



System Operators, Transmission  
System Owners, Generators,  
Suppliers, Traders, Customers  
and Other Interested Parties

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Date: 24<sup>th</sup> May 2013

Dear Colleagues,

## **Update on the Future Trading Arrangements consultation and invitation for applications to participate in the new Future Trading Arrangements Forum**

Following our consultation with industry in February 2013<sup>1</sup>, Ofgem has decided to establish a Future Trading Arrangements Forum. This letter sets out our reasons for taking this step and invites applications from people that wish to be considered for membership of this Forum.

The electricity market is in transition. The government's Electricity Market Reform (EMR) is driving a significant shift in the generation mix towards more renewables; European reforms are creating a single European electricity market and capacity margins are tightening over the next decade as ageing plants close.

Ofgem is committed to ensuring that the electricity market evolves to meet these new challenges and delivers secure, low carbon, and affordable electricity, including through integration with the wider European market. Several streams of work<sup>2</sup> are already underway within Ofgem to address some of these challenges.

The Future Trading Arrangements (FTA) Forum will bring together informed and influential industry players to look across trading arrangements issues. Through it we seek to provide a focal point for all matters relating to the electricity trading arrangements; build consensus on the direction of travel for the electricity wholesale market and provide greater certainty for industry stakeholders. DECC has agreed to be a member of the Forum to ensure that trading arrangements are compatible with EMR and support government policy objectives.

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<sup>1</sup>Open letter: *Update on Electricity Balancing Significant Code Review and new process to review Future Trading Arrangements*, Ref. No 20/13, published 18/02/2013. The Open Letter and all formal responses can be found at: <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=69&refer=Markets/WhlMkts/CompandEff/electricity-balancing-scr>

<sup>2</sup>For example, Ofgem launched the Electricity Balancing Significant Code Review (EBSCR) in 2012; we are working with industry to comply with binding EU TM implementation requirements and, along with other regulators and Transmission System Operators in Europe, to finalise the remaining detailed design of the EU TM; and we work closely with DECC on the detailed design of EMR to ensure alignment between our work and the government's reforms.

The FTA Forum's Draft Terms of Reference can be found in the annex to this letter.

## **Background and stakeholder responses to date**

Ofgem published an open letter in February 2013 informing stakeholders of our decision to amend the scope of the Electricity Balancing Significant Code Review (EBSCR). The letter asked for industry views on our proposal to start a separate project to draw up a high level design for future trading arrangements. A Roundtable event was also held on March 25<sup>th</sup> to further discuss the potential FTA process with stakeholders.

Our open letter noted that the challenges identified in Project Discovery<sup>3</sup>, and subsequent market and policy developments, emphasised the importance of GB electricity trading arrangements remaining fit for purpose and adapting to the changes triggered by government policy, European reforms and market trends. We suggested that the consideration of interactions between the multiple drivers of change in the GB electricity market is crucial to ensure that the trading arrangements deliver: efficient operation of existing assets; appropriate incentives to maintain existing assets and invest in new capability; and effective and efficient integration with wider European markets to the benefit of GB consumers.

A holistic approach to trading arrangements should also help to avoid the development of an incoherent set of mechanisms or a series of overlapping reforms which may involve undoing previous decisions within the space of just a few years. Moreover, such an approach could lead to improved investor certainty, with potential benefits for consumers in terms of lower cost of capital and less redundancy in systems redesign.

Comments from the roundtable and stakeholder responses following our February 2013 Open Letter provided a number of key messages, including:

- There is general agreement that we have identified the most important issues facing the GB electricity market.
- Most respondents supported Ofgem considering the interactions between the challenges facing the GB market and any required changes to trading arrangements.
- Several respondents urged caution around the idea of launching a large programme of reforms and many noted the importance of a thorough scoping phase to identify issues and priorities.
- There was a clear appetite for Ofgem to run a *process* which would provide a focal point for discussing the challenges to the trading arrangements and the appropriate response.
- An initial focus of this process should be an assessment of the principles underpinning current trading arrangements and consideration of any updates to these in light of current/future challenges.
- Rigorous stakeholder involvement will be necessary to provide assurance and build investor certainty.
- Ofgem and DECC should work closely throughout to ensure that both organisations are in agreement and provide consistent messages.

The following section sets out how we have taken these comments into account in designing the FTA Forum.

## **FTA Forum objectives, scope and process**

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<sup>3</sup> In 2010, Project Discovery highlighted that current trading arrangements do not always provide the right signals for investment or efficient operation; allow equal treatment for the demand side; mitigate risks associated with the increasing interdependence on international markets; nor ensure consistency between gas and electricity.

## **Objectives**

The objective of the FTA Forum is to seek to build consensus on the approach to wholesale electricity trading arrangements in the context of EMR, European Target Model, market and technological developments. The FTA Forum will:

- provide a focal point for stakeholders, Ofgem and DECC to engage on the full range of matters affecting trading arrangements;
- aim to support industry certainty regarding any future developments;
- identify future challenges for wholesale electricity market as a result of policy and market changes as well as key interactions with the gas market;
- support Ofgem's policy development in this area and identify further streams of work that Ofgem or industry could take to address these challenges;
- help all stakeholders to better understand future developments which could affect trading arrangements;
- ensure consistency between market and network<sup>4</sup> policy changes.

