

EBSCR Draft Policy Proposals

Cornwall Energy welcomes the opportunity to respond to Ofgem's draft policy proposals emerging from the electricity balancing Significant Code Review (EBSCR).

We support the move to more marginal prices. However, the practical consequences of implementation of the full package proposed by Ofgem is too much, too soon. In particular:

- it would be inappropriate to move to PAR1 as this creates a cost signal that is not representative of the SO's typical costs;
- at a practical level it would be more prudent to move to perhaps PAR100 or at most PAR50, especially as the marginal action could well continue to be susceptible to system pollution and may be game-able by large portfolio players;
- we also support the separate proposal to move to a single price to be calculated for imbalances in both directions, as this will incentivise grid supporting actions and remove the artificial distortion of the reverse price; but
- to facilitate both changes, Ofgem needs to give much more thought to the necessary information needed by the market after Gate Closure to help it respond to the sharper price signal and consider further appropriate measures to allow them to manage volume risk.

The other elements of the package—notably pricing of disconnections and voltage reductions and the introduction of the Reserve Scarcity Pricing function—are only defined at a high level, and Ofgem has not demonstrated why these would materially enhance the price signal and incentives produced by a single, more marginal price.

We also believe further assessment of measures that would enable market participants to manage volume risk. We have previously set out in an editorial that we believe changes to Gate Closure and contract notification timescales have not been properly assessed. We were also expecting more considered analysis of netting of production and consumption accounts in the light of the P282 decision letter, but this has not happened.

We remain concerned that there will be unforeseen interactions between the capacity market (CM) and the mechanisms that deal separately with voltage reductions and disconnections and the reserve scarcity pricing function. In this context we note Ofgem acknowledges it has not been able to adequately model cash out prices under the CM.

Because of this we believe these further changes should be considered against the background of the Future Trading Arrangements review rather than as this wave of the EBSCR, which should focus on producing a more representative marginal price as the basis for payments to both sides of the market.

Answers to the specific consultation questions are attached.

Please let me know if you have any comments or queries on this response.

Nigel Cornwall


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Cornwall Energy responses to consultation questions

Question 1: Do you agree with our proposal to make cash-out prices more marginal?

Yes in principle a proportionate increase in the PAR value. This should provide the incentive for greater flexibility at times of system stress and finally help encourage demand side response into the market. However, we are concerned that based on the current package without further steps to help market participants manage the increased risk of higher and more volatile price there is a real danger of providing the incentive but not the means for parties to manage their positions.

We foresee the following problems:

- given that the distribution of imbalance prices is skewed to high prices, a risk-averse party will tend to stay long rather than short. This overly cautious behaviour creates inefficiency;
- participants in the Balancing Mechanism could have an unjustified competitive advantage as they can anticipate being the marginal provider and will enjoy pricing information not seen by the wider market; and
- providers of balancing services, which tend to have low balancing costs due to the flexibility of their portfolio, might have an incentive to increase balancing costs and have more influence on these costs if they only have to increase the price for the marginal unit.

These adverse impacts could be mitigated if Elexon or National Grid provides reliable online information about the actual status of the grid and committed generation through the Balancing Mechanism after Gate Closure. Similarly information on likely flagged acceptances should be made available ahead of delivery.

Question 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?

No; we believe marginal pricing should be reflective of the true cost to the SO to balance. We believe that PAR1 is not reflective of the true cost as it highlights only the most expensive action taken.

There is a good case to reduce the PAR value but that the regulator should give further thought to reducing it to 100MWh or 50MWh rather than 1 MWh at this stage. With further experience at this level, the PAR value could then be reviewed again in the future.

We have no major concerns about flagging errors, but we welcome that National Grid is exploring options to allow ex-post correction of SO flags. As noted in the previous answer, information on flagged plant should be shared with the market after Gate Closure.

Question 3: Do you agree with our proposals for pricing of voltage reduction and disconnections, including the staggered approach?

No. We agree that attributing a cost to the currently non-costed actions of disconnections and voltage reductions could in theory make prices more efficient. But setting the cash-out price at an artificially high administered level under such circumstances creates disproportionate risks.

Thus:

- parties facing costs of £6,000/MWh would be incentivised to remain systematically long;

- the proposed approach appears not to differentiate between disconnections for system reasons and those for energy reasons, which would increase the incidence of triggering the ceiling price; and
- the impact assessment shows that the introduction of a Capacity Mechanism (CM), which includes incentives to provide demand side responses, is likely to significantly decrease the need for demand control and may possibly remove it entirely (in combination with the other measures in this SCR).

Question 4: Do you agree with our assessment of the interactions with the CM and its impact on setting prices for Demand Control (DC) actions?

There is clearly substantial uncertainty in how the interaction will operate in practice, given that there is still work to develop the CM in detail.

It would be better to introduce the CM and then re-evaluate if the inclusion of DC into the cash-out price is still necessary to incentivise the correct balancing behaviours. Rather than forcing involuntary demand control, the SO will be able to contract voluntary DSR even at very high prices for activation. In doing so, a market price for disconnections can be achieved, so that cash-out prices remain a proxy for the actual costs of balancing.

