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Open letter: Implementing the European Electricity Target Model in Great Britain

Dear Giuseppina,

I write in response to the Ofgem Open letter: Implementing the European Electricity Target Model in Great Britain.

Introduction

SmartestEnergy is very supportive of European harmonisation for international trading purposes. However, we are less convinced that harmonisation is necessary for domestic issues such as connection and charging methodologies. By and large we favour minimal change.

We welcome any development which leads to a robust and trusted reference price for GB and we believe that the day-ahead market will naturally gain greater liquidity over time as it has done in the NordPool area. Indeed, we believe that Ofgem should take this into consideration with regards to their plans to introduce mandatory auctions and alter the cash out arrangements. In other words, European harmonisation should make the need for other interventions unnecessary. The same is also possibly true of the DECC proposals for a capacity mechanism.

As a final introductory word we would like to say that we believe that care should be taken when discussing “reforms to create a single European energy market.” The terminology of a “single market” is somewhat misleading as what is being proposed is in fact that certain elements (such as day-ahead trading) are pan-European, but they are by no means obligatory mechanisms for participants and do not suggest that there should be identical arrangements in all aspects which the terms “single European energy market” might imply.

Ofgem's specific questions

We now answer Ofgem's specific questions below in the order in which they appear in the next steps section of the open letter.

Q1. What are the key aspects of the Target Model for GB?

Firstly, the greatest impact on the UK will be the coupling of day-ahead and intra-day markets to the rest of Europe. These are initiatives which we greatly welcome as they will facilitate cross border trading by removing barriers to interconnector capacity.

Secondly, and given the problems associated with the Cheviot boundary, we feel that market coupling/splitting provides a real opportunity to consider a separate market for Scotland and transfer the costs of constraints into the day-ahead market. We therefore welcome the binding requirement on National Grid Electricity Transmission plc (NGET) to propose, and for Ofgem to consider, the merits of separate price zones to manage internal constraints in GB more efficiently.

All other aspects of the target model are of significantly lesser importance.

Q2. What changes will be needed to GB market arrangements?

The major requirements are a) to ensure that the current market coupling arrangements are appropriate i.e. review whether Scotland should be a price area in its own right and b) to ensure that the day-ahead and intra-day market exchanges are linked to a European counterparty.

It has been suggested that there may be implications for the BSC because of gate closure and market splitting. We are not convinced that the implications are that great. Firstly, our understanding is that gate closure can remain at 1 hour. Secondly, as far as market splitting is concerned, the price zones need only affect the day-ahead and intraday exchange markets which are, indeed, voluntary markets. Clearly the interactions need to be investigated further but it should be from the position of asking whether change to the domestic arrangements is absolutely necessary.

There will be some implications for Ofgem's oversight of NGET's revenues, incentives and charging methodologies; the monies transferred to the TSOs for the value of constraints will need to be removed from the BSUoS element that NGET charges its customers.

Q3. Should we try and minimise change or consider holistically the best combination of GB and EU requirements?

On the whole we feel that change should be minimised. There is a clear distinction between issues that are related to cross border trade and those which are not. The EU Target Model does not justify making changes to those in the latter category.

Q4. How can we deliver the best outcomes?

We believe that incremental change is more beneficial than massive interventions which are not needed at this point in time. We would be wary of anticipating change from Europe which could potentially lead to costly reverse changes in future.

Rather than attempting to effect grand change Ofgem needs to ensure there is joined-up thinking across the board to make sure separate initiatives do not conflict with one another.

Q5. What process is needed to take this work forward?

NGET are already comparing UK arrangements with those in Europe under the JESG and the processes for certain elements are already in place. For instance, there is already a binding requirement on NGET to propose, and for Ofgem to consider, the merits of separate price zones to manage internal constraints in GB more efficiently and as the 3rd package legislation takes precedence over UK's there is no need to recreate these obligations.

We would also highlight that market coupling is already underway, as apparent in the appointment of Nord Pool Spot to develop and operate a 'virtual hub' to facilitate the full participation of the GB electricity market in the North West European (NWE) market coupling project. As the NordPool Spot website states this will allow GB traders to continue their usual contractual relationship with their power exchange whilst gaining access to interconnector flows. The virtual hub will facilitate the pooling of GB liquidity and the formation of a common reference price for electricity across all participating GB power exchanges by the end of 2012, in line with the objectives of the NWE project.

It will be necessary to ensure that the integration of market information from the exchanges is brought about and the linking to a European counterparty so that money can flow where there are cross border price differentials. However, we

would anticipate these changes being co-ordinated at a European level, with perhaps an on-going overseeing role for Ofgem.

As already stated some analysis needs to be conducted as to whether the BSC arrangements would need to change in the event that there is a split of the market. However, this should be done as part of the process when National Grid Electricity Transmission plc (NGET) propose the merits of separate price zones to manage internal constraints in GB more efficiently.

Should you wish to discuss any aspect of this matter, please do not hesitate to contact me.

Yours sincerely,

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