ofgem

Minutes

Electricity Balancing Significant Code Review Stakeholder Workshop

From	Stephen Lee	08 October 2013
Date and time of Meeting	Tuesday 24 September 2013, 13:00 to 17:00	
Location	Ofgem, 9 Millbank, London, SW1P 3GE	

1. Present

Ofgem representatives:

Giuseppina Squicciarini (Chair)
Andreas Flamm
Dominic Scott
Ryan McLaughlin
Grendon Thompson
David Beaumont
Adam Gilham
Stephen Lee
Tom Corcut (from 16:00)

Stakeholders:

Alan McAdam (RWE Group)
Alex Haffner (National Grid)
Andrew Colley (SSE)
Anthony Tricot (DECC)
Arthur Probert (The Energy Services Partnership Ltd)
Cem Suleyman (Drax)
Chris Welby (Good Energy)
Colin Prestwich (Smartest Energy)
Dele Olawoye (PTC Inc.)
Emma Piercy (First Utility)
Esther Sutton (E.ON UK plc)
Faisal Bachlani (Statoil)
Gaia Morleo (Gazprom)
Gregory Swinand (London Economics)
Jakob Foreman (DONG Energy)
James Anderson (Scottish Power)
James Greenleaf (Baringa Partners LLP)
Kevin Swinton (Engage Consulting Ltd)
Lars Weber (Neas Energy)
Laurence Barrett (E.ON UK plc)
Libby Glazebrook (GDF SUEZ Energy International)
Lisa Waters (Waters Wye Associates)
Mari Toda (EDF Energy)
Martin Mate (EDF Energy)
Matt Bunney (The co-operative Energy)
Murray Rennie (Intergen)
Nigel Cornwall (Cornwall Energy)
Olaf Islei (APX, Inc.)
Pavel Miller (Energy UK)
Philip Davies (Centrica plc)
Richard Cullen (Engage Consulting Ltd)
Richard Hall (Consumer Futures)
Sara Bell (UK Demand Response Association)

Sarah Husband (RES)
Sarah Owen (Centrica plc)
Simon Bradbury (Pöyry plc)
Søren Kjær Petersen (Neas Energy)
Stephen Powell (Independent)
Tom Breckwoldt (Gazprom)
Zoltan Zavody (RenewableUK)

2. Apologies

Aily Armour-Biggs (Global Energy Advisory)
Amisha Patel (ESB International Ltd)
Chris Lawley (Neas Energy)
Ebba Phillips John (DONG Energy)
Ed Reed (Cornwall Energy)
Maf Smith (Renewable UK)
Martin Rawlings (Blizzard Utilities Ltd)
Nick Frydas (Mott MacDonald Group Ltd)
Torkel Sjoner (Statoil)

3. Introduction

3.1. Giuseppina Squicciarini (GS) of Ofgem welcomed stakeholders, outlined the plan for the day and set out the workshop's objectives. She explained how the workshop fits into the wider Electricity Balancing Significant Code Review (EBSCR) timeline, noting that the process began in 2012, Ofgem published the Draft Policy Decision on 30 July 2013 and the consultation closes on 22 October 2013.

4. Ofgem's high-level proposals

4.1. Andreas Flamm (AF) of Ofgem gave a high-level overview of the approach of the project, the rationale for reform, Ofgem's proposed reform package and likely impacts.

4.2. Discussion

4.2.1. One stakeholder clarified that the policies in discussion now will be published in spring 2014 and asked if there would be any opportunities for stakeholder engagement after this. AF responded by saying yes, as part of the usual Balancing and Settlement Code (BSC) modification process.

4.2.2. It was questioned whether the whole reform package would be introduced at the same time. GS stated that some elements of the reform package are likely to require a relatively short implementation time and invited stakeholders to express their views on this issue.

4.2.3. A stakeholder asked for clarification on what the 'Do nothing' scenario in the quantitative model refers to and whether it assumes the introduction of the Capacity Market (CM). Ofgem's response noted that the 'Do nothing' scenario assumes no changes to the cash-out price calculation are made and that the model considers the likely impacts of possible reforms both with and without the introduction of the CM. It was also noted that the capacity mix is likely to change over time including under the 'Do nothing' scenario (which the model takes into account) and that the modelled distributional impacts of implementing the reform package are broadly similar irrespective of whether a CM is introduced or not.

5. Making cash-out prices marginal

5.1. Dominic Scott (DS) of Ofgem introduced Ofgem's proposal to make cash-out prices marginal. He set out the rationale for reform, the possible policy options, and further considerations around Ofgem's lead policy option (setting the Price Average Reference at 1MWh).

5.2. Discussion

5.2.1. One stakeholder asked if there is a process in place to deal with accidental or incorrect tagging and flagging. DS responded by saying National Grid (NG) is considering ways to correct such incorrect tagging or flagging ex-post and has put forward proposals. Alex Haffner (from NG) noted that this system aims to make any corrections necessary within 7 days.

