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Dear Martin,

**Response to open letter: Implementing the European Electricity Target Model in Great Britain**

SSE welcomes the chance to offer our views on the implications for GB on the EU Target Model and we are pleased that Ofgem is taking a proactive role in this.

Overall we believe that the GB and other EU countries have much to gain from harmonising in line with the EU Target Model. However, there are some significant risks for GB. Our direct responses to the questions raised in your letter are attached in the annex but we would like highlight the following key points:

- **The process for delivering the network codes is currently flawed and is not democratic.** The key problem here is that ENTSO-e is responsible for drafting the codes and yet they are not impartial and have their own commercial interests. As we have already seen with the Requirement for Generators (RfG) and Demand Connection (DCC) codes this will lead to biases where costs and risks are loaded onto generators, suppliers and other market players and away from TSOs. There has also not been sufficient opportunity for non-TSO stakeholders (e.g. generators, suppliers and distribution network operators (DNOs) to actively input into the development of these industry codes and we are concerned that once at comitology stage, there will be little, if any, scope to amend the codes before they become law;
- **Ensuring overall market efficiency with regard to bidding zone configuration.** The current (23<sup>rd</sup> March) version of the CACM code emphasises that bidding zones should be set according to where congestion lies. However, this misses two key points: (i) that congestion can be and is being dealt with efficiently through re-dispatch markets and efficient, approved, network investment and (ii) large and stable price zones are extremely important in delivering liquidity, competition and investment; and

- **To fully realise the benefits of market coupling, developing continuous intraday coupling is key.** In particular there is likely to be a significant trading benefit for GB and Ireland from continuous intraday trade as wind penetrations increase in both markets. Therefore it is important that reform of the Single Electricity Market (SEM) allows for continuous intraday coupling.

If you have any questions or require more information on any of these issues please do not hesitate to get in touch.

Regards

Will Steggals

## Annex: Responses to questions raised in the Open Letter

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

From SSE's perspective, there are three key aspects of the Target Model for GB:

*i) Achieving market coupling at both day-ahead and intraday level.*

The key source of benefit from harmonising markets will come from improved efficiency of cross-border trade as a result of market coupling. Therefore, the key focus for GB should be on ensuring our day-ahead and intraday markets are fully coupled with all neighbouring countries with whom we have (or are planned to have) interconnections. Intraday coupling is clearly less advanced than day-ahead but we believe there are significant gains to be had from intraday trading in helping to manage variations in demand and generation, such as in wind output, over this timescale.

There are significant gains to be had from coupling GB with the All Ireland SEM and clearly there are major reforms that will be needed in the Irish market to allow this on both day-ahead and intraday timescales.

*ii) Bidding zones*

The prospect of splitting GB into bidding zones is probably the largest potential disruption to the GB market that could result from the EU network codes and the CACM in particular. It should be resisted because:

- **there are no clear benefits in terms of congestion management from market splitting.** We believe the current re-dispatch market in GB in conjunction with efficient infrastructure build is effective in minimising congestion costs and the only significant effect of zonal pricing would be to move congestion costs away from TSOs onto generators with no net gain to end consumers. There is also no evidence that our current congestion management system is imposing any costs on other neighbouring countries (as is being argued, for example, is the case in Germany). Moreover, it is important to keep congestion costs in context. They currently represent around 50p/MWh supplied in the GB market and the scope to reduce this through zonal pricing is highly questionable;
- **there are very clear costs and damaging effects that would result from market splitting.** Moving to smaller price zones would be a fundamental change to market arrangements and to transmission access rights. It would also seriously undermine liquidity and competition in the GB market. Moreover, the damage to investor confidence of sudden changes in the value of generation assets resulting from market splitting would be large and there would be other major transition costs (e.g. unwinding of contracts between generators and suppliers as well as those between suppliers and end consumers).

Prices in small zones are also likely to be more volatile and unpredictable - again damaging much needed investment in renewable and other low carbon generation. Allocation of grandfathered Financial Transmission Rights could help mitigate some of these risks but this would create its own complexities and barriers to entry.

The GB market already has locational transmission use of system charges which are disproportionate, difficult to predict and which discriminate against renewables. Whilst change may be forthcoming through Project TransmiT that should ameliorate some of the detrimental effects of the current ICRP methodology, having two overlapping locational signals (the current ICRP based TNUoS regime and the possible multi-zone GB in a 'CACM world') would be distorting, overly complex and disproportionately penalise renewables.

