

BEIS' consultation on "re-coupling GB auctions for cross-border trade with the EU at the day-ahead time frame"

Energy UK Response

3 November 2021

About Energy UK

Energy UK is the trade association for the energy industry with over 100 members spanning every aspect of the energy sector – from established FTSE 100 companies, right through to new, growing suppliers and generators, which now make up over half of our membership.

We represent the diverse nature of the UK's energy industry with our members delivering over 80% of both the UK's power generation and energy supply for the 28 million UK homes as well as businesses.

The energy industry invests £13bn annually, delivers £31bn in gross value added on top of the £95bn in economic activity through its supply chain and interaction with other sectors, and supports 738,000 jobs in every corner of the country.

Both GB power exchanges EPEX SPOT and Nord Pool are members of Energy UK.

The views expressed in this consultation response do not represent the unanimous views of all Energy UK's members. In particular, while the majority of EUK members support the government's proposed action to bring about the recoupling of the GB power exchanges in the day ahead market, there is greater diversity of views on further actions beyond this immediate priority.

Introductory Remarks

One of the immediate consequences of the EU Exit and the departure from the Internal Energy Market (IEM) was the de-coupling from the European markets.

In addition, as of the 1 January 2021 the GB power exchanges now have to run and calculate their own day-ahead auction results independently of any cross-border capacity allocation process and of each other.

As the Nord Pool and EPEX SPOT exchange platforms have de-coupled, their separate and distinct order books, volumes and liquidity characteristics have created divergence in outturn prices.

Over the past couple of months (and especially in early January), the GB market experienced several exceptional price events, with noticeable difference between both GB day-ahead prices. While the situation described above was probably attributable to an accumulation of circumstances, having two day-ahead auctions, often clearing at different prices, inevitably leads to additional risks for market participants, and ultimately additional costs for consumers.

Therefore, in our view, re-coupling both power exchanges and re-merging their order books, with a single day-ahead auction, should be prioritised in order to reduce the additional and avoidable risks and costs that have been imposed on market participants and consumers.

We, therefore, welcome BEIS' consultation and consider it a necessary step in resolving the immediate consequences of the day-ahead price decoupling issue. At the same time, it is also encouraging that

the Government contemplates some wider measures, such as full and fair competition for power exchanges in other timeframes, which will be equally important to address in the longer term.

Our detailed answers to the consultation questions are included below.

1. What has been the impact (financial or otherwise) of power exchanges ceasing to couple their auctions in the day-ahead timeframe and not producing a single GB clearing price? Please provide details and estimates of the impact.

The decoupling of the GB day-ahead auctions has resulted in:

- Practical difficulties for market participants to manage two day-ahead market auctions;
- Inefficiencies associated with the gap between the day-ahead auctions and scheduling of the interconnector flows;
- Difficulties in terms of identification of a single GB day-ahead price;
- Less liquidity in both exchanges (simply lower volume traded) which, in turn, has led to higher volatility and uncertainty where the outturn of DA markets has been particularly hard to predict, and price deviations between exchanges have been significant. This removes confidence from the market, and creates an additional risk cost to trading activities; and
- Difficulties (greater uncertainty and complexity) with the management of portfolios, particularly on the most pronounced days where the differences between hourly prices in the auctions are hundreds of pounds per MWh.

2. Do you agree with the proposal for the two day-ahead auctions noted in paragraph 22 to be used as the 'relevant day-ahead markets' for the purposes of Annex 29 of the TCA?

Yes, we agree with the proposal for the two day-ahead auctions noted in paragraph 22 to be used as the 'relevant day-ahead markets' for the purpose of Annex 29 of the TCA. We also support the view that any necessary adjustments to the timing of those auctions to accommodate MRLVC can be made in the future.

In addition, in respect of timing, while not directly linked to the core of this consultation we consider that careful consideration should be given to the period in which an asset has been submitted to the auction and the publication of the final clearing price which will ultimately determine the asset's running profile at the day-ahead stage. Given the physical nature of day-ahead auctions, it is important to note that commercial parties participating in these auctions are exposed to underlying price volatility in relation to the cost of generation of the plant being submitted in these auctions. This is particularly relevant to Combined Cycle Gas Turbine (CCGT) stations with the profitability of these assets heavily impacted by the swings in gas prices during the period in which an asset has been submitted to the auction and the publication of the final clearing price which will ultimately determine the asset's running profile at the day-ahead stage. In particular, coupling arrangements prior to market de-coupling meant that auction results were known 45 minutes after submission of bids and offers. This time period was acceptable by market participants given that gas price volatility was less pronounced compared to volatility of gas prices seen in the GB market more recently. Given this, there is a concern that 'loose market coupling' and any underlying processes that are yet to be developed to deliver this function could result in a longer time period between submission of the orders and the auction outcome. Given the extreme gas price volatility that has been observed recently, a lengthy MRLVC process could result in generation assets committing to run unprofitably as a result of underlying movement in prices. This could have unintended consequences of drying up liquidity in the auction as market participants try to mitigate the risk of committing the plant in the auction when exposed to volatile fuel prices. Therefore, careful consideration of this issue should be given at the time of the development of the detailed processes and procedures underpinning the MRLVC mechanism.

