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April 12th 2013

Dear Guiseppina,

Future Trading Arrangements Design project

Thank you for the opportunity to provide views on the Future Trading Arrangements project. We agree that trading arrangements will need to evolve in the coming years to accommodate changes in the market environment. We also recognise that the regulatory process for dealing with such changes would benefit from more central coordination and a more holistic perspective. However, we are not convinced that the best way of managing these changes is to launch a one-off review to develop an entirely new design for the market. Instead, we suggest that Ofgem sets up a clear process for addressing these issues in a more continuous and incremental manner. The remainder of this letter summarises our views on the questions set out in Ofgem's update letter.

1. Do you agree Ofgem should launch a project to create a high level design for the future electricity trading arrangements?

The challenges faced by the market are reasonably well identified – the main objectives are to incorporate a large share of intermittent generation, to support demand-side response, and to maximise opportunities for cross-border trading. These challenges are already being considered in a number of regulatory processes, notably the Electricity Balancing Significant Code Review (EBSCR), the Smarter Market programme, and the EU network codes. These processes have complex interactions with other policy initiatives, especially with EMR, and they operate on different timeframes. If there are any 'gaps' in these initiatives, these would be better addressed through incremental changes implemented in a timely manner, rather than a complete redesign of market arrangements. Given the complexity of the changes involved in the transition to a low carbon power sector, trading arrangement will need to adapt to the new environment progressively. We doubt that it would be possible to identify a precise 'end-state' for trading arrangements in a one-year review.

For these reasons, we recommend that Ofgem take a different approach to this workstream, focusing on two objectives.

- The first objective would be to clarify the governance arrangements and the allocation of responsibilities for managing changes in market design. At the moment, the ownership of these issues is unclear. For example in 2012 Ofgem initiated the EBSCR while DECC coordinated an evaluation of the future challenges facing the electricity system, including a study of balancing issues. Ofgem should set up a more coherent framework for managing future changes. For example, Ofgem could propose the establishment of a new body responsible for overseeing changes in trading arrangements with representatives from Ofgem, DECC, and industry. This body would be responsible for identifying priorities in regulatory change and allocating responsibilities for finding solutions and implementing changes.

- The second objective would be to identify possible gaps (or inconsistencies) in current regulatory processes dealing with trading arrangements. These gaps would then be addressed incrementally when the timing is appropriate. This gap analysis could be refreshed on an ongoing basis, say every one or two years, and linked with a work programme for the industry.

2. What key issues should be examined as part of a work stream on future GB trading arrangements?

The first deliverable of this project should be a clear analysis of the gaps in current regulatory processes, ie significant issues in trading arrangements that are not already being addressed by ongoing reviews. While we do not have any firm views on what these gaps will be, we expect that it might be worth examining the way the system operator (SO) purchases balancing services and reserves in the market, and notably the way in which the SO can use offers from resources located in adjacent markets under the EU Target Model. The need for balancing services is expected to grow considerably over the coming years, so the industry needs to ensure that the current systems are fit for purpose. This analysis will also have to examine the implications of the changes introduced as part of the EBSCR.

In order to reduce uncertainty, we recommend that Ofgem pre-commits to maintaining the fundamentals principles of NETA, notably the principle that generators can ‘self despatch’ their plants based on market signals, and the principle that market participants can trade power bilaterally on the platforms of their choice. We believe that reopening these principles would create significant uncertainty without any substantial benefits.

3. What form should the process take?

The governance arrangements for this process would need to include:

- a new body responsible for overseeing changes in trading arrangements (for example a steering board with representatives from Ofgem, government, and industry);
- clear governance rules designed to encourage collaborative working and clear responsibilities;
- pre-defined outputs (for example a ‘gap analysis’ and a forward-looking work plan updated on a regular basis).

Some of the changes identified as necessary through this process could be implemented through the industry’s normal process (eg significant code reviews, code modification, etc).

I hope that these comments are useful. Do not hesitate to contact me if you have any question.

Yours sincerely,

By e-mail

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