

Future Trading Arrangements – 3rd Forum

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ofgem

1. The FTA process so far
2. Outline of potential workstreams
3. Criteria for prioritisation
4. Scope and prioritisation of workstreams
5. Scope of stage 2, role of forum and next steps

The market is changing and the challenges are significant

Challenges



Change in generation mix (intermittency, plant retirement, new technologies)



European integration (European Network Code reforms, greater interconnection)



Government's Electricity Market Reform (capacity mechanism, CfDs/FiTs)



Financial regulation (REMIT, MiFID/MiFIR, EMIR)



Technological changes (smart metering, DSR capabilities, storage)

Strategic questions

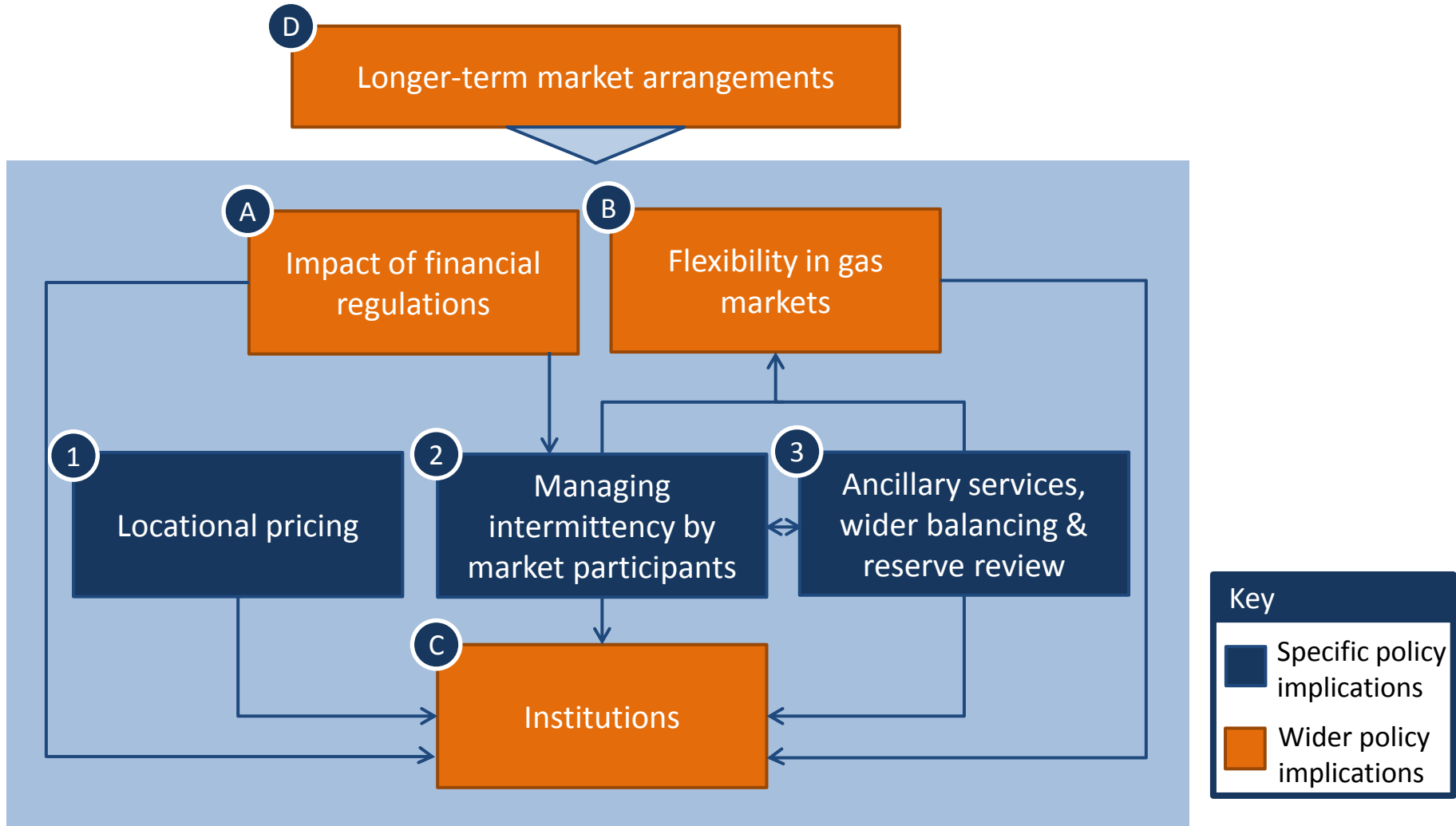
(1) How do trading arrangements need to evolve to provide for the transition to EMR, European integration and make the most of technological developments?

