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Rachel Fletcher
Wholesale Markets
Ofgem
9 Millbank
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12th April 2013

Dear Rachel Fletcher,

Re: RES Response to Update on the Electricity Balancing Significant Code Review (EBSCR) and request for comments on proposed new process to review future trading arrangements.

RES is one of the world's leading renewable energy developers working across the globe to develop, construct and operate projects that contribute to our goal of a sustainable future. We have a portfolio of low-carbon energy technologies and a range of services which together can meet demand from the industrial, public and commercial sectors on whatever scale.

RES has been an established presence at the forefront of the wind energy industry for over three decades. Our core activity is the development, design, construction, financing and operation of wind farm projects worldwide. RES have developed or built almost 7GW of wind energy worldwide and we have several thousand megawatts under construction and in development, we continue to play a leading role in what is now the world's fastest growing energy sector. RES is also involved in the dedicated biomass, solar, offshore wind, wave and tidal sectors.

RES welcome the opportunity to respond to Ofgem's update on the Electricity Balancing Significant Code Review (EBSCR) and request for comments on the proposed new process to review future trading arrangements. We hope you take our comments into consideration. The key points to note in our response are outlined below:

1. We welcome this project to create a high level design for the future electricity trading arrangements and support the overall aims of the project. The market has changed a great deal since the implementation of NETA and additional changes will become apparent going forward. The current GB electricity market is structurally biased against renewables and was not designed with the necessary levels of renewable energy deployment in mind.
2. We specifically welcome the recognition that the review will consider the integration of renewables and that "it is key to ensure that future trading arrangements ensure appropriate routes to market to renewable generation"¹. However, this review must be in addition to, and not detract from, DECC's current route to market work which is being undertaken now. There is a pressing need to resolve the route to market issue now and we fully support the Green Power Auction Market (GPAM) proposal to enable independent generators to find a route to market.

3. The treatment of renewables should be the first key issue examined as part of a work stream on the future GB trading arrangements as outlined in the consultation. The integration of renewables is vital to meeting the UK Energy Trilemma: renewable energy targets, security of supply and lowering costs to consumers.
4. To limit any unintended detrimental effects on investor certainty, the timing of the review is vital, timescales need to be clear and adhered to and the review needs to be transparent. To provide additional certainty Ofgem must establish clear project principles and objectives from the outset.

RES are grateful for the opportunity to comment and look forward to Ofgem's decision and further details on the EBSCR and the proposed new process to review future trading arrangements. We hope you take our comments on board and welcome any further contact in relation to this response, please contact myself at Sarah.Husband@res-ltd.com or on 01923 299 454.

Yours sincerely,

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

- **If not, why not and how would you see the changes to the industry noted above being managed?**

We agree that it is valuable for Ofgem to launch a project to create a high level design for the future electricity trading arrangements and support the aims of the project. We support the review being launched at this time. The current GB electricity market is structurally biased against renewables and was not designed with the necessary levels of renewable energy deployment in mind, as acknowledged in the consultation: “the existing trading arrangements, dating back to the NETA implementation in 2001, were not designed primarily with the integration of renewables in mind”¹. We specifically welcome the recognition that the review will consider the integration of renewables and that “it is key to ensure that future trading arrangements ensure appropriate routes to market to renewable generation”¹. However, this review must be in addition to, and not detract from, DECC’s current route to market work which is being undertaken now. There is a pressing need to resolve the route to market issue now and we fully support the GPAM proposal to enable independent generators to find a route to market. We discuss this in more detail in response to question 2 below.

We support the commencement of this project and some of the preliminary issues identified in the consultation, this is discussed in more detail in response to question 2 below. However, a review conducted at this time during the Electricity Market Reform (EMR) transition may not yield the correct results. While the EMR is still being developed and established, caution is needed as areas in which there are issues at present may iron out as the EMR develops. For example, preliminary issue 5, “incentives to maintain and invest in new capability”, may be resolved through the Capacity Mechanism. Regular reviews should make these areas clearly identifiable. It is important this review does not regulate over an existing policy which is just becoming established.

The title of the review “proposed future trading arrangements” does not correspond with the preliminary issues identified. The issues represent market arrangements on the periphery and not trading directly, the title is misleading. The title is also too grand considering that it stated in the consultation that “many of the existing features of the trading arrangements and the principles underlying them are expected to remain fit for purpose.”

Project Drivers

We support Ofgem looking at the electricity market holistically and conducting this review of future trading arrangements. The market has changed a great deal since the implementation of NETA and additional changes will become apparent going forward. We support the implementation and timing of this review to ensure we are as prepared as possible for future market developments.

