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Open Letter Consultation: Potential Significant Code Reviews August 2010

Dear Mark,

We welcome the opportunity to comment on this open letter. This response is provided on behalf of the RWE group of companies, including RWE npower, RWE Supply and Trading GmbH and RWE npower renewables, a fully owned subsidiary of RWE Innogy.

The Significant Code Review (SCR) process enables Ofgem to address industry arrangements that have become fragmented over the past ten years. Consequently it is difficult to initiate, implement and coordinate changes that apply to more than one industry code. There is, therefore, scope for well targeted issues to be considered under the SCR process.

We have concerns about Ofgem's role in SCRs, since there may be insufficient separation of power at the various stages of the process. We welcome the proposed modifications to the codes that would provide a higher level of assurance about decisions relating to issues covered in the SCRs. We believe, therefore, that the SCR introduces a requirement on Ofgem to justify fully proposals to implement significant changes to the industry trading arrangements.

Our comments on the individual proposed SCRs are set out below:

Electricity cash-out

We welcome inclusion of electricity cash-out in the SCR process. There are a number of issues associated with the current pricing methodology, including the nature of marginal pricing and the way that services procured by National Grid in advance of gate closure influence cash-out prices.

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However, we note cash-out has already been subject to a number of reviews and that the issue of cost-reflective cash-out prices is difficult to resolve. We look forward to Ofgem's proposals in this area.

In the context of electricity cash-out and the Project Discovery work, cost reflective cash-out prices are one dimension of a properly functioning energy-only market. We are concerned that wider proposals for market reform and market design will impact on the economic and efficient functioning of the electricity market. The current electricity balancing regime is an important element of our electricity market and we are concerned that proposals for reform create uncertainty that the current arrangements will survive the review process. We are also concerned that elements of subsidy such as feed-in tariffs effectively foreclose a proportion of the market by excluding certain users from the risk of electricity imbalance. We believe that these issues require consideration as part of the cash-out review.

Finally, DECC has signalled its intention to undertake an Electricity Market Reform (EMR) project this autumn, with a White Paper in spring 2011. While the scope of this project has yet to be clearly defined, cash-out will form but one part of any reformed market design. If Ofgem undertakes it's proposed SCR on electricity cash-out, the industry need to be clear that this is consistent with the framework developed under the EMR project.

Gas Security of Supply

Ofgem's concern with gas security of supply is mainly the extent to which the gas emergency cash-out arrangements will attract incremental non-UKCS gas to GB in an emergency. Given the GB market's growing import dependency, we accept that the cash-out arrangements need to be robust, both inside and outside of an emergency. We consider that Shippers already face strong commercial incentives to put in place appropriate arrangements to balance their portfolios, including at times of system stress. These include contracting for both demand and supply-side actions. To the extent that any deficiencies previously existed in the emergency cash-out arrangements, which may have weakened shipper incentives to balance in an emergency, we believe these have been appropriately and proportionately addressed through the implementation on Modification Proposals 044, 0149A and 0260.

In the context of establishing priority areas for consideration, we do not think gas emergency cash-out warrants a SCR. Instigating a review specifically on this issue under the pretext of improving gas security of supply is wholly disproportionate and we are not aware of any evidence to suggest that a frozen emergency cash-out price is discouraging investment in gas infrastructure, or peaking capacity in particular. Emergency cash-out and gas security of supply needs to be considered in a wider context, whose scope extends beyond industry codes into statutory and licence obligations.

In light of the soon to be adopted EU Security of Gas Supply Regulation, we believe Ofgem's attention should be focused on working with stakeholders to implement efficiently the requirements of this binding Regulation. This, along with the issue of gas quality and the impact of out-of-spec preventing efficient arbitrage with interconnected markets, is of far greater significance to the security of supply to GB end users than any technical change to emergency cash-out arrangements.

Smart metering, impact on wider industry processes

It is appropriate to consider the impact of smart meters on the wider industry processes as part of the SCRs. There are potential changes to the industry processes and systems that customers would not need to be aware of, but could improve the customer experience. These changes are not in the scope of the Smart Metering Implementation Programme (SMIP), which is understandably quite narrow and well defined. Harmonising processes for trading, balancing, settlement, data flows and the governance arrangements could make them better suited to a smart metering world. The SCR could give the industry the opportunity to include wider elements of the Codes and Agreements into Ofgem's proposed smart energy code.

There are already programmes underway that are considering aspects of the arrangements that smart metering will impact; for example Elexon's review of settlement and profiling and XOserve's Project Nexus. Both are well advanced, and whilst they are capable of being incorporated into the scope of the SCR, Ofgem should consider how best to take into account the work already done as well as how to maintain the value of investments needed to complete the work.

Furthermore, the volume and pace of change may provide challenges for the Code Governance Administrators and Managers of the Agreements to maintain a viable and stable industry baseline for the trading arrangements.

Whilst running the SCR simultaneously with the SMIP may have the benefit of co-ordinating two areas of work, it will put a strain on the resources of parties involved in both areas of activity. In view of this, we would like Ofgem to set out how it will avoid duplication and make the best use of time and analyses. For example Ofgem should avoid setting up meetings at the same time, give adequate time to consider proposals and encourage parties to manage changes in an efficient and co-ordinated manner.

Transmission Charging

Ofgem has initiated a review of transmission charging arrangements[1] across the industry. We look forward to participating in any such review but would like to make the point that, in our view, the general principles of cost-reflectivity that underpin electricity transmission charging and operational arrangements must be maintained. The current charging arrangements have an important role to play in moving to a low carbon electricity market, producing a more efficient electricity transmission system and an efficient market structure at a lower cost to the consumer whilst delivering Government targets. We believe that there would need to be convincing arguments to move from the current position. Given the complexity of reviewing electricity transmission charging arrangements, our view is that gas transmission charging should be partitioned from the electricity charging arrangements in the overall Ofgem review.

We hope these views are helpful and if you wish to discuss any aspect of them in further detail, please do not hesitate to contact me.

Yours sincerely,

By email so unsigned

Charles Ruffell
Economic Regulation

[1] Ref: 119/10 Project TransmiT, September 2010