

Rachel Fletcher
Partner, Wholesale Markets
OFGM
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16th April 2013

Attn: Rachel Fletcher
Partner, Wholesale Markets

Dear Rachel,

Open Letter Electricity Balancing Significant Code Review and proposed project Future Trading Arrangements

Energy UK is the Trade Association for the energy industry. Energy UK has over 70 companies as members that together cover the broad range of energy providers and suppliers and include companies of all sizes working in all forms of gas and electricity supply and energy networks. Energy UK members generate more than 90% of UK electricity, provide light and heat to some 26 million homes and in 2011 invested over £10 billion in the British economy.

Energy UK is pleased to respond your open letter of 18th February 2013 regarding the status of your Electricity Balancing Significant Code Review and following your Future Trading Arrangements meeting of 25th March 2013.

We note that the scope of the work to be considered within the Electricity Balancing Significant Code Review process has been reduced and welcome this move. The initial list was too wide given the amount of change currently under discussion within the broader energy arena primarily to deliver Electricity Market Reform and European Third Package initiatives.

It is important that Ofgem is clear that this is an exercise to identify the gaps and develop an ultimate Road Map for delivery of Government and EU agreed Policies. Investors will become nervous if this project looks in danger of extending its remit. Ofgem's role in the process should be to determine:

- How DECC's institutional arrangements work can be implemented in a way that complements other industry initiatives, whilst remaining consistent with the outcome of Electricity Market Reform developments;

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- How incentives to maintain and invest in new capability introduced via changes to the GB market design can be developed in a way that does not interfere with the incentives introduced by the EMR proposals;
- How changes that result from the EU Target Model can be introduced in a way that is least-disruptive to the GB market, defining clear responsibilities for national decisions and how industry will be consulted on such decision processes.

Should this Ofgem project be established it should focus on providing greater certainty to market participants, not increase uncertainty regarding our future energy strategy. This can be achieved by ensuring Ofgem:

- considers the identified issues holistically,
- guarantees that it does not to "reinvent the wheel" by interpreting Government policy that has been over two years in the making, in a manner that results in an outcome different to that which was understood to be the intention; and
- confirms that issues such as, for example, the integration of renewables, incentives to maintain and invest in new capability and institutional arrangements, are considered as implementation issues for Ofgem at the end of the EMR process and not independent development work-streams.

It is important to be clear on the Governance arrangements for this project. Industry will be looking for transparency and inclusivity for all impacted parties and clarity about the roles and responsibilities of BIS/DECC, Ofgem and the industry is required. Energy UK would happily input to development of the project governance process, including the establishment of the technical working groups which will be required. We would urge that any working groups include a range of participants and that trade associations such as ourselves have the ability to source more and specialised views from their members as appropriate.

Ofgem should also take time to explain the proposed treatment of any issues identified by its gap analysis. Industry will take comfort from understanding its role in any problem solving phase.

You requested views on three specific areas:

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

Members agree that with so many energy related initiatives there is a need to take stock and ensure that the proposed outputs do indeed deliver appropriately against Government Energy Policy Objectives. There is clearly a need for a degree of 'joined up thinking' which should include opportunities for significant input from BIS/DECC and the wider industry. An initial scoping exercise to clearly identify potential problem areas to be included is a must and this should aim to prioritise and identify areas

demanding early action. However, this should be taken into consideration current industry initiatives and be adaptable in light of ongoing UK Government and EU Policy developments. There will be a fine art in balancing what could be a wide variety of options to ensure that the UK Government Policy will be delivered, and not to change the intent or design of that policy.

Buy in and agreement across UK Government and the stakeholder community is crucial to ensure a successful outcome and will probably work best if some form of Project Board and Expert Groups are appointed to engage in the project going forward. Transparency and inclusivity will be at the heart of the initiative and we appreciate the sentiment behind your statement that you 'are seeking to build consensus and provide clarity' through this exercise.

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

You highlight seven issues for potential consideration, comprising:

1 The increase in the number of renewable projects onto the transmission and distribution Networks provides a variety of options for full integration within the existing or future trading arrangements. This should be assessed against options for the creation of a separate market;

2 SMART developments should encourage increased activity in relation to Demand Side Response. This may be an issue to address as this project evolves rather than one for immediate concern as there is still much to do with regard to the design of the future SMART arrangements;

3 Efficient balancing and system operation within GB should be regularly reviewed and not just an item for this proposed project. Technological improvements mean there may often be better ways to balance and operate the Networks;

4 The effective integration with the wider European market is important. To that end we must have early clarity regarding the impact on the wide ranging initiatives emanating from Europe. In particular the treatment of the vast array of Third Package Network Codes including the potential for market splitting. An early understanding of how Ofgem intends to undertake its wider role as National Regulatory Authority would be most helpful;

5 It is the intention to ensure that incentives to maintain and invest in new capability be delivered within the EMR. Care will need to be taken that any agreed UK Government policy is clearly implemented and not reopened or rewritten by this SCR;

6 It is forecast that there will be increased investment in gas generation and as such it is important to identify where there are clear interactions between the gas and electricity arrangements; and

7 It is clear that the wide variety of proposed change will impact the current institutional arrangements. The DECC EMR program is currently assessing the preferred design going forward and Ofgem should facilitate delivery of the agreed policy framework.

In addition to the list above you suggest that the initial principles which were at the heart of the New Electricity Trading Arrangements (NETA) may need to be adapted or extended to better reflect the current need for electricity prices to reflect scarcity and risks to security of supply.

As a starter for ten the list would appear comprehensive, albeit that any proposals for change should be restricted to reflect the minimum necessary change required to ensure delivery given the extent of the wider current developments.

An explanation of where the Electricity Balancing Significant Code Review process maps across into this one would also be useful.

3. What form should this process take?

The scope, timeline, project milestones and associated deliverables together with a detailed engagement process must be clear at the time of the project launch with adequate checks and milestones included to ensure against scope creep.

This must also include an honest assessment of resource requirements from BIS/DECC, Ofgem and the wider industry, including independent suppliers and generators, in order to appropriately populate whatever project management framework Ofgem proposes to establish. Transparency and inclusivity are fundamental prerequisites to success. Given the raft of ongoing developments this may mean the project runs for longer than initially envisaged simply due to lack of resource availability.

We would appreciate some clarity around the timing of the project. Is it right to assume that the next phase of this SCR will not commence until after the Energy Bill has completed its passage through Parliament and the finer detail of the EMR design has been agreed or even bedding in? Or does Ofgem envisage an early problem identification stage which could conclude rapidly, with the potential for any issues deemed to be urgent being addressed quickly and timed to address imminent policy developments such as the first capacity auction and CfD price setting, which are scheduled to take place in 2014?

Finally it will be important to ensure that this UK review takes full account of, and does not conflict with, the changes emerging from the ongoing development of the European

Network Codes such as those for Balancing, Forward Capacity Allocation and Capacity Allocation & Congestion Management.

We look forward to further updates regarding next steps. Should you require any further information or wish to meet with our members to discuss this further then please feel free to contact me on 0207 747 2925 or 07736 107 020.

Yours sincerely

Barbara Vest
Director of Generation