Ofgem state in the consultation that a key driver in opening this review is to avoid: “the alternative of postponing consideration of potential changes to the market design until the current arrangements are demonstrably no longer fit for purpose”¹. However, the consultation goes on to say that: “it should be emphasised that we do not envisage that establishing a long term vision for GB electricity trading arrangements will involve a radical departure from the current market design” and that “many of the existing features of the trading arrangements and the principles underlying them are expected to remain fit for purpose”¹. Therefore, the value of the review will be limited if it is constrained from the outset. We do not support limiting the review in this way, to realise the full value of the review the willingness to implement changes needs to be adopted from the outset.

It is stated in the consultation that one of the drivers for commencing this new project is that: “Investors are starting to commit to projects as the investment environment under EMR becomes clearer”¹. We would disagree that the EMR has reached this point. There are many investor issues to be resolved in relation to the EMR, particularly the ability for independent generators to obtain investment for their projects under Feed-in Tariff with Contracts for Difference (FiT CfD).

Another driver for this project which is presented in the consultation is that: “to meet binding EU legislation that mandates sudden changes may prove more disruptive to investors in the medium term”¹. It would be beneficial for GB to align with the incoming EU legislation as swiftly as possible. Finally it is argued that: “developing a long term vision for the GB trading arrangements will build on the known features of the EU Target Model (TM), while providing an opportunity to influence further harmonisation measures”¹. We agree that this project could provide valuable input to the EU TM work stream.

Alternative

Additionally, regarding the EBSCR it is also stated in the update letter that “the risk of undoing the reforms that we intend to pursue at this stage is limited”¹. However, the risk will remain. It is also stated in the consultation that concern has been raised by several stakeholders that “a holistic approach is required to consider the strong interactions between the multiple drivers of change in the electricity market”¹. But although stakeholders have stated this and this is acknowledged in the consultation, Ofgem still intend to carry on with the EBSCR in isolation from a completely new project on the future trading arrangements design. Conversely, we suggest that the EBSCR is absorbed in the new future trading arrangements design project.

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

- **We welcome specific comments on our initial thoughts set out in Annex 2.**

1. Integration of Renewables

The treatment of renewables should be the first key issue examined as part of a work stream on the future GB trading arrangements as outlined in the consultation. The integration of renewables is vital to meeting the UK Energy Trilemma: renewable energy targets, security of supply and lowering costs to consumers. Improving the trading arrangements to develop a market more suitable to the current and future energy mix is welcome, in particular the electricity market needs to work for intermittent renewable generation. As discussed above the GB electricity market was not designed for renewables and therefore their full benefits are difficult to realise. The changes outlined in the consultation to improve the ability for generators to trade closer to real time would be beneficial to all generators and would even align with facilitating demand side response. We would like to see consideration of the efficient integration of renewables into the GB electricity market arrangements.

Conversely, under the current EBSCR some proposals such as the consideration 1 (more marginal main cash-out price) and consideration 6 (improved allocation of reserve costs) have a specifically detrimental impact on wind and intermittent renewable generation which will lead to an adverse impact in terms of the cost they incur. The sharpening of cash-out prices will not benefit independent market participants with small portfolios, particularly intermittent renewable generators in the illiquid GB power market. At present the vertically integrated nature of the market and lack of liquidity means we require PPAs with one of the Big Six suppliers in order to secure project finance for our developments. If cash-out prices become more marginal it will increase the cost of balancing which will be reflected in the PPA terms offered to us which may impact our ability to secure project finance. Furthermore, improving the allocation of reserve costs may lead to volatility in the balancing mechanism and a negative impact on wind generation. For example it may be that more of the reserve costs are apportioned to the times of low wind generation, this would increase the cost and therefore the risk of balancing intermittent renewables.

However, to integrate renewables more radical changes to the future trading arrangements may be needed and the consultation outlines the lack of appetite to implement significant changes: “many of the existing features of the trading arrangements and the principles underlying them are expected to remain fit for purpose”¹. Furthermore, as discussed above, this review must be in addition to, and not detract from, DECC’s current route to market work which is being undertaken now. There is a pressing need to resolve the route to market issue now and we fully support the GPAM proposal to enable independent generators to find a route to market.

The GPAM proposal builds upon the existing Non-Fossil Purchasing Agency (NFPA) structure, provides a market-led solution, improves liquidity, allows market access for small suppliers and new entrants but most importantly will lower cost to consumers. Under GPAM a low-carbon generator will auction their output every six months to a supplier, in line with the current NFPA power auctions. The supplier will purchase all the output from that generator and manage all the balancing. The cost of balancing will be factored into the auction price and therefore adjusted every six months to take into account actual balancing costs, removing the risk of over estimating long term balancing costs in Power Purchase Agreements (PPA's) and CfD strike prices. Under this proposal the auction clearing price every six months will be used for each generator as their CfD reference price thereby removing CfD reference price risk. GPAM will promote competition and lower the cost of reaching renewable energy targets for consumers.