5.2.2. Another stakeholder followed this question up by asking if there is a dispute resolution system. Alex Haffner responded by saying that Elexon currently has a dispute function and will continue in this role under the proposed reform.

5.2.3. A participant asked if the implementation of more marginal cash-out prices could be phased, noting that parties could initially struggle to get a 'feel' for what cash-out prices are likely to be in a given settlement period. GS answered by saying that Ofgem's current intention is to not phase the introduction of more marginal cash-out prices, on the basis of qualitative and quantitative analysis undertaken by Ofgem's team prior to the Draft Policy Decision publication. However, it was noted that this is an option Ofgem could consider if arguments and evidence supporting a phased implementation are put forward.

5.2.4. A stakeholder asked if Ofgem could extend their historical analysis back to 2008, a year of relatively volatile prices, to see what the effect of implementing marginal cash-out prices would have been. AF noted that 2008 was prior to the implementation of BSC modification P217A and this may have been a cause of the relative volatility in prices observed. It was also stated that if the historical analysis looked at dates before and after the implementation of P217A, the data from these time periods would not be comparable. Finally it was noted that the quantitative model estimates volatility in cash-out prices going forward.

5.2.5. Finally, one stakeholder asked what fuel mix is assumed in the forward modelling of impacts. AF answered by saying DECC's CM scenarios were used.

6. Pricing reserve according to value

6.1. Ryan McLaughlin (RM) of Ofgem gave an overview of Ofgem's proposal to price reserve according to value. He set out the rational for reform, Ofgem's proposal, likely high-level impacts, and implementation issues to be considered.

6.2. Discussion

6.2.1. A stakeholder asked if there is always a negative relationship between cash-out prices and system margin. RM explained that NG has to take each action based on its position in the 'Merit Order'. Therefore, it follows that at times of relatively low margin the market price will increase (the relatively cheap plant will have dispatched itself in the market, leaving only relatively expensive actions available to the System Operator (SO) through the Balancing Mechanism (BM)).

6.2.2. One stakeholder asked if Ofgem has conducted any analysis on whether reserve has historically been used for system or energy balancing reasons. RM responded by saying that the majority of actions would be taken for energy balancing reasons and

Alex Haffner said that if reserve was used for a system (rather than energy) balancing action, this would be tagged out of the cash-out price calculation as is currently the case; therefore only energy actions feed into the cash-out price calculation. [Subsequent analysis provided by NG on Thursday 03 October 2013 indicated that less than 1% of BM Short Term Operating Reserve (STOR) instructions over the previous 12 months were flagged as being for "system" reasons.]

6.2.3. Another stakeholder requested that Ofgem develop more detail around the proposed Reserve Scarcity Pricing (RSP) function prior to publication of the Final Policy Decision and GS noted this.

6.2.4. It was suggested that Ofgem could consider drawing up a similar function to the proposed RSP function but one that doesn't solely apply when reserve is used, which may allow parties to predict cash-out prices during periods of scarcity more accurately. GS responded by stating that scarcity can be captured by appropriately set cash-out prices but noted that reserve is an element that is missing.

6.2.5. A participant asked how this proposal is consistent with that of cost-reflective pricing. AF answered by saying the RSP function reflects the value of STOR when it is used. As it is not possible to accurately allocate the actual cost of pre-contracted reserve to the appropriate settlement period, using the value to the system is the best proxy for the cost and would make the pricing arrangements more accurate than they currently are.

6.2.6. A stakeholder then asked if this is placed as a value proxy, will the same value that is placed on STOR be given to the providers and, as such, will there be a firm link to the procurement process. Ofgem's response was that the way STOR is contracted and procured would not change, only the value given to it in the cash-out price calculation. The pre-contracted availability and utilisation payments remain the same.

7. Including a cost for disconnection and voltage control in cash-out prices

7.1. Grendon Thompson (GT) of Ofgem introduced Ofgem's proposals around Value of Lost Load (VoLL) pricing, outlining three issues addressed by the policy. He summarised a study conducted by London Economics which estimated different VoLLs, explained the methodology used by Ofgem to select an appropriate VoLL, which would be integrated into cash-out, and set out the expected high-level impacts and implementation issues to be considered.

7.2. Discussion

7.2.1. One stakeholder asked how supplier imbalance volumes would be adjusted and how payments would be made to consumers. Ofgem's team noted that implementation details will need to be fleshed out, as well as the points that BSC modification P199 provides a sensible starting point and that Ofgem will work closely with NG and Distribution Network Operators on this issue. It was also said that engagement prior to the publication of the Draft Policy Decision indicates that there are no 'show-stoppers' – the data required is available but the necessary processes need to be defined to implement this policy.