(2) What is the long-term role of the market and trading arrangements to deliver security of supply, and low-carbon and affordable energy?

The Forum previously agreed that these challenges should be considered holistically

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Workstreams identified



Workstreams may address multiple challenges

		5 Challenges				
		Changes in generation mix	EU integration	EMR	Finance regulation	Technology changes
7 Workstreams	1. Locational pricing		✓			
	2. Managing intermittency by market participants	✓	✓	✓		✓
	3. Ancillary services, wider balancing & reserve review	✓	✓	✓		✓
	A. Impact of financial regulations				✓	
	B. Flexibility in gas markets	✓				
	C. Institutions		✓	✓		✓
	D. Longer-term market arrangements	✓	✓	✓		✓



Have we identified the right workstreams to address the challenges?

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1. Legal requirement

- This indicates where Ofgem may be required to act by legal obligations, such as binding European Network Codes.

2. Materiality

- This reflects both a direct assessment of the size of the issue addressed by the workstream, where applicable, and a more qualitative assessment of the potential impacts on industry arrangements.

3. Urgency

- This relates to the timing of when action might be required. Although there may not be a legal requirement to consider the issue, action may be required in the short-term to address a specific challenge.

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Questions for each workstream

The following slides will outline the workstreams and their proposed ratings against the three criteria. We would appreciate your views on the following:

What are your views on the scope of the workstream?



Are the ratings against the criteria appropriate?

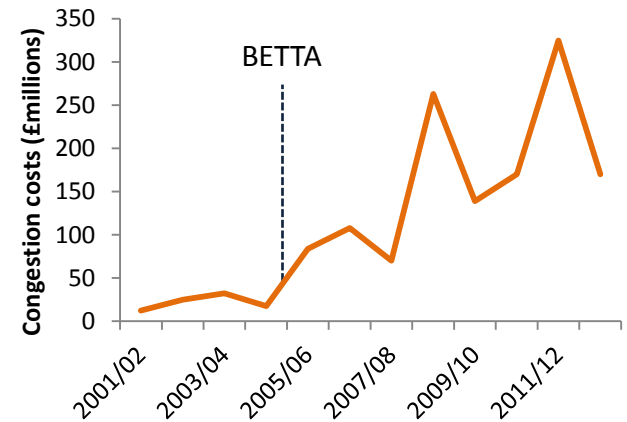
Have we missed anything?

WS1: Locational pricing

Scope	<ul style="list-style-type: none"> ■ Examine the merit and potential options of introducing locational pricing in GB ■ Feed into and/or incorporate CACM obligations, but recognise need to assess additional GB implications, costs/benefits and distributional effects ■ Develop a methodology for GB assessment, then undertake assessment to provide a recommendation to FTA Forum with pros/cons of different options
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High Legal requirement	<ul style="list-style-type: none"> ■ Requirement of CACM code* for consideration of Bidding Zones <p><small>*CACM code text still to be finalised. Exact responsibilities and timings are therefore still subject to revisions</small></p>
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High Materiality	<ul style="list-style-type: none"> ■ Congestion costs increasing ■ Any changes to locational prices would have far-reaching impacts upon industry
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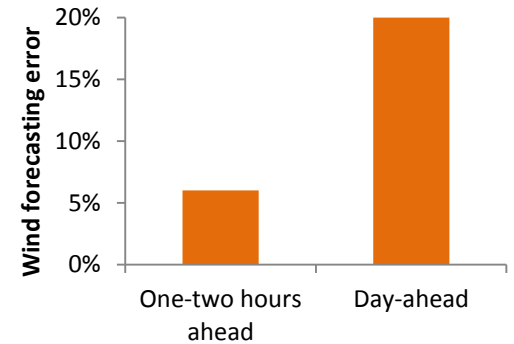


Source: National Grid

High Urgency	<ul style="list-style-type: none"> ■ CACM should enter into force in mid-2014 with expected obligations within 6 months.
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WS2: managing intermittency by market participants

