International
ESBI Energy Innovation

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Dear Ofgem GB Markets Team

Ofgem proposed Future Trading Arrangements Design project

Introduction to ESBI

ESB International (ESBI) is a wholly owned subsidiary of ESB, Ireland's premier power utility. With increases in physical interconnection, in particular the commissioning of the East-West interconnector last year, coupled with the further development of the regional market, our operations in Ireland will become increasingly linked with the GB market. In the All-Islands Market context, we will be a medium sized player and increased GB gas generation investment is core to our corporate growth strategy as the All-islands becomes our home market. To this end, ESBI is responsible for the identification and development of power generation investment opportunities in the All Islands energy market. ESBI has been a developer and operator of independent Combined Cycle Gas Turbine (CCGT) generation projects in the GB market for almost 20 years. To date we have invested over £1.5 billion in UK generation assets and are developing further large-scale CCGT projects at other locations across GB.

We are the only company to have announced new-build CCGT investment in the UK in recent years, having reached financial close on our 860MW CCGT development at Carrington in September 2012. Construction is underway with a commercial operation date of early 2016. We are also developing a 1500MW CCGT at Knottingley in Yorkshire.

ESBI response

ESBI welcomes the opportunity to comment on Ofgem's proposed project to review and reform trading arrangements and participated in the industry roundtable that took place on the 25th March. The roundtable provided a much needed opportunity to obtain a better understanding of Ofgem's objectives and indicated that work had progressed further since the publication of the open letter of 18th February. We would like to make the following points in response to the issues raised in the letter and during discussions at the roundtable.

Electricity Balancing Significant Code Review (EBSCR)

ESBI welcome the progress Ofgem has made under the Electricity Balancing Significant Code Review (EBSCR) to define the scope of the review and better specify its 4 main primary considerations and 3 secondary considerations. However, we have concerns over Ofgem's limited engagement with industry in developing these proposals. We therefore urge Ofgem to increase its level of engagement to allow a broader group of participants to input before the draft policy decision is published.

With the developments taking place under Electricity Market Reform (EMR), particularly the Capacity Mechanism, the work being undertaken under the EBSCR will be critical to ensure that the market and associated policy interventions work together to effectively deliver efficient and enduring security of supply. It is critical that the EBSCR is completed and implemented in time for the first capacity auction in 2014. In addition, it is important that foresight of the enduring regime is provided at the earliest opportunity to facilitate generators' bids in the first auction.

ESBI Investments is a trading name of ESB International Investments Limited.

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High level design for the future electricity trading arrangements

As identified in the open letter there are many changes and policy developments occurring at a national and European level which will impact the GB electricity market and undoubtedly have impacts on the enduring trading arrangements. Whilst we agree in principle that there may be a need to ensure that there is consistency between the various workstreams, we are not convinced that this requires a review and possible fundamental reform at this stage in the process.

ESBI believes that a project on future trading arrangements may be required at a later stage. We suggest that Ofgem be minded to consider a more holistic piece of work once the many policies under development are implemented and the impacts of the EU target model are more clear.

We believe that work conducted prematurely i.e. prior to on-going market reforms being fully developed, will increase investor uncertainty and further undermine confidence in the market at a time when the opposite is required to ensure energy policy objectives are met.

Key issues in relation future GB trading arrangements

As we have explained above it is premature to identify conflicts and issues at this stage in the development of various policies. Of the issues specified for review in Annex 2 of Ofgem's letter, most are being addressed as part of the Government's EMR process. Industry and investors have been led to believe that: improving signals for demand side response; incentivising new capacity; and the better integration of renewables are all primary or secondary objectives of EMR. We are therefore surprised that Ofgem would choose to review current trading arrangements against these objectives at this stage. For example, Government is legislating to introduce a capacity market that will remunerate reliable generation capacity to ensure sufficient supply margins in the future. We therefore do not believe Ofgem should be undertaking a project to deliver similar incentives until the Government's work is complete and the final form of the capacity market is known.

