Co-operative Energy
Co-operative House, Warwick Technology Park
Gallows Hill, Warwick, CV34 6DA

t: 01926 516174
f: 01926 516078
e: regulation@cooperativeenergy.coop
www.cooperativeenergy.coop

The co-operative energy

Andreas Flamm
Ofgem E-serve
9 Millbank
London
SW1P 3GE

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Dear Andreas

EBSCR – draft policy decision – Co-operative Energy consultation response

At Co-operative Energy we welcome the opportunity to respond to the consultation on your Draft Policy Decision relating to the Electricity Balancing Settlement Code Review. Launching in 2011 we are a relatively new entrant to the supply market with growing numbers of customers. We focus on acting ethically for our customers and pledge that the energy for our electricity will have less than half the carbon content of the national average.

In line with our low carbon commitment we purchase our electricity from a range of sources, including intermittent technologies such as onshore wind and hydro. Notwithstanding this portfolio based purchasing strategy we generally achieve consistently good forecasting results.

We do not believe that the package of proposed measures will deliver its stated aims and we believe there will be a disproportionate competition impact with smaller, one sided energy suppliers being particularity disadvantaged.

We have responded to each of your consultation questions on the following pages. However, in summary our view is as follows:

- Taken together your proposals will significantly increase price volatility without recognising the impact on suppliers' purchasing strategies and associated credit requirements.

- The policy proposals are predicated on the basis that the proposals will incentivise increased investment in forecasting technologies as a result of more marginal cash out prices. It is also assumed that there will be widespread rollout of smart technologies. However, given the price signals will be after the event, we do not believe that investment in generation capacity or demand-side solutions will be driven by the proposed measures.

- There is a significant cost attached to the degree of sophistication required for forecasting (human and technology based) to avoid punitive imbalance charges. This has a disproportionate impact on smaller suppliers who, as yet, do not have the economies of scale of the largest suppliers.

- The proposals provide disincentives to commit to the purchase of intermittent technologies such as renewables. We think it likely that the proposals will particularly discourage investment in community led renewables.

- The cost exposure to suppliers of these proposals is further compounded by the plans to recover the costs of CfDs and the supplier obligation.

- The proposals do not unpick the impact on credit requirements, which have already been highlighted as a barrier for entry and growth for smaller, one sided suppliers.

- There are gaps in the analysis particularly around the reasons for behavioural change and differential performance on forecasting and reconciliation.

There are aspects of your impact assessment where we disagree with your analysis. For example you have concluded that smaller suppliers have higher imbalance levels "due to less experience with balancing or greater inherent uncertainty associated with intermittent generation". From our experience to date we would suggest that any differences in imbalance performance are due to the following reasons:

- Smaller suppliers do not have the same resources to invest in expensive forecasting software, partly due to the credit requirements placed upon them.

- Smaller suppliers can find it very difficult to access short-term markets, especially within day trading.

- Flexible generation products can be very expensive to purchase and unviable without sufficient economies of scale.

- Smaller suppliers specialising in domestic or SME customers generally won't have access to effective DSR products.

Together these factors create a significant cost barrier for smaller suppliers. We are already incentivised to balance accurately by current cash-out prices and moving to fully marginal prices will create a punitive cost risk without substantial forecasting investment, which even then will not enable response to prices that are not visible ahead of delivery. We fear that in the round costs for consumers would be driven up as a result and retail competition could be damaged due to the greater difficulty smaller one-side players face in procuring short-term power.

We would welcome increased efforts to open up smaller supplier's access to day-ahead and within day markets. This would, in turn, reduce imbalance.

We would welcome the opportunity to discuss these matters with you and to share our analysis.

Yours sincerely

Phil Gregory
Head of Purchasing, Regulations and Commercial, Co-operative Energy

Annex A – consultation responses

<table>
<tr><th></th><th>Consultation questions</th><th>Our response</th></tr>
<tr><td>1</td><td>Do you agree with our proposal to make cash-out prices more marginal?</td><td>We do not support this proposal.

As a responsible business we recognise the need to forecast as accurately as possible and to avoid the additional costs associated with settlement imbalances. In common with other providers we strive to achieve consistently accurate forecasting.

