



Renewable Energy Systems Limited
Beaufort Court, Egg Farm Lane, Kings Langley
Hertfordshire WD4 8LR, United Kingdom
T +44 (0)1923 299 200 F +44 (0)1923 299 299
E info@res-group.com www.res-group.com

Martin Crouch
European Wholesale Team
Ofgem
9 Millbank
London
SW1P 3GE

Our Ref: GS-000471

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Dear Martin Crouch,

Re: Open Letter Implementing the European Target Model in Great Britain

RES is one of the world's leading renewable energy developers working across the globe to develop, construct and operate projects that contribute to our goal of a sustainable future. We have a portfolio of low carbon energy technologies and a range of services which together can meet demand from the industrial, public and commercial sectors on whatever scale.

RES has been an established presence at the forefront of the wind energy industry for over three decades. Our core activity is the development, design, construction, financing and operation of wind farm projects worldwide. With a portfolio of more than 5GW constructed and several thousand megawatts under construction and in development, RES continues to play a leading role in what is now the world's fastest growing energy sector. RES is also involved in the offshore wind and wave and tidal sector.

RES welcomes the opportunity to respond to Ofgem's open letter on implementing the European (EU) electricity Target Model in Great Britain (GB) and we hope you take our comments into consideration. Our comments in this response represent high level comments and concerns rather than specific issues on implementing the EU electricity Target Model in GB.

It can only be assumed from the high level nature of this open letter that it is just the initial start to what will inevitable become a much bigger project. The identification of the EU Target Model appears to have taken a top down approach and the beneficial aspects of each existing European market should not be forgotten. There needs to be robust analysis undertaken by Ofgem into the impact on the GB power market of all the potential changes to implement the EU Target Model. Given the EU Target Model has been left relatively open for individual member states to implement the full implications cannot have been accurately assessed in Europe to date. The EU Target Model is part of a bigger move to align the EU energy market which is a large project and needs to be given a great deal of consideration.

Consultation Questions

1. What are the key aspects of the Target Model for GB?

There are many key aspects of the Target Model, which we outline below:

- **Market coupling** – Market coupling will assist liquidity improvement across both the near and long term markets and could potential lead to a trusted reference price for GB. To enable market

coupling and to remove a liquidity barrier GB will need to move away from the EFA trading calendar so trades can align with other EU markets. For the Contract for Difference Feed-in Tariff (CfD FiT) proposals within the EMR to work effectively it is crucial that investment incentives paid to low-carbon generators are linked to a robust wholesale market reference price. This is the only way to ensure the correct market signals exist and generators can benchmark their investments off a robust reference price. However, the suggested introduction of prize zones to manage internal constraints will potentially split liquidity and could be extremely complicated to manage. How price zones will impact CfD FiTs needs to be considered in detail.

Increased market coupling will encourage more participants into the market. At present the vertically integrated nature of the market and lack of liquidity means we require Power Purchase Agreements (PPAs) with one of the Big Six suppliers in order to secure project finance for our developments. It is vital that the wholesale market is made highly liquid so that independent aggregators and traders can be attracted into the market to compete with the traditional PPA providers. Ideally we would like the number of aggregators active in the market and the ability for new renewable electricity projects to be able to secure a Power Purchase Agreements (PPAs) within a fully competitive market, with actors beyond the current incumbents.

Along with market coupling leading to enhanced liquidity encouraging new market entrants, a simplified consistent EU market should also facilitate new market entrants. A single consistent EU market will be simpler for new entrants to understand than multiple diverse individual markets. However, there is also a risk a simplified consistent EU market could lead to a limited number of big market participants throughout the whole of the EU as they out compete smaller market players.

- **Intra-day market coupling** – The continuous intra-day coupled market is encouraging for intermittent forms of renewable energy generation as it could reduce curtailment issues by enabling wind to be exported as predicted generation is known more accurately closer to gate closure. Reducing curtailment will assist the UK and Europe to meeting their legally obligated renewable energy targets and reduce costs to consumers. Intra-day market coupling will prove essential with increase wind generation both onshore and offshore of wind generation. According to DECC's UK Renewable Energy Roadmap published in July 2011 at present in the UK there is more than 4 GW of installed onshore wind capacity in operation and their central range for deployment indicates that onshore wind could contribute up to around 13 GW by 2020. Furthermore, in the UK there is 1.3 GW of operational capacity in offshore wind and their central range projections indicate that up to 18 GW could be deployed by 2020. Beyond 2020 there is a very high potential for deployment with over 40 GW possible by 2030.
- **Electricity balancing** – Electricity balancing between Transmission System Operators (TSOs) may result in reduced balancing costs and if so the benefit of this should be passed onto consumers. It depends on how security of supply is defined as to whether balancing between TSOs will be improved. If National Grid cannot balance the GB system and they are dependent on balancing measures elsewhere which may also be experiencing system tightness then there is no guarantee the National Grid will be able to secure the power and at an satisfactory cost for the GB system. It is unclear from the EU Target Model proposals whether there will be a sole TSO for the EU system, or a regional TSO (price zone) or national TSOs will remain. Whichever approach is ultimately chosen it needs to ensure the right incentives for participants to have balanced positions remain along with the correct incentives for flexible generation investments.
- **Long-term transmission rights** – The EU Target Model mandates the development of cross-border markets based on increasingly harmonised long term rights to access capacity on interconnectors. We agree with the expectation that these changes should enhance the long term hedging opportunities for GB market participants. However, to work effectively there needs to be strong regulation around congestion management. We appreciate ACER's Capacity Allocation and Congestion Management (CACM) Framework Guidelines. Nevertheless, we believe the introduction of price zones should be seen as a last resort measure in the absence of physical or geographical reasons rather than an optimal market solution.