- 3. Do you agree that the coupling of the ‘relevant day-ahead markets’ is necessary to provide the appropriate market arrangements to support efficient trade of electricity over interconnectors, as part of and in any case in advance of MRLVC? Please provide supporting evidence for this necessity.**

Yes, we agree that the coupling of the ‘relevant day-ahead markets’ is necessary and can be implemented in advance of MRLVC. This would ensure that the benefits to market participants and consumers from coupling is realised sooner. MRLVC itself, which per definition is a “looser” arrangement to the existing coupling arrangement and the coupling of the relevant day-ahead markets is a no regret option, which is independent of the decisions on the technical procedures.

- 4. Do you agree with the proposal that legislative intervention is necessary to enable the formation of a single GB clearing price in the ‘relevant day-ahead markets’ to ensure efficient electricity trading over interconnectors, now and as part of MRLVC? Do you have evidence to support this proposal? Do you have any alternative proposals with supporting evidence?**

Yes, we agree with the proposal that legislative intervention is necessary. Energy UK considers that both the Government and Ofgem should have explored, in the first place, any possibilities for a voluntary solution by facilitating a conducive environment for cooperation between power exchanges and interconnectors.

However, and, bearing in mind that such a voluntary mechanism to enable a formation of a single GB clearing price has not been found just yet, we would urge BEIS to prioritise a legislative intervention to ensure the provision of a de-facto single price for GB day-ahead market.

- 5. Do you agree with our outcomes in paragraph 27 against which the market operators should re-couple their ‘relevant day-ahead markets’? Are there additional outcomes that should be required in the recoupling of the ‘relevant day-ahead markets’?**

In principle we agree with the outcomes mentioned in paragraph 27 against which the market operators should re-couple their ‘relevant day-ahead markets’, subject to the following addition (highlighted in *green*):

“(...) as outcomes, the operational arrangements should ensure that the recoupling of these auctions:

- *results in a single GB clearing price across the two ‘relevant day-ahead markets’;*
- *can take place and operate in advance of implementation of MRLVC and be standalone;*
- *allows for future interaction with, and amendment as necessary to facilitate, MRLVC and other efficient price coupling solutions;*
- *is fair and non-discriminatory in the treatment of the relevant market operators, TSOs, and wider market participants; and*
- *account for the needs of the relevant market operators, TSOs, and wider market participants.*

We would emphasise that re-coupling of the relevant day-ahead markets should be prioritised, as it can take place and operate in advance of implementation of MRLVC and be independent. We also believe that the debate on the ultimate price coupling solution is ongoing and, therefore, do not feel that it is appropriate to limit it to MRVLC.

- 6. Taking account of the UK's obligations under the TCA, with particular reference to those provisions in Annex 29, do you agree with the proposed timeframe for making operational the new mechanisms for a single GB clearing price?**

We believe it is critical that re-coupling of the relevant day-ahead markets is operational "as soon as possible" and definitely prior to the entry into operation of the MRLVC. Energy UK considers that the new mechanism for a single GB clearing price should not be conditional on the timelines provided in Annex 29 of the TCA specifically for the MRLVC process.

- 7. Do you agree with our proposal for the costs of re-coupling the 'relevant day-ahead markets' be borne by the operators?**

Our members express different views as to whether the costs of re-coupling the 'relevant day-ahead markets' should be borne by the operators or socialised amongst those who benefit directly from the market. Irrespective of the above, we would, however, add that the final solution to this should be consistent with the outcome of Ofgem's consultation on costs to MRLVC and, if socialised, Ofgem will need to provide a mechanism for cost allocation and recovery. We would also welcome greater transparency from Ofgem and BEIS as to exactly what these costs would be.

- 8. What do you estimate to be the costs of implementing the proposal for either or both operators and the industry more widely? Please provide details and estimates of any relevant activities required to transition from the current arrangements to the new arrangements laid out in the proposal.**

We would argue that it is not yet possible to estimate the costs of implementing the proposal for either or both operators and the industry, more widely, due to the absence of any detailed technical procedures for MRLVC and how a single price would feed in.

- 9. What do you estimate to be the impacts (financial or otherwise) to operators and market participants from adopting the new arrangements laid out in the proposal? What are the impacts of not implementing the proposal? Please provide details and estimates of the relevant costs and benefits.**

We would argue that the ongoing risk cost of operating in decoupled markets is the largest cost we see facing market participants. Please also see our response to question 1 regarding the impact of power exchanges ceasing to couple.