We invest in low carbon and other renewable technologies as part of our ethical and environmental pledges. The proposal to make cash-out prices more marginal creates significantly more imbalance risk for those providers who purchase volatile technologies. We believe this runs counter to the long term commitments of the government and the other parties to reduce the carbon emissions.

The documentation suggests that the total imbalance costs will reduce over time. It is not clear to us that this will be the case given policy is incentivising increased volumes of intermittent generation to meet targets, which are ultimately paid for by consumers. It may lead to suppliers looking to discount wholesale contracts with generators more likely to be subject to energy imbalance—which may see “system” imbalance cost rise instead. To secure such reductions will require significant additional investment in forecasting technologies and skills which are costs which will need to be passed on to customers. These costs have a disproportionate impact on smaller suppliers who do not have large customer bases over which to smear costs or access to a sizeable generation portfolio.

We believe this proposal, particularly if the measure used to calculate the marginal price is PAR1, will lead to a situation where significantly higher credit cover will be required to cover the increased risk of imbalance exposure. If this proposal was to go ahead we would welcome a phased approach using PAR50 as we believe this would provide an indication on how significantly stakeholders will be able to change their processes to reflect the more marginal prices.

The separate workstream on wholesale electricity liquidity should create some welcome improvements to open up the wholesale markets. However these don’t go far enough to create a level playing field between vertically integrated suppliers and other market participants and there remains considerable uncertainty surrounding their final form and the timing of implementation.</td></tr>
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	Consultation questions	Our response
2	Do you agree with our rationale for going to PAR1 rather than PAR50? Are you concerned with potential flagging errors, and would you welcome introduction of a process to address them ex-post?	As set out above we are concerned about the impact of making the cash-out price more marginal. Using PAR1 means that cash out prices won't necessarily be reflective of the system operator's actions, only the system's most severe action. In times of severe stress this could cause significant risk for suppliers which if market participants were to withdraw or fail could adversely impact competition. The move to PAR1 could have the effect of dragging up the within day wholesale price. This would then no longer be a fair market price but would arbitrage the cash-out price instead. Any more marginal approach will necessitate the need to screen the price stack to ensure non-energy actions are eliminated.
3	Do you agree with our proposals for pricing of voltage reduction and disconnection, including the staggered approach?	We agree with the principle of pricing voltage reduction and disconnection on a cost reflective basis. It is far from clear however how such actions would be properly identified and how they would be reconciled at the GSP Group level. It is also not clear how compensation would be paid and how this might impact a supplier's risks and costs.
4	Do you agree with our assessment of the interactions with the CM and its impact on setting prices for Demand Control actions?	
5	Do you agree that payments of £5/hr of outage for the provision of involuntary DSR services to the SO should be made to non-half-hourly metered (NHH) consumers and for £10/hr for NNH business consumers?	We agree with the principle of remunerating customers for involuntary DSR. However, given the variety of domestic and non-domestic consumers this applies to, we are unclear about how this will work in practice. As different consumers will have a different impact, the set amounts could be seen as a compensatory gesture and pressure placed on suppliers generally to compensate more generously This could mean that the compensatory gesture is in danger of becoming rather meaningless.
6	Do you agree with the introduction of the Reserve Scarcity Pricing function and its high-level design? Explain your answer.	The concept may have merit, but its application is very unclear. For the reasons we gave earlier incentives to avoid imbalance are already sharp. If a reduced PAR were pursued, this should be given a period to operate without further major interventions that could artificially inflate prices.
7	Do you agree with our	Yes we agree with the rationale. A single price could mean

