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23 May 2012

Dear Martin,

IMPLEMENTING THE EUROPEAN ELECTRICITY TARGET MODEL IN GREAT BRITAIN

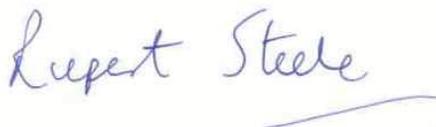
I am writing in response to your open letter of 28 March 2012 requesting views on how the European Electricity Target Model should be implemented in Great Britain.

As far as we are aware, Ofgem has correctly identified the specific areas where action is required and have no additional suggestions at this stage.

At a more general level, we believe Ofgem's focus should be on ensuring that existing programmes are taken forward in a way that is fully compatible with future Target Model requirements, and coordinating where appropriate between these programmes. In this sense, we would support Ofgem taking a more 'holistic' view. We do not however believe it would be appropriate at this stage for Ofgem to open up a wider review of GB market arrangements, except in so far as they need to be adjusted in response to forthcoming European requirements.

Our answers to your questions are attached. Please contact me using the details shown if you wish to discuss any of the points made in this response.

Yours sincerely,



Rupert Steele
Director of Regulation

Implementing the European Electricity Target Model in Great Britain

ScottishPower response to Ofgem consultation

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

The key aspects of the Target Model for GB are the opportunities it affords to benefit from closer market integration with other EU member states. Implementation of the Target Model should promote more efficient use of existing interconnector capacity and facilitate investment in additional interconnector capacity between GB and neighbouring countries. This in turn will help GB deliver security of supply and decarbonisation objectives at lower cost than would otherwise have been possible.

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

We agree with the three main areas of change identified by Ofgem:

- a) Exempting interconnectors from various categories of charge which might otherwise create obstacles to cross-border trade:
 - o TNUoS charges (removed from Interconnector Users as of April 2010);
 - o CUSC modification proposal to remove BSUoS charges from both Generators and Interconnector users;
 - o BSC modification proposal to remove GB losses from Interconnector users;
- b) Making more effective use interconnectors, via the 'GB hub' and related initiatives:
 - o market coupling over the French interconnector (IFA) and BritNed;
 - o continuous implicit trading over IFA and BritNed;
- c) Integration with the SEM market.

Trading across the interconnectors will also benefit from increased harmonisation of products traded via power exchanges, cross-border gate closure times, etc, and this may be an area where change is also required.

While the European Network Codes will stand alone as primary legislation and will therefore have precedence, there will need to be a programme of work to update the GB Codes to ensure that there is no conflict with the European Network Codes and provide clarity on their obligations to GB market participants.

Ofgem points out that the CACM Framework Guidelines create a new obligation on the TSO to review price zones, and that if market splitting were to be considered in the UK, the most likely boundary would be between Scotland and England & Wales. However, any such change would need to be justified on grounds of overall market efficiency¹ and it is difficult to envisage such a case being made in the foreseeable future, not least because of the impact on renewable generators. The key to resolving constraints within GB remains the timely investment in transmission infrastructure to facilitate the deployment of renewable generation in the areas providing the highest resource.

¹ The CACM FG (section 2.2) makes it clear that overall market efficiency includes consideration of 'socio economic welfare, liquidity, competition, network structure and topology, planned network reinforcement and redispatching costs.' Section 1.1 also notes that in evaluating the proposed CACM NC, ACER will take account of the need to fulfil security of supply objectives and the Union's targets for penetration of renewable generation.

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

There are a number of important DECC and Ofgem initiatives already under way which will potentially have a bearing on, or be impacted by, the EU Target Model:

- Electricity Market Reform (EMR), including proposals for a Capacity Mechanism to enhance security of supply and feed in tariffs to support low carbon generation;
- Significant code review (SCR) of the cash-out arrangements, looking at how the cash-out price signals could be improved to better support security of supply and low carbon investment;
- Integrated Transmission Planning and Regulation (ITPR) review, looking at how transmission planning and regulation can be evolved to better support (*inter alia*) investment in new interconnectors;
- Proposed Mandatory Auctions to enhance liquidity in the GB power market and facilitate market entry by new generators and suppliers;
- SCR launched under Project TransmiT, to amend transmission charging arrangements in support of renewables investment and other objectives.

The main thrusts of these initiatives are security of supply, low carbon investment and increased competition. We believe that these remain the most important issues facing the GB market at present, and the priority should be to deliver these initiatives as effectively as possible, taking full account of any interactions with EU market developments.

Ofgem says in its open letter that ‘the physical system and wholesale market arrangements (BETTA) were designed for controllable, predictable generation and limited integration with neighbouring markets’ – with the possible implication that increasing penetration of less controllable intermittent generation and increased interconnection with neighbouring markets may make this an appropriate juncture for a more fundamental review of the BETTA arrangements. Although a number of other European member states have pool-based markets, we do not see that harmonisation of market models is necessary to achieve the objective of efficient cross-border trade in power. We do not therefore think there is any need for a fundamental review of GB market arrangements at this stage. In fact, given the number of initiatives already underway, such a review could be counter-productive and be detrimental to investor confidence.

Rather, we would suggest that if a ‘holistic’ review is undertaken, it should focus on ensuring that the current initiatives take due account of existing and future EU requirements, and are appropriately coordinated in that respect.

4. How can we deliver the best outcomes?

As noted above, the priority should be on delivering security of supply, decarbonisation and competition-related objectives. Closer integration with other EU markets should help to achieve these objectives, as more efficient cross border trade can improve liquidity, competition and integration of renewables.

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

As noted above, there are a wide range of existing initiatives which have a bearing on, or are impacted by, the EU Target Model. We do not see a need at this stage for a further programme to look holistically at implementing the EU Target Model. Rather, we believe Ofgem should focus on ensuring that existing programmes are properly coordinated and aligned with known requirements of the Target Model.

ScottishPower
23 May 2012