Our approach will be to build on the successful characteristics of existing trading arrangements while reflecting on the market impacts of increased European integration and government's implementation of EMR.

## **What is the Forum and how does it work**

We are looking to bring together a small number of people (around 25) who can help inform and shape our work on trading arrangements. Our intention is that membership of this Forum should be from senior experts within the industry. In addition to DECC, membership should include National Grid and representatives from the Irish regulatory authorities. This will ensure appropriate coordination between CER's Market Integration Project<sup>5</sup> and the work of the FTA Forum. We will invite a range of speakers to present at the Forum so that all members develop a clearer understanding of key developments, such as the European Target Model, EMR and the work that Ofgem is already undertaking related to electricity trading arrangements.

Ofgem will provide the Forum's Chair and Secretariat and will ensure that papers are circulated in advance. Ofgem will ensure that all papers presented to the Forum, including working papers delivered by the Forum's Working Groups, and minutes of Forum meetings will be published on a dedicated microsite for this purpose. The FTA Forum will not have any decision making power in respect of Ofgem's statutory functions and Ofgem's decision making will remain with the Authority (GEMA) and Executive Committee. The FTA Forum will play an important role in developing and discussing the options and analysis to allow the Authority to take informed decisions.

It is intended that the FTA Forum will guide the establishment of sub-groups to address specific issues. We expect that these Working Groups include representatives from Ofgem, DECC, industry, and other relevant parties. The Working Groups will report to the FTA Forum and will provide technical inputs to assist the FTA research and analysis. Further details of our proposal for the initial Working Groups can be found in the section below.

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<sup>4</sup> For example, Ofgem's ITPR project is a review of the current arrangements for system planning and delivery to determine whether these are appropriate to achieving a long-term efficient integrated network - onshore, offshore and cross-border. See here for more information:

<http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/itpr/Pages/index.aspx>

<sup>5</sup> The Irish Market Integration Project is jointly run by CER and UREGNI. For more information, see SEM-13-009a - SEM Committee Next Steps Response Paper, February 15<sup>th</sup> 2013:

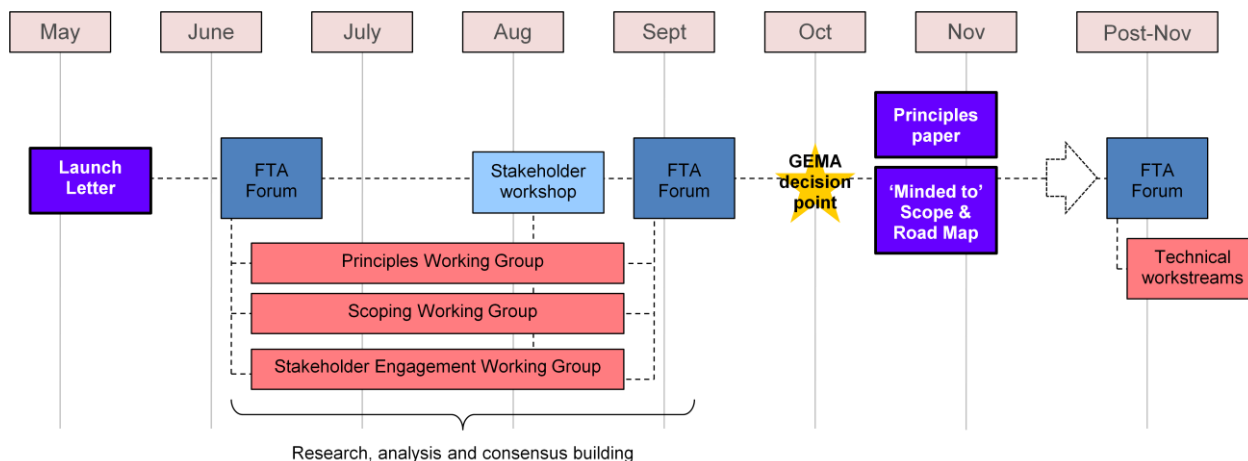
[http://www.allislandproject.org/en/sem\\_publications.aspx?year=2013&section=2](http://www.allislandproject.org/en/sem_publications.aspx?year=2013&section=2)

We place great importance on building industry-wide consensus and certainty throughout the FTA process. As such we would like to emphasise that the Forum will not replace Ofgem’s standard consultation and stakeholder engagement process.

### Initial process

Our indicative timeline for the initial phase of the FTA Forum is illustrated in Figure 1 and described in more detail below. Initially we expect the Forum to meet twice in the period to autumn 2013: in early July and in September.

Figure 1: FTA process timeline



The initial working groups within the Forum will consider:

- (1) the **principles** underpinning the GB trading arrangements;
- (2) the **scoping of issues** and priorities related to electricity trading arrangements to assist the Forum to consider the scope of additional work that should be undertaken from late 2013 onwards;
- (3) the most appropriate approaches to **stakeholder engagement** and dissemination of relevant information, in respect to FTA, bearing in mind the need to build certainty for investors and other stakeholders.

