

Dear Colleague,

Electricity Cash out review – independent consultants' reports

On 8th February, Ofgem presented to the BSC Panel its proposed programme for taking forward a review of the electricity cash out arrangements.¹ That presentation outlined our plan to undertake a number of bilateral meetings with industry parties, to discuss their views and concerns with the current arrangements. We have already held a number of those meetings and will continue to do so over the coming weeks. We will also be holding an open industry meeting on 30th March on progress to date and the way forward for the review.

In order to stimulate debate over the electricity cash out arrangements, Ofgem has commissioned two independent experts to write reports on the subject. We asked Nigel Cornwall to produce a report on where he sees the problems with the current arrangements, and where changes should be focused. We asked Professor Stephen Littlechild to take a more "top-down" approach, and report on his views of how the electricity cash out rules should look.

We would like to thank the authors for their contributions. The two completed documents are now on Ofgem's website, and we hope they will stimulate thought and debate within the industry on where the key issues with electricity cash out lie.

Nigel Cornwall highlights the main problem areas as being:

1. the approximate nature of tagging rules and the imprecise energy/system split;
2. continuing interactions between the energy market, the transmission access regime and the management of transmission constraints through the balancing mechanism; and
3. the complexity of pricing rules and their lack of transparency.

Professor Littlechild's main conclusions include that:

¹ The slides from that presentation can be found here:

<http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/cashoutreview>

1. the underlying objective of the cash out arrangements should be to facilitate competition in the electricity market;
2. a single price methodology would be more conducive to efficiency and competition;
3. there would be advantage in reconsidering the present rules for cost allocation and tagging;
4. the options of ex-ante pricing and ex-post trading deserve further consideration; and
5. the SO should continue to seek innovative balancing services, but this should be advanced through the promotion of markets.

The authors were specifically requested to present their own views, and as such there may be some issues on which Ofgem's position differs from that taken in the reports. This is consistent with our desire to promote as full and open debate as possible in the review.

The presentation referred to above makes clear that we see two key areas for review: the inputs that go to making up the cash out price, and the RCRC mechanism. We consider that addressing the imperfections associated with those issues would make the cash out mechanism much simpler and more efficient. However, we do not want at this stage to exclude any topic from the scope of the review, and hence we welcome views and analysis on any of the other issues raised in these papers, as well as other points that stakeholders consider to be important.

The open industry meeting on the cash out review will take place at Ofgem's offices on Friday 30th March, 10am – 12.30pm. Please email wholesale.markets@ofgem.gov.uk if you would like to attend.

Yours sincerely,



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