<p>Scope</p>	<ul style="list-style-type: none"> Consider additional measures to manage uncertainty near real-time such as intra-day auctions, balancing energy market, cross-border trading, DSR, etc. Cost benefit assessment of measures Recommendation to the Forum on options to better manage intermittency
<p>Medium Legal requirement</p>	<ul style="list-style-type: none"> Consider in context of the European CACM code, which promotes continuous intraday trading
<p>Medium Materiality</p>	<ul style="list-style-type: none"> Volume of wind capacity expected to increase from 7 GW currently to around 20 GW in 2020 Forecasting error falls considerably closer to real time (from 20% day ahead to 5% one-hour out)
<p>Medium Urgency</p>	<ul style="list-style-type: none"> 3-fold increase in renewables by 2020 requires more tools to manage intermittency; also intraday trading across interconnectors grows in importance



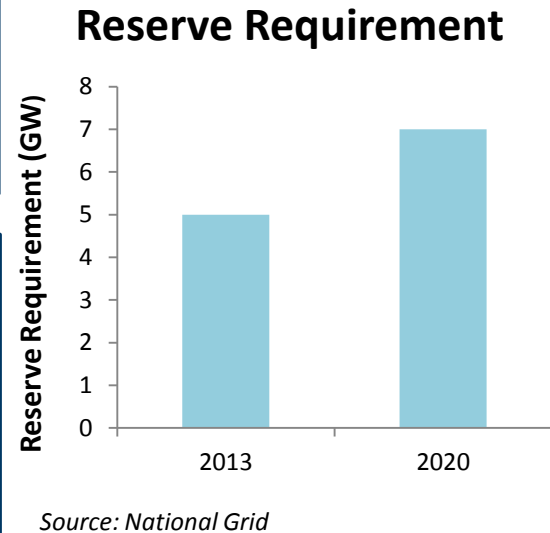
Source: National Renewable Energy Laboratory

WS3: ancillary services, balancing & reserve review

Scope	<ul style="list-style-type: none"> ■ Consider measures such as a short-term organised reserve market, ancillary service review, pay-as-clear in balancing market, changes to timing & settlement periods etc ■ Consider cross-border balancing requirements, as established in the Balancing NC ■ Recommendation to Forum on requirement for additional services, changes to how services are procured and any other potential market changes
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Medium	Legal requirement	<ul style="list-style-type: none"> ■ Review how the SO procures ancillary services in the context of developments required due to Balancing NC obligations
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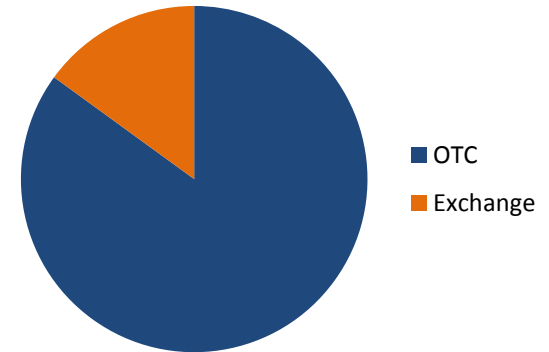
High	Materiality	<ul style="list-style-type: none"> ■ Currently costs of approx. £850 million pa to balance the system. These costs are projected to increase ■ Growth in RES generation may require to access new tools for SO to efficiently balance the system
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Medium	Urgency	<ul style="list-style-type: none"> ■ Medium urgency as intermittent generation will grow steadily over the decade and cross-border balancing will likewise grow
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Workstream A: impact of financial regulations

Scope		<ul style="list-style-type: none"> ■ Analyse the impact of the different regulations on trading arrangements e.g. likely that trades will need to go through clearing houses ■ Identify benefits (such as transparency and liquidity) and costs (such as credit/collateral requirements). ■ Provide Forum with analysis on impact of regulations, once they are finalised
Low now	Legal requirement	<ul style="list-style-type: none"> ■ At this stage in the development of financial regulation there is no legal obligation to change trading arrangements, however it is unclear what the effect of regulations could be once finalised
No rating	Materiality	<ul style="list-style-type: none"> ■ Depending on the final design of the rules, materiality may be high or low, it is not possible to assess the impact at this point.
Low	Urgency	<ul style="list-style-type: none"> ■ At this point there does not appear to be an urgent requirement for Ofgem to act



