, APX would be happy to provide an assessment of the impact on price levels, volatility and volumes traded in APX's day-ahead and intraday markets.

Non-costed actions

APX supports Ofgem's proposal to improve the cost reflectivity of GB cash-out arrangements. We only caution that Ofgem should balance the cost and complexity of any proposal to improve cost-reflectivity, against the anticipated benefit.

APX would like to highlight that the use by National Grid of cross-border balancing actions and intraday transfer limits (ITLs) to curtail cross-border flows are also (respectively) balancing actions and a form demand control, and should be priced accordingly in the proposed cash-out arrangements. This is to ensure equal treatment of cross-border and internal exchanges by the System Operator.

Dual or single cash-out prices

APX support Ofgem's proposal to simplify GB balancing arrangements. However, we understand that market participants have raised some concerns. We believe that the proposal is too high-level to fully understand the potential impacts (for example on intraday liquidity) and that it is not necessary for Ofgem to rule out the need for potential additional measures at this stage.

For example, two design questions that are not clearly addressed in Ofgem's draft policy decision, but could have an impact on market participants, relate to the calculation of the single price:

1. whether the highest or the lowest price action would be considered marginal if the system is long and the system operator is taking sell actions; and
1. how the marginal price is determined if the system operator takes both buy and sell actions in a single balancing period.

APX believes that such design questions should be answered prior to Ofgem producing its final policy decision.