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Date : 22nd October 2013

Dear Andreas,

Electricity Balancing Significant Code Review

Thank you for the opportunity to respond to Ofgem's draft policy decision consultation in respect to the Electricity Balancing Significant Code Review.

SSE continues to share Ofgem's view that cash-out prices are currently being dampened by a number of factors (PAR effect, lack of pricing of demand control actions and targeting of reserve costs); and that scarcity and flexibility therefore are not being properly valued by the market resulting in inefficient balancing and dispatch signals and undermining investment.

SSE continues to support Ofgem's desire to reform the arrangements. We are supportive of the majority of the proposed policy package 5, with notes of caution in some areas, but cannot support the proposed customer compensation arrangements.

In summary, our views on the key aspects of policy package 5 are:

Marginal pricing – SSE supports the introduction of a PAR1 price as this will sharpen prices, better reflect scarcity value and reward flexibility, which is necessary in our view to ensure that a credible incentive exists to trade and invest in order to improve security of supply. An ex-post method of correcting flagging errors seems appropriate.

Single price – SSE supports the introduction of a single price which will improve balancing efficiency and market liquidity. This is doubly necessary when considered in the context of a marginal pricing regime where dual price spreads (and participant costs) would become more pronounced.

Reserve Scarcity Pricing function – SSE supports the desire to price the use of long-term reserve contracts in a different way, as the current process is not optimal. We support in principle the concept of the RSP. However significant detail of how it would work in practice remains outstanding and we would caution against a hasty implementation in order to guard against unintended consequences.

VoLL pricing of non-costed actions – SSE supports the inclusion of VoLL price within cash-out formulation, but would caution Ofgem to take care that the price level is carefully considered in the context of its interaction with the EMR Capacity Market and the gas cash-out arrangements.

Consumer compensation payments – SSE does not support the proposed customer compensation arrangements. We believe that the administrative burden will be excessive and costly; that significant definition issues exist that will create consumer confusion as to which payment arrangements apply in which circumstances thus further damaging industry credibility; that compensation payments in these circumstances imply firm connection rights which is not supported by the current industry arrangements; and that firm connection rights cannot be expected where Government is going to set a Loss of Load Expectation on behalf of the consumer, effectively recognising that the consumer does not wish to pay for an infinite system that always guarantees security of supply.

Decision and implementation timetable – SSE would urge Ofgem to consider whether certain aspects of the proposal could be implemented in time for Winter 2014/15, as system margin faces being squeezed over next Winter. Security of Supply would therefore benefit from an early introduction of improved flexibility signals. Regardless of whether an accelerated implementation is available for certain aspects of the proposals or not, clarity on the final decision is needed as soon as possible in advance of the first Capacity Market auction in Winter 2014.

Collateral arrangements – sharper, more volatile cash-out prices are likely to increase the credit burden on all market participants, but particularly smaller and independent players, increasing wholesale transaction costs. SSE would urge Ofgem in particular to consider the potential impact of ongoing European financial regulation development and the subsequent cost and liquidity implications to the industry and consumers that could ensue.

Market prices – in the short-term, a move to sharper cash-out arrangements is likely to lead to an increase in the wholesale price, which could lead to a subsequent increase in retail price. Given the current public scrutiny of retail prices, we believe that this risk

ought to be clearly understood and communicated in Ofgem's final decision document. Additionally, SSE are concerned that market participant fear of inadvertently breaching regulations put in place to deter and prohibit inappropriate pricing behaviour may undermine Ofgem's intent to allow prices to tend towards VoLL in response to system stress signals. We would urge Ofgem to carefully consider any unintended consequences that could arise as a result.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'A. Colley', with a long horizontal stroke extending to the right.

Andrew Colley
Regulation Manager