Source: 2013 GB National Report to EC

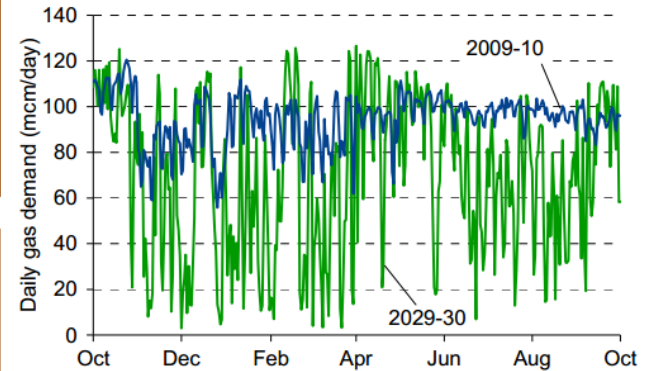
Workstream B: flexibility in gas markets

Scope	<ul style="list-style-type: none"> ■ Consider the possibility of intra-day balancing market for gas ■ Review implications for price of gas and value of flexibility, such as line pack storage and additional flexibility products ■ Consider interactions with EU Gas Target Model e.g. more market-based balancing ■ Recommendation on policy options to inform Forum
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Low	Legal requirement	<ul style="list-style-type: none"> ■ There is currently significant flexibility in the gas system and it is an issue that has been examined over the last 10 years.
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Low but increasing	Materiality	<ul style="list-style-type: none"> ■ Profile of gas generation likely to be much more volatile in the next decade ■ Challenge to NTS design
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Low	Urgency	<ul style="list-style-type: none"> ■ There is low urgency, due to the volatility of gas-fired generation becoming an issue only in the next decade.
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Source: 2010 Poyry multi-client study

Workstream C: institutions

Scope	<ul style="list-style-type: none"> ■ Consider the changing roles and responsibilities of institutions and their governance arrangements and if there is scope for complementary improvements to the trading arrangements ■ Benefit assessment of taking on new roles (e.g. synergies, experience, informational advantages, economies of scale) vs. cost impact (e.g. implementation costs, conflicts of interest, competition) ■ Recommendation to the Forum on governance, rules and regulations (to be considered once Workstreams 1-3 have been further developed)
Low	<p>Legal requirement</p> <ul style="list-style-type: none"> ■ Ofgem and DECC are currently developing the detail of the roles and responsibilities of the various institutions as part of EMR implementation. There is no other legal requirement for us to formally consider the roles and responsibilities of institutions.
Medium	<p>Materiality</p> <ul style="list-style-type: none"> ■ Changes in the trading arrangements will ultimately lead to changes in institutional arrangements.
Low	<p>Urgency</p> <ul style="list-style-type: none"> ■ This workstream is considered to be low urgency, as changes are likely to occur further in the future, once other prioritised workstreams have been undertaken.

Workstream D: longer-term market arrangements

Key driver

- Path dependency in policy and regulatory choices means that the short-medium term affects the longer-term picture
- Trading arrangements need to allow for Capacity Mechanism in short-medium term and provide market signals to drive long run investment when the capacity mechanism transitions out

Scope

- Draw up the high-level picture for the GB electricity market for 2025 and beyond, especially relating to security of supply
- Identify the trading arrangements necessary to ensure that security of supply is achieved over the long-term
- Recognise potential uncertainties and opportunities associated with future e.g. generation mix, impact of technology, interaction with other policies, etc
- Where appropriate, identify and assess policy solutions

Ensure policy conclusions in other workstreams are consistent and compatible with the long-term picture

Summary of workstream prioritisation

		Legal requirement	Materiality	Urgency	Priority	Key
1	Locational pricing	High	High	High	High	Legal requirement: Ofgem required to act, for example by binding Network Codes
2	Managing intermittency	Medium	Medium	Medium	Medium	
3	Ancillary service review	Medium	High	Medium	Medium	
A	Impact of financial regs.	Low now	<i>unclear</i>	Low	Low	Materiality: Estimated magnitude of issue workstream is to address
B	Flexibility in gas markets	Low	Low now, but increasing	Low	Low	Urgency: Short-term action required to address a challenge
C	Institutions	Low	Medium	Low	Low	
D	Long-term market view	All of the above workstreams must be consistent with the long-term view of market arrangements			High	



What are the Forum's views on proceeding with these workstreams?

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Options for future governance of FTA

1

FTA
Project,
no Forum

> Ofgem would progress the project, engaging with external stakeholders through consultations and occasional workshops.