	Consultation questions	Our response
	rational for a move to a single price, and in particular that it could make the system more efficient and help reduce balancing costs? Please explain your answer.	suppliers do not err on the side of caution and attempt to go long (to receive SSP rather than pay SBP). However if Ofgem believes suppliers should look to invest in forecasting tools, is there a danger that those that can will seek to benefit from the more marginal prices by going long at times of system stress to benefit from a high cash-out price?
8	Do you have any other comments on this consultation, including on the considerations where we did not propose any changes?	We recognise that the Secure and Promote proposals address a number of points we have made regarding market access. However the market needs to see the impacts of these proposals in practice prior to accepting a significant increase in imbalance risk. Additionally we have concerns over the combination of the EBSCR and the Electricity Market Reform and the interactions between the two. With the EMR removing the Renewable Obligation currently faced by suppliers and the EBSCR making cash out prices more marginal, the easiest way for suppliers to manage their risk would be to not purchase any renewable generation, especially the more intermittent of these. We believe that the combination of the two proposals could have one of the following impacts: • Renewable generators find it difficult to identify a supplier to purchase their power. This would increase the number of generators having to rely to the supplier of last resort • The lack of obligation on suppliers could mean that prices offered to the renewable generators are significantly below the reference price. This would then reduce the certainty offered to investors, which contradicts one of the key aims of the EMR – encouraging investment in renewable generations. • If so the costs of the offtaker of last resort would be smeared across all suppliers, effectively removing the generators from the market. At a European level the GB industry is about to embark on a major package of work to shape and then implement network codes that seek to align practices across the EU. At this stage the implications of the balancing code are not sufficiently understood and there exists a danger that Ofgem's plans are superseded by European developments.
9	Do you have any comments regarding any of the three approaches we have taken to assess the impacts of the cash-out reform packages?	We agree with the three approaches undertaken and believe that, if fully completed, that the combined results over the different timescales should provide sufficient evidence to inform decisions about the proposed changes. However we believe that more attention needs to be paid to distributional effects of different types of participant, especially the additional challenges faced by smaller suppliers, who are not a homogenous class. We would like to respond in particular to a point in the impact assessment. It is stated in paragraph 3.14 'it is assumed in the short term parties can change their strategy for hedging

	Consultation questions	Our response
		imbalance risk before Gate Closure to minimise this risk'. Co-operative Energy already makes every effort to balance successfully and generally we manage to do this in a reasonably accurate manner. It would be very difficult to change our strategy in the short term and would require significant investment in software and human resources, without any guarantee of significantly improved results. A more effective way of assisting small suppliers to reduce their imbalance would be to continue assisting them in gaining market access, mainly in the day-ahead and within day markets.
10	Do you agree with the analysis of the impacts contained in this IA? Do you agree that the analysis supports our preferred package of cash-out reform? Please explain your answer.	We recognise that there will be significant impacts as a result of the EBSCR proposals. We are especially concerned about the impact on credit requirements. Package 5 offers reduced impact on balancing compared to the Do Nothing approach and Package 1 and 3, however it still represents a significant risk of increased imbalance costs compared to current levels and the credit requirements will be equivalent. Ofgem note in paragraph 5.21 that 'impact on cost of capital is likely to be mixed and case specific' after stating that EBSCR could increase the value of flexible generation and demand side capacity. As a smaller supplier we find it very difficult to effectively access flexible generation or manage our demand side (predominantly domestic customers) and therefore won't be able to benefit in either of these ways. The EBSCR and Electricity Market Reform together are likely to place significant additional credit requirements on suppliers and in a number of areas require this credit to be placed using a cash deposit, impacting cash flow and the ability for newer entrants to grow their businesses. They also increase the fixed costs of smaller players disproportionately to our large scale competitors.
11	Do you agree that the key risks identified and the analysis of these risks? Are there any further risks not considered which could impact on the achievement of the policy objectives? Please explain your answer.	We agree with the key risks identified. As mentioned above, we are concerned that the impact of these risks on different stakeholders hasn't been fully analysed.
12	What if any further	We would like to see additional analysis completed on the impact

	Consultation questions	Our response
	analysis should we have undertaken or presented in this document? Do you have any further analysis or evidence you would like to contribute to support the development of the EBSCR towards its Final Policy Decision?	on smaller suppliers, specifically addressing how Ofgem believe they will be able to reduce their imbalance. We would also be interested in seeing analysis combining the impacts of the EBSCR alongside the Secure and Promote proposals and wider impacts on retail competition in a post-EMR world. As a general observation, we think insufficient attention has been focussed on measures that would allow trading parties to manage mitigate volume risk (allowing consolidation from other trading accounts, reducing gate closure, ex post trading).