7.2.2. It was asked what Ofgem's basis for using a VoLL of £6,000. GT responded by saying that the figure was based on the evidence presented in the VoLL study. A key input into this decision was that £6,000 is greater than the majority of Industrial & Commercial (I&C) VoLL estimates, and hence provides incentives for most I&C consumers to enter into interruptible contracts and provide Demand Side Response (DSR) services (a VoLL below this level would remove the incentive to enter into these contracts for a proportion of I&C consumers).

7.2.3. Another stakeholder asked if any other values of VoLL were used in the Impact Assessment and it was stated that £6,000 was the only value used.

7.2.4. One participant asked if VoLL is a cap and in response GS said that it wasn't.

7.2.5. A stakeholder expressed concern that the calculation of disconnection volumes may be inaccurate and Ofgem's team noted that should inaccuracy be a material risk, this would need to be addressed.

7.2.6. Another stakeholder asked why the peaks of the willingness to pay and willingness to accept estimates in the in London Economics study don't coincide. In response, Gregory Swinand (from London Economics) said that one doesn't necessarily dictate the other and that what is presented is simply empirical evidence.

7.2.7. A stakeholder asked what Ofgem expected the impact of the reform package to be on credit requirements. GS responded by noting that the EBSCR - Draft Policy Decision Impact Assessment describes potential impacts on credit requirements at a high level, and that this is an area Ofgem's team may look at prior to the publication of the Final Policy Decision.

7.2.8. Finally, one stakeholder mentioned potential reputational impacts for suppliers of making payments to consumers in case of disconnections, depending on the way the payment would be made, and also questioned whether the level of payment proposed was too low to satisfy the customer. AF answered that the level proposed is based on evidence from the VoLL study.

8. Moving to a single cash-out price

8.1. DS introduced Ofgem's proposal to move to a single cash-out price. He set out the rationale for reform, the proposal itself, some of the expected impacts and a couple of implementation issues.

8.2. Discussion

8.2.1. A stakeholder asked how often Ofgem expects prices to be negative assuming the implementation of the reform package and how cash-out prices can provide a signal to the market if they are only known ex-post. In response, AF noted that parties have an expectation of cash-out prices when making their trading and dispatch decisions intraday. The participant commented that the penetration of renewable generation is relatively high and therefore, in general, it is becoming more difficult to balance – an issue this policy does not address. AF noted that the reform package would place appropriate incentives on parties to balance and ensure cost-reflective cash-out prices. This was followed by a discussion on the incentives to spill and the self-defeating nature of this strategy.

8.2.2. A stakeholder asked what Ofgem's reaction would be if a financial market in hedging products developed. In response it was noted that this would generally be viewed as positive as liquidity would be likely to increase as a result.

8.2.3. In response to the previous stakeholder's line of enquiry, a stakeholder asked if Ofgem believes all parties have equal access to risk management tools and GS responded by saying this was an issue that would be considered as part of the FTA Forum.

9. Interactions

9.1. Anthony Tricot (from DECC) gave a presentation outlining the interactions between the CM and EBSCR. Specifically, he set out the distinct but complementary roles of the CM and cash-out reform in the market, the interaction between the CM penalty regime and cash-out, and the integration of values of VoLL in the CM.

9.2. Discussion

9.3. GS then invited stakeholders to ask any questions they may have on interactions between EBSCR and other internal or external projects.

9.4. A stakeholder asked if there may be any unintended consequences of implementing Ofgem's Gas Significant Code Review (SCR) and EBSCR. In response, Tom Corcut (from Ofgem) said the Gas SCR is about placing appropriate incentives on parties to build more back up generation. He noted that Ofgem is consulting on specific proposals under the Gas SCR to implement a DSR auction, which among other things considers the payments to gas-fired generators in a gas deficit emergency and therefore the interactions with the electricity market.

9.5. A stakeholder asked for clarification on what the CM penalty would be if the cash-out price exceeded DECC's figure for VoLL and Anthony Tricot said it would be £0/MWh.

9.6. Another stakeholder asked if it would be possible to export when demand control actions were taking place and it was noted this is an issue out of the scope of the EBSCR.

10. Summary of key themes and close

10.1. GS concluded the workshop by noting that it had been very constructive; the team had heard a number of important questions providing good steer for any further refinement of Ofgem's proposals.

10.2. She then summarised the key areas where stakeholders indicated that further thinking may be helpful: RSP function details; clarity on how consumer compensation (with regard to VoLL pricing) will work in practice; and more detail on what the effects of the reform package on credit requirements are likely to be. GS noted that some of the questions were around implementation details and therefore, whilst Ofgem will consider further policy development in these areas, industry may be best placed to develop some of the more practical aspects of the policies.

10.3. GS also listed a number of wider questions which the workshop had picked up on: whether flexibility and DSR are valued accurately in the market; whether all parties in the market have equal access to risk management tools; whether more information should be provided to the market to help parties manage imbalance risk; and whether the roles of the SO and DNOs should be adapted to reflect the increasing complexity of the market. GS said that Ofgem is engaging with industry in these wider questions as part of the FTA process.