More fundamentally, it is important that unintended consequences are avoided through parallel development of the CM and the EBSCR. In this context it would be prudent to allow the CM design to be finalised and then Ofgem's proposals for the EBSCR properly evaluated and tested.

Question 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 NHH business consumers?

No. This should be re-examined at a late stage only if the decision to implement pricing for voltage and disconnections is implemented.

Question 6: Do you agree with the introduction of the Reserve Scarcity Pricing (RSP) function and its high-level design? Explain your answer.

No. The RSP function is designed to reflect the value rather than the cost of reserve in the cash-out price, but only provided it is accompanied by pay-as-clear by reserve providers. This could strengthen signals on both sides of the market during times of system stress. However, we think the shift to a more marginal price should be sufficient on its own for the foreseeable future and allow some of Ofgem's behavioural assumptions and assessment of impacts to be properly tested..

Question 7: Do you agree with our rationale 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.

Yes. We are strongly in favour of moving to a single price because it rewards participant actions that support the grid when the system is tight.

Furthermore the current dual pricing rules have had a profound effect in evolving the market structure that exists today, providing an incentive towards vertical integration.

Question 8: Do you have any other comments on this consultation, including on the considerations where we did not propose any changes?

Yes. We have concerns relating to the decision on no change to the timing of Gate Closure and contract notifications timescales, which seems not to have been properly evaluated.

In the absence of specific measures to enable the market to better manage volume risk, we think that much more consideration needs to be given on enhancing the information available to the market if it is to be able to respond rationally to the price signals.

We were also expecting more considered analysis of netting of production and consumption accounts in the light of the P282 decision letter. In this context, the following wording should be highlighted: the case for approving P282 "is not proven *at this stage* [Ofgem's emphasis]. There is significant uncertainty around the possible impacts and the arguments to approve or reject are finely balanced". The decision then goes on to state: "We consider that these issues require fuller, more holistic, consideration as part of the EBSCR process, to ensure overall consistency of the outcomes". That has clearly not happened.

Question 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 believe there are still gaps in the assessment. See comments in response to Q8 and also below.

Question 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.

The impact assessment is highly dependent on qualitative assessment.

At a more detailed level:

- more volatile short term prices will not incentivise more flexible capacity to be built. In order to build new flexible generation (such as CCGT or OCGT) developers will need to see long term security over revenues to secure finance. This incentive should be provided through the CM;
- we have already noted that cash-out reform will feed back into market pricing and risk premiums. This is very likely to push consumer bills up if the cash-out price is artificially inflated through including an artificially inflated value for demand control actions and the RSP function. In particular there is no assessment of the impact on short-term forward prices;
- Ofgem seems confident that the impact of the CM will be to significantly reduce any signal through cash-out reform for additional capacity to be provided. It has not been able to estimate the extent to which the signal is reduced because of the limitations of the cash-out model. This is not very satisfactory given the importance of the issue; and
- as we have already noted, sharper cash-out prices will only lead to better balancing behaviour if it is also accompanied by adequate information which allows parties to respond to the signals in advance. If this information is provided, this impact should materialise to a certain extent (although intermittent generation will still struggle with forecasting to balance). However, without extra information provision the impact is likely to be increased costs for parties and increased barriers to entry in the energy market.

Question 11: Do you agree with 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 are cautious of the analysis which concludes that the risk of system pollution is very low, and believe an initial step of moving to PAR100MWh or PAR50MWh is more appropriate at this stage. Moving to PAR1MWh is not cost-reflective as it only represents the cost of the most expensive action.

Similarly there is clear scope for portfolio players who participate in the Balancing Mechanism to hold advantageous knowledge ahead of the market more generally under the proposed arrangements. Ofgem would need to continue to monitor behaviour and to rigorously carry out its obligations under REMIT and enforce the generator constraints licence condition.

We think any incentives towards increasing short term liquidity may be dampened by parties' inability to forecast accurately what the cash-out price might be and how its balances compares with the market overall. Information will need to be provided in a timely fashion on the anticipated NIV to allow parties to react to balancing signals.

We are particularly concerned that there will be unforeseen interactions between the capacity market (CM) and the mechanisms that deal separately with voltage reductions and disconnections and the reserve scarcity pricing function. In this context we note Ofgem acknowledges it has not been able to adequately model cash out prices under the CM. Because of this we believe these further changes should be considered against the background of the Future Trading Arrangements review rather than as this wave of the EBSCR.

Question 12: What if any further analysis should we have undertaken or presented in this document? Do you have any additional analysis or evidence you would like to contribute to support the development of the EBSCR towards its Final Policy Decision?

We believe that further analysis is needed of the potential behavioural changes which the proposed measures could lead to. This also needs to explicitly consider the impact that better types of information will have on these behaviours. Above all there is an urgent need to consider how information dissemination can be improved after Gate Closure and whether it is feasible for National Grid to construct indicative cash-out prices.

We also believe that the general impact on market price should be considered. We believe that, if these elements are not considered further, there could be a number of unintended consequences that will cause participant and consumer detriment resulting from the implementation of the EBSCR proposals. In this context the net annual benefit calculated for 2030 is very modest.