We agree that there should be a process of review and possible reform post-EMR to ensure investment signals are as intended and that the market operates as efficiently as possible. The general areas identified in Annex 2 appear an appropriate starting point for such a review but we would reiterate that this should only be done at a time when other policy reforms have been completed or their outcomes more fully understood. In the meantime, we urge Ofgem and the Government to provide assurances to investors that the reforms and signals being introduced under EMR will not be changed by the results of the work proposed under this project. Without these assurances, investment will not be forthcoming and energy policy goals will not be met.

We therefore suggest that Ofgem become more closely involved with that work, and that DECC, and Ofgem look to identify a more robust and transparent way of working together and call on industry for support where appropriate rather than create a whole new project unnecessarily . We provide detail in relation to each of the issues below.

- *Integration of renewables* **–** Whilst we agree that the effective integration of renewables places a major challenge over the period to 2020 and beyond, we do not believe that further individual focus for renewables is needed within the proposed project. Initiatives such as the forthcoming Contracts for Difference incentive mechanism under the Electricity Market Reform and particularly DECC's work on Power Purchase Agreements and Route to market are focused primarily on the integration of renewables in the electricity market. Duplication of work in a different arena will only cause confusion and uncertainty.

- *Facilitating demand side response* **–** We recognise that the current market structure is not designed to integrate Demand Side Response. However, and once again, we would reiterate that work looking at the area is already being undertaken within the Capacity Mechanism under the Electricity Market Reform, indeed the Energy Efficiency Deployment Office in DECC which has a project dedicated to demand reduction and management has left DECC's Capacity Mechanism team to lead on this area to avoid duplication.

- *Efficient balancing and system operation* **–** We strongly agree that efficient system operation and balancing should, wherever possible, be supported by the market and trading arrangements. In addition, we agree with Ofgem's view that the changing nature of generation in GB will lead to increased system balancing costs in the future. We believe there is merit in Ofgem looking again at how these costs are managed and recovered but are mindful of Government's previous statements that balancing costs should not be subject to locational recovery. We would welcome any further views that Ofgem has on this area, in advance of decisions to undertake any significant work/reform of the balancing arrangements.

- *Effective integration with the wider European Market* – We agree with Ofgem's assertions that there will need to be work done to ensure the trading arrangements are compatible with the enduring European market structure. However, in light of the many unknowns – including European work on the 2030 framework for climate and energy policy, and nine detailed network codes currently underway that will affect the domestic level electricity market arrangements as well as cross-border rules – we are strongly of the view that it would be premature for Ofgem to undertake work in this area now.

- *Incentives to maintain and invest in new capability* **–** We believe that further work to look at incentives to invest in new capability may be premature at this stage. Forthcoming changes must be allowed to come into play before an assessment as to whether further work is needed is conducted.

- *Interactions with gas arrangements* **–** DECC last year published its strategy on gas generation and initial views on improving future gas security of supply. The strategy already usefully outlines the policies that will support investment in new gas plant and ways in which indigenous gas storage could be better incentivised. Industry currently awaits Government's further thinking on improving gas security of supply. We note that Ofgem is part-way through its Significant Code Review (SCR) process to reform the gas cash-out regime. Industry has raised a number concerns over the interactions between the signals emerging from gas SCR and the various incentives/penalties in the proposed capacity mechanism and electricity SCR. We would urge Ofgem to be mindful of these interactions and ensure that different interventions do not create conflicting incentives.

- *Institutional arrangements* **–** Work has started to develop the institutional arrangements that will be required to implement and then manage the various policy strands of EMR. We believe that Ofgem should continue to work closely with DECC, NG, and Elexon (BSC) to ensure these arrangements are effective and that further changes are not required until they are known and tested.

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Process

We suggest that Ofgem approaches the proposed project as a 'gap analysis' once policies are fully developed and implemented rather than start a process to develop 'a high level design' at a time when so much change is occurring. Any project should ensure that the resulting incentives are as intended and consistent with those inherent in the market interventions being introduced as part of EMR.

We would urge Ofgem to adopt a broad approach to stakeholder engagement with industry on any steps to progress with this project. ESBI has experience of participating in the DECC's Electricity Market Reform expert groups. Whilst this process has been valuable a broader more inclusive approach to engagement – drawing on the expertise of many industry participants would perhaps have been beneficial to the development and help identify any gaps or conflicts within the proposals.

Should you wish to discuss any of the points raised in this response further, please do not hesitate to contact me.

Yours sincerely,

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