



System Operators, Transmission  
System Owners, Generators,  
Suppliers, Traders, Customers  
and Other Interested Parties

Direct Dial: 020 7901 7000

Email: [wholesale.markets@ofgem.gov.uk](mailto:wholesale.markets@ofgem.gov.uk)

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Dear Colleagues,

## **Update on the Future Trading Arrangements Process**

This letter sets out our plans over the next six months for the work on future electricity trading arrangements. We plan to hold the next Future Trading Arrangements Forum in the summer.

Following consultation with stakeholders, Ofgem has launched a Future Trading Arrangements (FTA) programme to consider the wide range of issues impacting on the electricity wholesale market. These include: Government's Electricity Market Reforms (EMR); increased levels of renewable generation; greater European integration; and technological developments such as smart meters and storage. Through the programme, we aim to take a holistic, coherent and timely approach to addressing the impact of developments on the market and to limit uncertainty.

In May 2013 we launched the FTA Forum<sup>1</sup>. It provides an opportunity for Ofgem and DECC to meet jointly with the industry to consider the key issues affecting the electricity trading arrangements and to discuss how the arrangements could evolve.

During 2013, the Forum established a number of working groups to consider the key principles that should underpin the electricity trading arrangements and to identify the priority issues for consideration in the Programme. The latter topic reflected feedback from many stakeholders that while they supported the FTA Programme, it needed to be carefully scoped and prioritised given the range of initiatives in the electricity sector and the competing pressures on stakeholders, especially in the run up to the introduction of EMR<sup>2</sup>.

Feedback from those attending the Forum has been positive. Stakeholders generally found it helpful, and agreed that it should continue in some form. We appreciate industry's input into our FTA work, the opportunity to include DECC in the discussions and the positive feedback. We intend to continue with the Forum. We propose to hold the next meeting of the Forum in the summer to allow the industry to focus on EMR implementation in the first half of the year.

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<sup>1</sup> | <https://www.ofgem.gov.uk/publications-and-updates/update-future-trading-arrangements-consultation-and-invitation-applications-participate-new-future-trading-arrangements-forum>

<sup>2</sup> <https://www.ofgem.gov.uk/electricity/wholesale-market/forums-seminars-and-working-groups/future-trading-arrangements-fta-process>

In the meantime, and ahead of the next Forum, Ofgem will commence one priority workstream discussed in the Forum and will give more consideration to the scope of other work for inclusion in the FTA Programme. This is explained in more detail below.

### ***One priority workstream – locational pricing***

Members of the Forum were in agreement that a priority was to develop an analytical framework for assessing the case for introducing locational pricing in GB. At present we have a single electricity market across GB. However, a new European network code, which is expected to come into force later this year, will require regular assessments of whether the boundaries should be drawn according to enduring network constraints instead. The Forum identified the need for the development of this framework as a preparatory step ahead of the new requirements coming into effect.

Over the next few months we will develop our thinking on the challenges posed by locational pricing and on the appropriate analytical framework to apply to this issue. We will bring our initial work to the Forum during summer 2014, and consult more widely on this framework as appropriate.

### ***Areas for potential further work***

The Forum considered three other potential workstreams, as follows:

- Workstream 2 – Managing intermittency: This would examine measures to promote liquidity close to real-time and to consider measures and tools for market participants to better manage imbalance risk.
- Workstream 3 – Ancillary services, wider balancing and reserve review: Changes to the structure of generation are likely to increase the residual balancing role of the SO. This workstream would consider whether the SO has the correct tools to ensure the most efficient dispatch of the system overall is achieved. More widely, this workstream could also consider whether the division of responsibilities between the market and the SO is correct.
- Workstream 4 – Long-term market arrangements: There is a degree of uncertainty regarding the future because of the range of significant developments facing the market. There is also a concern that without greater clarity, changes to the market arrangements could happen in a piecemeal manner. Consequently there is a call for a better understanding of how the arrangements will evolve, while recognising that it is not appropriate to be overly prescriptive or deterministic. The FTA Forum has usefully developed draft high level guiding principles for the market<sup>3</sup>. We are keen to take this work further so there is a more useful output to give greater certainty for current and potential market participants.

When we meet with the Forum in the summer we will share our further thinking on how the above three workstreams should be taken forward. Further details of the proposed workstreams can be found on the dedicated Ofgem FTA micro-site<sup>4</sup>. If you have any comments or questions on the content of this letter, please contact Andrew Ryan at [wholesale.markets@ofgem.gov.uk](mailto:wholesale.markets@ofgem.gov.uk).