For all these reasons it is important that NRA's (such as Ofgem) retain the discretion to define price zones in this, and future iterations of, the CACM code and that the GB market can continue to operate as a single price zone.

Furthermore, in respect of the bidding zone configurations, we find it perverse that some participants at the 30<sup>th</sup> April workshop on the Target Model were advocating that GB be split into two zones, namely Scotland and England & Wales whilst at the same time arguing that no other zones should be formed in GB.

We find it very hard to accept the argument that Scotland; which on its own equates to circa 10% of GB demand and circa 15% of generation capacity; would be of sufficient size particularly in terms of liquidity, to be a bidding zone on its own whilst other parts of GB, be that (i) an area south from the B6 ("Cheviot") boundary to B9 ("Midlands") boundary area or (ii) the Thames Estuary are not - even though both, on the face of it, are larger in terms of both demand and generation than Scotland. In our view, given the planned HVDC link(s) and other developments on the GB transmission system, the current constraints associated with the Cheviot boundary should decline significantly by the time the suite of European Network Codes come into effect towards the middle/end of the second half of this decade. Therefore it does not, on initial examination, appear appropriate to just create a Scotland (only) zone whilst the rest of GB remains as a single zone.

A similar argument would also apply to the SEM where creating a "Northern Ireland" price zone would create a zone with very limited liquidity and competition and be highly undesirable.

### *iii) Balancing markets*

Harmonising balancing markets is potentially a highly challenging area. National balancing markets are likely to have products that are well-tailored to their specific markets. However this may be in conflict with the desire to trade balancing services which is better facilitated through standardised products. The compromise solution may be to standardise some key traded products whilst still allowing some important, nationally-specific products.

TSOs should only be able to trade balancing services on unallocated interconnector capacity. In line with the current draft Balancing Framework Guideline, TSOs should not be able to 'hoard' interconnector capacity that market players would otherwise be able to access and use more efficiently and economically. If continuous intraday

market coupling is successfully implemented, there will be less need for balancing markets in any case.

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

Given that GB already has functioning day-ahead and intraday markets there should be limited change required for GB to be compliant with the Target Model (providing these exchanges can be successfully coupled via the GB Hub initiative). There may be some changes required in balancing markets to ensure efficient trade with neighbouring countries can take place (e.g. some standardisation of ancillary service products) and GB will also need to ensure its gate closure periods and market units are appropriate (although an intraday gate closure of one hour and a market unit of a half-hour appears to be the likely standard for Europe and therefore no change will be needed in GB).

To realise the benefits of market coupling the bigger changes will be needed in other markets, particularly those which operate under central dispatch. On this note we believe there is significant mutual benefit to be gained from achieving continuous intraday market coupling with the All-Ireland SEM market (e.g. in managing intraday variations in wind output). However, unless the SEM becomes a bilateral, self-dispatch market this will be difficult / impossible to achieve.

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

It is important that GB does consider the requirements holistically and is 'forward-looking' as to potential future requirements. As a principle, we should ensure any future changes and amendments to the GB market are consistent with the Target Model and that all reforms (e.g. EMR) are 'future-proofed' to be able to cope with foreseeable changes from Europe.

A good example of this is the design of renewables support. To allow efficient market coupling it is important that renewables (and other low carbon generation) are exposed to market prices. However, the 'Contract for Differences' (CfDs) currently proposed by DECC reduces exposure to market signals. Many countries and organisations in Europe have recognised that Premium FITs are much more consistent with integrating EU markets and this is the support system the UK should be adopting. If Contracts for Differences (CfDs) for low carbon generation are to be pursued they must be robust to any future changes in price zone configuration (however undesirable this may be).

We also need to understand the welfare impacts for customers of implementing the Target Model and establish how Ofgem can deal with any conflicts here (e.g. if trade with a high price country is enhanced, GB customers may see higher prices even if overall European welfare is improved).

## **4. How can we deliver the best outcomes? What process is needed to take this forward?**

We have a number of suggestions here:

- Ofgem/DECC could conduct a review of areas where existing (and anticipated) GB market arrangements may not be compliant with the Target Model. Following on from this they could consult on what measure should be adopted to address these areas of potential non-compliance;

- It is also important that the development of processes needed to implement the CACM code (e.g. data exchange) start now, ahead of the codes coming into force, particularly in areas where new IT systems may be needed;
- To help address the issue of a lack of industry representation in the development of the European Network codes by ENTSO-E, a non-TSO forum could be introduced with review powers over codes; and
- Ofgem should continue to hold regular events on the Target Model - the most recent event on 30<sup>th</sup> April was extremely valuable.