- 10. To what extent do you agree with our proposals for regulating the new mechanism for a single GB clearing price? Should these obligations be capable of enforcement by Ofgem as if they were a relevant requirement on a 'regulated person' for the purpose of the Electricity Act 1989?**

We agree that it should be the role of Ofgem to verify and enforce the fulfilment of the outcomes described in paragraph 27 by the entities operating the 'relevant day-ahead markets', as if those outcomes were a relevant requirement on a 'regulated person' for the purpose of the Electricity Act 1989.

- 11. To what extent do you agree with the proposal for a designation process enabling eligible persons (including existing market operators) to apply to undertake MRLVC functions rather than establishing a new entity for this purpose?**

We agree with the proposal for a designation process enabling eligible persons (including existing market operators) to apply to undertake MRLVC functions rather than establishing a new entity for this purpose.

Energy UK strongly believes that the designation process under the new legislative framework should largely build on the previous processes applicable before our departure from the EU. Those processes worked well in the past and market participants are familiar with them.

12. To what extent do you agree Ofgem should be responsible for assessing entities against any future designation criteria and approving the designation of entities who undertake coupling activities under MRLVC? What do you think any such designation criteria and process should look like?

We agree that Ofgem should be responsible for assessing entities against any future designation criteria and approving the designation of entities who undertake coupling activities under MRLVC.

As already mentioned in question 11, in our view, such designation criteria and processes should largely build on those applicable prior to 1st January 2021.

13. An alternative legislative option would be to licence those entities who wish to undertake market coupling under MRLVC relating to ‘relevant day-ahead markets’ for the purposes of Annex 29 of the TCA. It would be beneficial to obtain stakeholders thoughts on this alternative approach.

It is our view that the process of “*designation*” and “*licensing*” of those entities who wish to undertake market coupling under MRLVC relating to ‘relevant day-ahead markets’ are not mutually exclusive, as the latter is more linked to the long-term governance process of those entities.

While our preference, in line with the responses to questions 11 and 12, would be to replicate the processes under CACM when the UK was still part of the IEM, we also consider that further details on the licensing process should be provided, so that the entities who wish to undertake market coupling under CACM, could make an informed decision on the available options.

14. Are there similar issues and concerns, as set out in this consultation for the ‘relevant day-ahead markets’, for the intraday trading timeframe?

Yes, we consider that there are similar issues and concerns for the intraday timeframe. However, it’s worth noting that the single intraday price already exists for the GB interconnectors to the island of Ireland, under existing regulation. Nevertheless, a single GB clearing price for intraday is still needed on the GB interconnectors to the continent, so that the flows of variable renewable energy could be managed more efficiently. As such, whilst changes would be welcome, it is not as critical as the re-coupling of the relevant day-ahead markets.

In the longer-term, we consider that in line with the TCA¹, the development of arrangements to deliver robust and efficient outcomes for all timeframes, including day-ahead, intraday, but also forward and balancing, should be considered. However, we would like to reiterate that the immediate focus should be on the day-ahead timeframe given the priority and deadlines set out in Annex 29 of TCA.

15. What are those issues and concerns, do they relate to domestic or cross-border trade between the UK and the EU, and do you have evidence of the associated impacts?

We do not have any specific comments to raise on the above question.

16. The proposed intervention spans the specific auctions noted in paragraph 22 which we propose should be used as the ‘relevant day-ahead markets’ for the purposes of Annex

¹ Article 311(1)(f) of TCA.

29 of the TCA. However, we would welcome views as to what extent you agree that a similar mechanism is needed to produce a single GB clearing price across existing intraday trading mechanisms?

Please see our response to question 14 above.

17. Do you agree that there are interactions between UK-EU trading and other UK trading borders, specifically with Norway? What are those interactions, and what are the associated impacts?

We believe that the arrangements should be the same for all UK borders, otherwise it could lead to market distortion. It is our view that the simplest way of offering open access to NSL capacity would be to implement the arrangements set out in this consultation.

18. Considering either day-ahead or intraday timeframes, to what extent do you consider that it would be beneficial for a new mechanism for a single GB clearing price to apply to all UK-EU and UK-Non-EU interconnection? What would be the impact (financial or otherwise) of having different arrangements in place on different borders?

As a matter of principle, Energy UK believes that there is certainly a clear benefit of having a single GB clearing price to all UK-EU and UK-Non-EU interconnection. However, in this context there are some further questions which need to be given a more detailed consideration than what's currently included in this consultation, e.g., to which extent it's legally possible to expand the MRLVC regime to UK-Non-EU interconnection? And if not, how different trading arrangements on different interconnectors would interact and what should be the appropriate governance arrangements to address those differences?

Should you have any questions regarding this consultation response then please do not hesitate to get in touch via the details below.

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