The preliminary comments in the consultation on the integration of renewables focus on enhancing the ability to trade renewables closer to real time and although this is important and we welcome exploring the options available in more detail, it should not be assumed that all renewable generators are responsible for trading their power. At present the vertically integrated nature of the market and lack of liquidity means we require PPAs with one of the Big Six suppliers in order to secure project finance for our developments. Therefore, we are not direct participants in the balancing market and under the terms of our financing agreements we never could be. However, we are indirectly exposed through our PPAs, where willingness to take the balancing risk over a long term contract is often cited as one of the key inhibitions to pricing PPAs or ensuring that they are bankable.

2. Facilitating Demand Side Response

We support improvements to energy efficiency introduced through demand side response and welcome the utilisation of technical advances such as smart meters and smart appliances. Improvements in demand side response will improve the utilisation of renewable energy, particularly intermittent renewable energy, by limiting curtailment and limit the need to build and use fossil fuel balancing technologies. Ofgem need to also consider how this aligns with DECC's demand-side management work and recent consultation on Electricity Demand Reduction².

3. Efficient Balancing and System Operation

As discussed in response to question one above, the EBSCR should be absorbed into this project. The overview of this issue is remarkably similar to the current EBSCR being investigated, the overview in the consultation states: "appropriate incentives and signals for market participants to facilitate efficient balancing and system operation"¹. Whereas, the front page of the consultation states that "the EBSCR aims to incentivise an efficient level of security of supply and address our longstanding concerns with short term price signals identified in Project Discovery"¹.

We also have concerns that these issues are already being covered by the Capacity Mechanism, as the consultation states: "the future electricity market design should signal clearly the requirement for flexibility and ensure there are sufficient incentives for the provision of balancing services"¹. We must emphasise the importance of not impacting the success of one policy by regulating over it. The Capacity Mechanism must be given the opportunity to establish and take shape.

4. Effective Integration with the Wider European Market

We welcome the investigation of the future integration with the wider European market and this area also needs careful integration with the existing EU TM project.

5. Incentives to Maintain and Invest in new Capability

As stated above in response to key issue 3, efficient balancing and system operation, there is a strong overlap here with the Capacity Mechanism and EBSCR project.

6. Interactions with Gas Arrangements

The interrelation of the electricity and gas markets is important and needs to be considered in detail.

7. Institutional Arrangements

It is important to consider the institutional arrangements, although if “many of the existing features of the trading arrangements and the principles underlying them are expected to remain fit for purpose”, it is this area in particular in which we envisage there will be little appetite for change but change needs to be considered.

Question 3: What form should the process take?

- **How can the process help increasing certainty about the impact of the EU TM and its interactions with EMR while limiting any unintended detrimental effect on investors' certainty?**
- **What structures should we use to maximise the opportunities for stakeholder involvement?**

To limit any unintended detrimental effects on investor certainty, the timing of the review is vital, timescales need to be clear and adhered to and the review needs to be transparent. The consultation suggests that the design phase of the project is expected to last 12 months, if this is considered achievable it should be adhered to. Industry needs to have certainty in the project, its process and timescales, otherwise investor confidence will be impacted and it will inhibit the success of other policy changes including all those being undertaken by the EMR and the EU TM.

To provide additional certainty Ofgem must establish clear project principles and objectives. The principles and objectives of the review need to be clear from the outset of the review, they should not be an output of the review. The output of this review should be a clear and open consultation on the proposed changes and thoroughly presented case(s) for change alongside a clear roadmap.

The roadmap needs to be realistic as all issues cannot be resolved at once. We agree that the “most important issues are dealt with first and sequenced appropriately” and as discussed in response to question 2 above, improvement to the integration of renewables particularly intermittent renewable generation needs to be considered first.

The workstream approach to stakeholder engagement and publication of project documents as outlined in the consultation seem appropriate. We particularly support the use of regular workshops, a dedicated website to provide information to which stakeholders can respond alongside formal consultations.

¹ Update on the Electricity Balancing Significant Code Review (EBSCR) and request for comments on proposed new process to review future trading arrangements, Ofgem, 18th February 2013, [http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=Update on EBSCR and new process to review Future Trading Arrangements.pdf&refer=Markets/WhlMkts/CompanEff/electricity-balancing-scr](http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=Update%20on%20EBSCR%20and%20new%20process%20to%20review%20Future%20Trading%20Arrangements.pdf&refer=Markets/WhlMkts/CompanEff/electricity-balancing-scr)

² Options to encourage permanent reductions in electricity use (Electricity Demand Reduction), DECC, 29th November 2012, <https://www.gov.uk/government/consultations/options-to-encourage-permanent-reductions-in-electricity-use-electricity-demand-reduction>