2. *What changes will be needed to GB market arrangements?*

There a multitude of potential changes that without more assessment of how the EU target model will be implemented in GB it is difficult for all to be outlined. However, as a starting point there will many legal

changes to existing contracts and industry codes such as the BSC. There will be changes to trading arrangements and corresponding contracts along with system changes. All of which will take time to implement and incur costs.

3. Should we try and minimise change or consider holistically the best combination of GB and EU requirements?

The implementation of the EU Target Model in GB should definitely be considered holistically. It should be considered holistically not just in terms of the GB market but the whole of the EU market. Without considering holistically the implications of the EU Target Model there will be a risk to implementing aspects into the market which dangerously distort the market. The EU Target Model also offers opportunities to enhance the GB power market. Without holistic consideration not all potential opportunities will be identified or considered. Holistic consideration will also allow aspects of the GB market that currently works well to be identified and retained.

Consideration in the first instance needs to be given to the alignment of the GB electricity market with the Single Electricity Market (SEM) in the Republic of Ireland and Northern Ireland. Implementing the EU Target Model in GB should align with the implementation of the EU Target Model in the SEM. The optimal solution for both markets and the required market aspects to allow both markets to couple should be identified.

Particular holistic consideration needs to be given to other ongoing and future regulatory changes. The impact of changing the GB market to align with the EU Target Model should be considered against all other ongoing changes for example the EMR, electricity cash-out significant code review and liquidity review. If all these changes are not considered holistically, then there will much uncertainty in the market which will harm investor confidence and potentially introduce more complexity further down the line.

4. How can we deliver the best outcomes?

As discussed above there needs to be robust analysis undertaken by Ofgem into the impact on the GB power market of all the potential changes to implement the EU Target Model. Given the EU Target Model has been left relatively open for individual member states to implement the full implications cannot have been accurately assessed in Europe to date.

There needs to be coordination with other power markets across Europe. In theory the whole of the EU should benefit from a simplified consistent EU market which would lead to pooling of resources and facilitate new market entry. However, there are different market mechanisms throughout Europe which could reduce the ability for markets to compete on a level playing field. The Target Model does not mention major aspects of individual member states electricity policy such as renewable support schemes and capacity mechanisms. For example the UK will have the Carbon Price Floor in 2013. Therefore, despite the EU Target Model's ambition to align trading arrangements the realities of trading incompatibilities will result in different trading patterns. There is much complexity in this approach to market integration, which will make it difficult to succeed especially when other political uncertainties are also considered. There are many scenarios and potential outcomes but without robust analysis by Ofgem into the impact on the GB power market of all the potential changes to implement the EU Target Model they cannot be identified. The costs which build up the power price in each EU market and transmission costs needs to be assessed. Only then can the ability for market coupling to occur be identified.

However, without combined consistent EU wide energy policy across all the markets there will be a distorted market for all. Without combined fiscal unity the single currency is failing and this could be the same for the energy markets.

5. What process is needed to take this work forward?

Ofgem need to outline clear objectives as to how the EU Target Model can be implemented including the benefits and risks of each approach. This work needs to include holistic assessment of benefits for both the GB and EU power market such as consideration of existing resources. Ofgem need to robustly consider what works well in the current market and what does not, alongside the needs of GB and the needs of Europe. Analysis needs to be undertaken by Ofgem into the impact on the GB power market of all the potential changes to implement the EU Target Model.

Conclusion

RES are grateful for the opportunity to comment and look forward to your next steps on implementing the EU electricity Target Model in GB. We hope you take our comments on board and welcome any further contact in relation to this response.

Yours sincerely,

Sarah Husband

Policy Analyst

E Sarah.Husband@res-ltd.com

T +44 (0) 1923 299 454