Yours sincerely,

Rachel Fletcher

Interim Senior Partner, Markets

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<sup>3</sup> <https://www.ofgem.gov.uk/ofgem-publications/83563/fta2ndforumslides.pdf>

<sup>4</sup> <https://www.ofgem.gov.uk/electricity/wholesale-market/forums-seminars-and-working-groups/future-trading-arrangements-fta-process>

## **Annex I Background to FTA Process**

### **Background to Forum**

Our open letter in February 2013 noted the challenges identified in Project Discovery<sup>5</sup>, and subsequent market and policy developments, emphasised the importance of GB electricity trading arrangements remaining fit for purpose and adapting to the changes triggered by government policy, European reforms and market trends. We suggested that the consideration of interactions between the multiple drivers of change in the GB electricity market is crucial to ensure that the trading arrangements deliver: efficient operation of existing assets; appropriate incentives to maintain existing assets and invest in new capability; and effective and efficient integration with wider European markets to the benefit of GB consumers.

A holistic approach to trading arrangements should also help to avoid the development of an incoherent set of mechanisms or a series of overlapping reforms which may involve undoing previous decisions within the space of just a few years. Moreover, such an approach could lead to improved investor certainty, with potential benefits for consumers in terms of lower cost of capital and less redundancy in systems redesign.

### **Objectives**

The objective of the FTA Forum is to seek to build consensus on the approach to wholesale electricity trading arrangements in the context of EMR, European Target Model, market and technological developments. The FTA Forum:

- provides a focal point for stakeholders, Ofgem and DECC to engage on the full range of matters affecting trading arrangements;
- aims to support industry certainty regarding any future developments;
- identifies future challenges for wholesale electricity market as a result of policy and market changes as well as key interactions with the gas market;
- supports Ofgem's policy development in this area and identifies further streams of work that Ofgem or industry could take to address these challenges;
- helps all stakeholders to better understand future developments which could affect trading arrangements;
- ensures consistency between market and network<sup>6</sup> policy changes.

Our approach is to build on the successful characteristics of existing trading arrangements while reflecting on the market impacts of increased European integration and government's implementation of EMR.

### **What is the Forum and how does it work**

We bring together a small number of people (around 25) who can help inform and shape our work on trading arrangements. Our intention is that membership of this Forum should be from senior experts within the industry. In addition to DECC, membership includes National Grid and representatives from the Irish regulatory authorities. This ensures appropriate coordination between CER's Market Integration Project<sup>7</sup> and the work of the FTA Forum. We will invite a range of speakers to present at the Forum so that all members

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<sup>5</sup> In 2010, Project Discovery highlighted that current trading arrangements do not always provide the right signals for investment or efficient operation; allow equal treatment for the demand side; mitigate risks associated with the increasing interdependence on international markets; nor ensure consistency between gas and electricity.

<sup>6</sup> For example, Ofgem's ITPR project is a review of the current arrangements for system planning and delivery to determine whether these are appropriate to achieving a long-term efficient integrated network - onshore, offshore and cross-border. See here for more information:

<http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/itpr/Pages/index.aspx>

<sup>7</sup> The Irish Market Integration Project is jointly run by CER and UREGNI. For more information, see SEM-13-009a - SEM Committee Next Steps Response Paper, February 15<sup>th</sup> 2013:

[http://www.allislandproject.org/en/sem\\_publications.aspx?year=2013&section=2](http://www.allislandproject.org/en/sem_publications.aspx?year=2013&section=2)

develop a clearer understanding of key developments, such as the European Target Model, EMR and the work that Ofgem is already undertaking related to electricity trading arrangements.

Ofgem provides the Forum's Chair and Secretariat and ensures that papers are circulated in advance. Ofgem ensures that all papers presented to the Forum, including working papers delivered by the Forum's Working Groups, and minutes of Forum meetings are published on a dedicated microsite for this purpose. The FTA Forum does not have any decision making power in respect of Ofgem's statutory functions and Ofgem's decision making remains with the Authority (GEMA) and Executive Committee. The FTA Forum plays an important role in developing and discussing the options and analysis to allow the Authority to take informed decisions.

We place great importance on building industry-wide consensus and certainty throughout the FTA process. As such we would like to emphasise that the Forum will not replace Ofgem's standard consultation and stakeholder engagement process.