Improving market access
Some thoughts for Issue Group 35

To date the issue 35 group has shown little appetite for getting to grips with analytical work to follow up earlier thoughts from the issue 30 group. This earlier group concluded that the timing of Gate Closure could be reviewed. On the positive side there has been an acknowledgement that current timescales for notifying contracts and issuing FPNs could be subject to different considerations.

Against this background this paper highlights the importance of extending market opening and identifies some candidate areas for possible rule changes to the BSC that might enable market participants to better manage imbalance volume risk.

Context

The dual key defining features of the Neta market model are:

- the assumption that electricity is a freely traded commodity (and therefore available in a variety of shapes and sizes over a variety of timescales) that will allow willing buyers and sellers to trade (i.e. strike contracts) without recourse to a centralised trading mechanism (i.e. a pool)

- the construction of dual cash-out prices that are designed to create an incentive to trade as the probability is that uncontracted trades will be cashed out at prices more reflective of high cost peaking or seldom used plant which is inherently higher cost and used to ensure the energy balance across the system is maintained.

However, there is a demonstrable track record that traded markets in electricity are immature. There is also debate about what constitutes healthy levels of maturity. Even if one were to accept that gross trading at levels ("liquidity") at say three or four times physical met the market designers expectations were acceptable, there are still important issues about trade sizes and shape that mean that onesided players, especially independent suppliers, are much more routinely subject to imbalance. This could systematically distort competition in a market that already rewards scale. The reality also is that much of the trading that occurs is trading between equals (the scale players), who for a combination of reasons see little purpose in trading with smaller counterparties who often have lesser credit ratings.

Consequently parties wishing to purchase must usually fully collateralise trades. And, as credit markets tighten, these limited trading options for smaller participants worsen. Against this background we have of course see the recent failures of Bizz Energy and Electricity4Business.

To mitigate similar risks across the market going forward at a time when credit concerns are likely to possibly deepen and almost certainly endure for some time, it is critical to consider within the BSC environment the interaction between traded markets and centralised trading rules. The objective is to identify whether these interactions optimise all parties' ability to trade and whether they fairly deal with imbalance, and if there are distortions in the rules these should be identified and addressed.

However substantive changes to cash-out are least with regard to price formation are in effect "out of bounds" for at least four years because:

- P217A won't be implemented until Nov 2009
- Ofgem then want a review after a year
- it will take a further year to identify further enhancements
- then a further year to implement them

The key question then is how trading parties can be provided with mechanisms to manage imbalance volume risk and increase legitimate trading options. Above all it is timely to ask whether it is possible to broaden trading options in the run up to real-time. Indeed some smaller participants believe it may be possible the introduce the concept of a liquidity market after conventional Gate Closure (GC) (presently at t-60 minutes).

Key objectives of change

Given the problems identified above and cash-out being off limits, discussion and analysis should focus on proposals that:

- extend trading
- allow suppliers to trade imbalances
- provide a route to market for increasing volumes of unpredictable generation

but without compromising the physical operation of the system.

Proposal

Against this background there are a series of inter-linked changes that might separately or in combination enable market participants to better manage imbalance risk and/or ameliorate the risk of exposure to it. They include (but are not limited to):

- keeping GC broadly as it is at t-60 minutes for key physical assets (in effect generation above 100MW)
- carving out types of intermittent plant below this defined threshold that are likely to have better information later by introducing a Final Indicative PN at t-60 and an FPN at t-30 for plant in this category
- allowing suppliers (whose FPNs do not seem to be used by National Grid) to adjust FPNs after t-60 minutes where they have better information or where the physical word changes or not submit them at all[1]
- allowing contracts to be notified up to t-30 minutes
- allowing notifications after this point of trades executed before t-30 minutes to eliminate current distortions under the BSC which in effect necessitate market close at t-90 minutes

[1] Other physical Grid Code notifications would be unaffected

- the combined effect of these last two steps would advance the market close by 60mins to t-30 minutes
- identifying options for suppliers to trade imbalances up to this point, that is t-30 (and perhaps afterwards) – for instance:
    - is there a GSP Group specific mechanism that allows netting
    - whether some form of bespoke agency role can be created for this purpose
    - considering the merits of ex post trading
- considering whether contract notifications could be pushed further forward than t-30 minutes
- identifying whether there is a clearing mechanism that could facilitate trading over these prolonged timescales.

There are several areas for analysis that should be examined to test the merits of these proposals:

- how the SO uses physical and contract notifications
- typical market movements after t-60 minutes
- demand forecasting error by suppliers and temporal risk
- impact of volume risk and cost through cash-out – effect on different participant classes
- how the Norwegians, Australians and PJM do it.

I propose the issue 35 should examine these issues. If they are considered out-of-scope, the group should note them in its report to BSC panel and ask for the relevant mandate to analyse these matters further and with urgency.

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