✓ Pros: limited industry resources required

✗ Cons: no senior industry focal point to engage with Ofgem and DECC

2

Forum to
continue

a. Continue existing approach

> Continue with the existing governance structure. Forum for senior engagement & working group providing technical input into workstreams

✓ Pros: Focal point remains, with senior industry input and working-level input

✗ Cons: Significant resources required from industry to engage at several levels

b. Forum only

> Continue with senior level engagements through the Forum but Ofgem would progress the main project tasks without working-level industry inputs

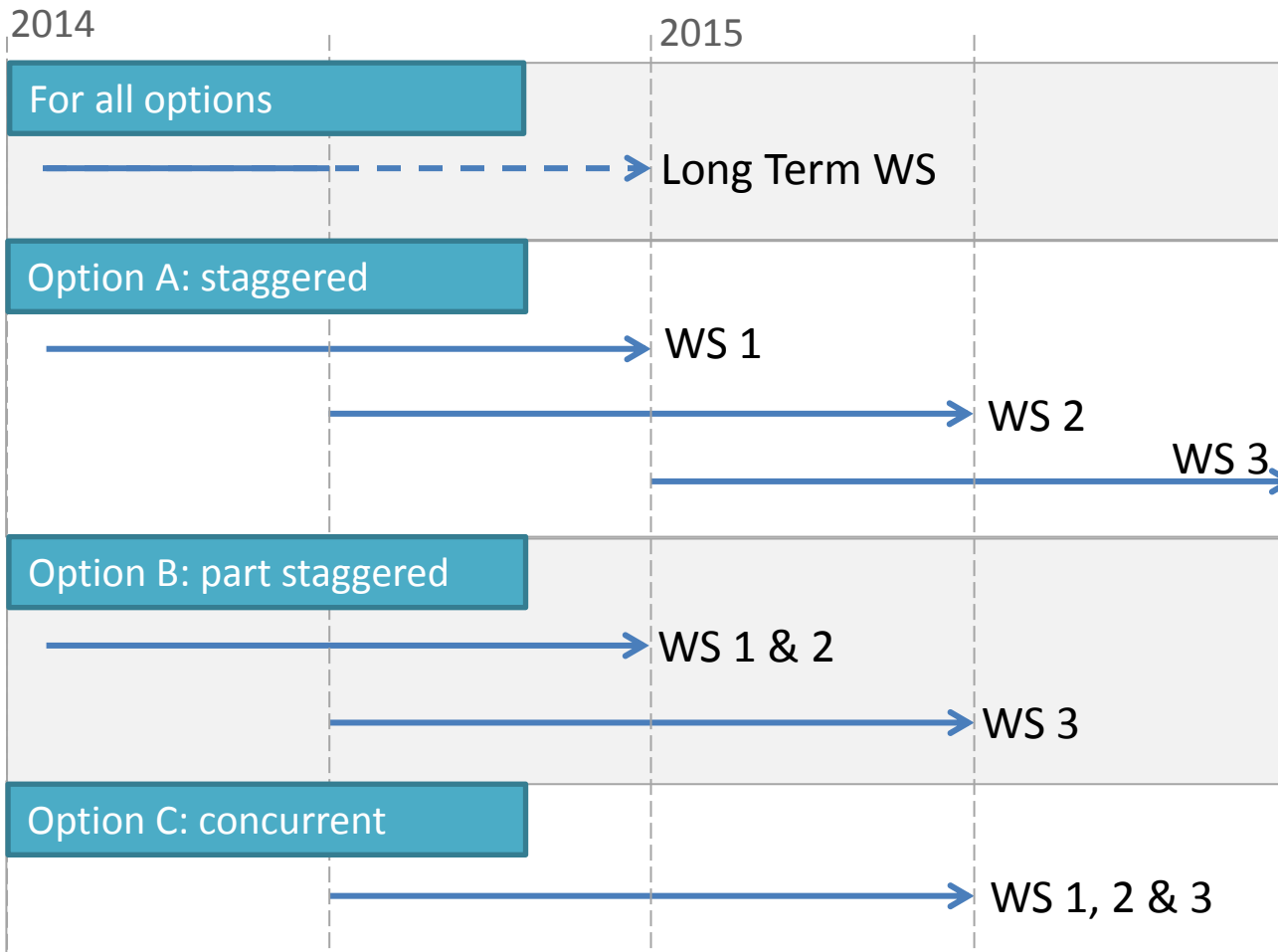
✓ Pros: Focal point remains, with senior industry input

✗ Cons: Less working level input



We have found the Forum helpful and are keen to continue with active industry interaction. Does the Forum agree, and is the Forum the best format?

