Scottish and Southern Energy

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Dear Mr Gialoglou,

Re: Guidelines for Good Practice for Electricity Balancing Markets Integration

Scottish and Southern Energy plc (SSE) is an established and active player in all aspects of the GB power market. As such, we welcome the opportunity to input into ERGEG's work on integrating electricity balancing mechanisms across Europe.

We agree that balancing mechanisms should be operated in an economically efficient manner and that imbalance arrangements and pricing should be both simple and transparent. To this extent, we support the General Principles set out in the draft Guidelines. We also acknowledge ERGEG's intent to make balancing markets compatible and, in the longer-term, *"to integrate European balancing markets as far as technically possible"*. However, the difficulties in doing so should not be underestimated. The recent integration of Scotland's electricity market with the England & Wales electricity market on 1 April 2005, and our position as a generator, supplier and North of Scotland transmission system operator and asset owner has provided us with recent first-hand experience of market integration.

Ideally, in a fully integrated market there would be complete consistency across all aspects of the arrangements, including transmission access and pricing, the application of security standards and the application of transmission losses as well as the balancing mechanism. Without such consistency, there is a risk of discriminatory treatment between participants, or sub-optimal generation dispatch.

A significant aspect of the GB market integration, and acknowledged as such by Ofgem, was the implementation of consistent transmission access and pricing arrangements across GB. Indeed, the market arrangements were delayed to allow for a consistent GB access arrangement to be put in place. We would consider therefore that for an integrated European balancing mechanism, not only do the market arrangements need to be consistent, the transmission access and pricing arrangements also need to be consistent.

However, we would not promote the adoption of the GB transmission access and pricing methodology across Europe, as we believe it has a number of fundamental flaws that could only be exacerbated by its application EU wide. Whilst the GB access and pricing methodology could be argued to have been consistently applied, it significantly favours generation in the south of England over that in the north of Scotland, despite there being a need for generation in Scotland and the historic development of both generation and the network infrastructure. Indeed there are a number of aspects of the methodology that we believe cause it to be flawed. The methodology is complex and not wholly transparent even when applied to the relatively small GB market. The locational signals it provides are volatile and we would argue that they are not cost reflective. The methodology attempts, but fails, to take account of the different transmission voltages that are found in Scotland and E&W, which again would be exacerbated if applied across Europe. The methodology, in favouring generation in the south of England, discriminates against the significant wind resource in the north of Scotland. We believe that for application across Europe, a simple arrangement for transmission access and pricing needs to be applied alongside consistent balancing mechanism arrangements.

Whilst full integration is a desirable long-term goal, in the interim, we believe the separate Regulators need to agree on the principles of a fully integrated market and work towards these. Therefore in the interim, there needs to be agreement between Regulators on these other aspects, i.e. transmission access and pricing, security standards, transmission losses, alongside consistent balancing mechanism arrangements. We also believe that in the interest of moving to consistent arrangements, the UK should sign on to the transmission charging principle that generator charges should be zero, i.e. "G = Zero", as proposed in ERGEG's Guidelines on Transmission Tarification.

Given the relatively recent development of GB balancing mechanism arrangements and the high level of competition in the GB market in general, we believe that the GB balancing mechanism largely complies with the Guideline proposals in terms of information provision and transparency. However, one aspect where we feel that the GB balancing arrangements are lacking is in relation to the pricing arrangements for being out of balance. The GB balancing arrangements are moving towards marginal "cash-out" pricing. We do not believe that this is cost-reflective of the costs to the TSO, that the only truly cost-reflective mechanism is to apply costs on an average basis as this is what the TSO faces. We believe that the Guidelines need to include this point.

Whilst we agree that there are benefits to be had through integration of balancing mechanisms in terms of Security of Supply and competition, this needs to be balanced against constraint costs (particularly at interconnectors) in a fully integrated market. For the GB market, with its relatively low level of interconnection with the rest of Europe, it is unlikely that the list of benefits outlined in ERGEG's paper will be realised, certainly in the period to full integration. In this interim period, adjacent balancing mechanisms would need to be operated to consistent balancing periods and gate closures and provide non-discriminatory access to the interconnections for any level of trading to take place and to provide the benefits envisaged.

In summary, we believe that it is necessary to have more than consistent balancing mechanism arrangements. Other aspects such as consistency of transmission access and pricing need to be put in place to provide a level playing field for all European participants to reap the benefits envisaged. We believe that what is required in the interim is for consistent access and pricing arrangements to be applied across the EU. In relation to the GB market we believe that the GB balancing mechanism largely fulfils the requirements of the Guidelines in terms of information provision and transparency, however we do not believe that the cash-out arrangements are reflective of the costs of the TSO. In addition, we believe that the GB Regulator, in the interests of moving towards consistent European arrangements, should sign on to the G = Zero principle of transmission charging.

I hope this proves to be useful feedback on the proposed Guidelines. Should you require any additional information or explanation, please do not hesitate to contact me.

Yours sincerely,

Rob McDonald
Director of Regulation.