This initial remit reflects the responses from stakeholders to our February Open Letter (as noted above), which highlighted these themes as initial priorities that should be covered early on in the FTA process and with stakeholder involvement. For each of these three aspects we intend to establish a dedicated Working Group as the primary vehicle for research and analysis. We expect industry, DECC and other relevant parties to join in these Working Groups.

The first Forum meeting in June will provide strategic steer for the work to be carried out by the Working Groups and request input from members into the Terms of Reference for these Working Groups. We expect the second Forum meeting will debate the analysis of the Working Groups and seek consensus to feed into Ofgem’s formal recommendation.

The scope of the Forum will be reviewed in November after the first work streams have delivered their analysis. The issues work stream, in particular, will inform GEMA’s decision on the scope of Ofgem’s work on electricity trading arrangements.

### Next steps

In order to establish the FTA Forum we are issuing this open invitation for market participants to apply to be members of it. We will be selecting the members for what they

can personally bring to the work of the Forum as well as on the basis of the organisation they represent. In particular, we are looking for market participants who have a good understanding of the issues and challenges facing the GB market (as noted above), who can influence others in their field and who may be able to take away actions from the Forum or offer resources to participate in our working groups. We are looking to ensure that the different aspects of the GB electricity market are represented on the Forum, while keeping it small enough to operate openly and effectively. A Draft Terms of Reference for the Forum is annexed to this letter for reference.

We invite those who are interested to submit applications for membership of the FTA Forum. These should be no more than two pages in length and should set out clearly your case for membership, based on our ambition for the Forum and our expectations from members (as set out in this letter and the annexed Terms of Reference). Applications should be sent to [gb.markets@ofgem.gov.uk](mailto:gb.markets@ofgem.gov.uk) by June 12<sup>th</sup>. The first FTA Forum meeting is planned to be held on in London on July 2<sup>nd</sup>.

If you have any comments or questions on the content of this letter, please contact Giuseppina Squicciarini (Head of Electricity Policy, Wholesale Markets) at [giuseppina.squicciarini@ofgem.gov.uk](mailto:giuseppina.squicciarini@ofgem.gov.uk).

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Rachel Fletcher', is positioned above the printed name.

Rachel Fletcher  
Partner, Wholesale Markets

**Annex 1: Future Trading Arrangements Forum Draft Terms of Reference**  
**Ofgem Future Trading Arrangements Forum (the Forum)**  
**Draft Terms of Reference**  
**May 2013**

The Forum will bring together market participants that are key opinion formers, experts and stakeholders to discuss and commission work relating to the development of the electricity trading arrangements in the context of market, technological and policy changes. The Forum will help Ofgem ensure that the trading arrangements remain fit for purpose, and seek to build consensus and support industry certainty regarding any future developments.

It should provide stakeholders with a common platform to consider and debate interactions between the current arrangements and ongoing changes to the electricity market and, where necessary, provide direction for the development of trading arrangements.

**The Forum will aim to develop a common understanding of market arrangements and requirements, including:**

- Discussing various market and policy developments to ensure that regulators, government and stakeholders are aware of issues which will have an impact on our trading arrangements
- Developing a common understanding of the principles underpinning the electricity market, building on the existing ones, and seek to build consensus on the most appropriate principles for future trading arrangements.
- Develop a common understanding of European requirements with which GB must comply
- Develop a common understanding of the impact of moving to a low carbon energy sector on trading arrangements
- To facilitate the exchange of information and knowledge between key parties

**The Forum will operate to:**

- Provide a focal point to consider interactions between different policy areas and ensure a consistent and coherent approach eg ensure consistency between market and network policy changes
- Assist in the development of further principles, where necessary, to underpin the electricity trading arrangements
- Aid Ofgem, government, industry and other stakeholders to identify activities that need to be prioritised and identify work that will help achieve the ultimate objective of establishing the adequacy of our trading arrangements
- Where action is required, for example to comply with new legislation or due to an assessment that part of the current trading arrangements is not fit for purpose, provide input into identifying potential solutions

**The Forum's ways of working and membership:**

- The Forum is an advisory body. It will provide advice and analysis for the relevant decision making body
- The Forum will publish the minutes of its meetings. Comments and views will be reported on a non-attributable basis
- Ofgem will provide the Chair and the Secretariat
- Ofgem will aim to circulate meeting papers 3 days in advance of meetings unless there are exceptional circumstances. Forum members will be requested to read papers in advance of meetings
- Materials from the reports / studies will be made available to The Authority (GEMA)

- The Forum will guide the establishment of sub-groups to address specific issues and these Working Groups will adopt an approach consistent with the operation of the Forum
- Forum members will provide resources to participate in the Working Groups
- Ofgem reserves the right to review the members in order to ensure that the Workgroup remains effective. Alternative participants will only attend the meetings in exceptional circumstances
- Ofgem attendees at the Forum do not represent The Authority and therefore their views do not represent those of the Authority or impact upon the discretion of the Authority