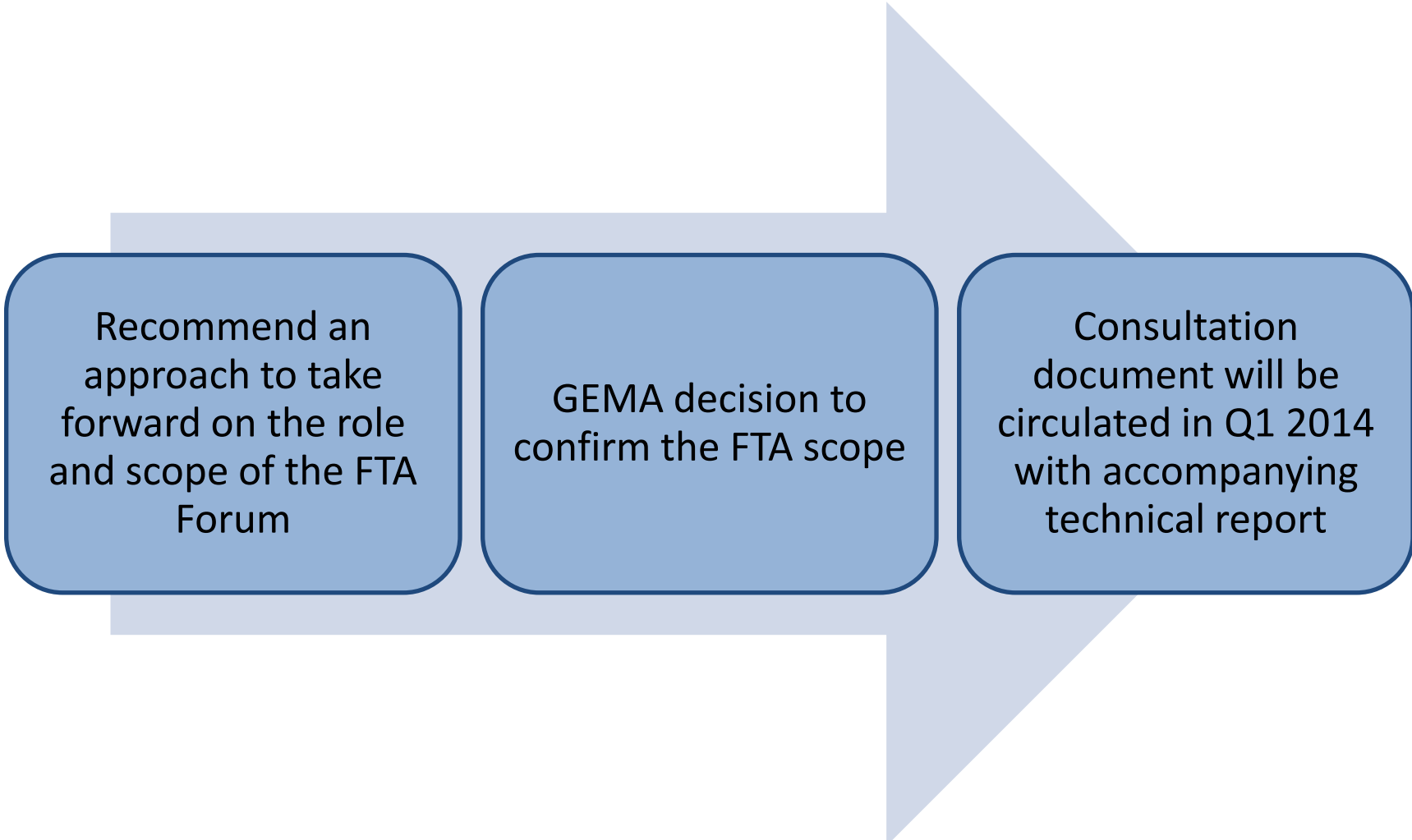
Illustrative timings of workstreams



Key
WS1: Locational Pricing
WS2: Managing intermittency
WS3 : Ancillary services



What are your views on the timings of the workstreams?



Recommend an approach to take forward on the role and scope of the FTA Forum

GEMA decision to confirm the FTA scope

Consultation document will be circulated in Q1 2014 with accompanying technical report