

Meeting 15th December 2022

Markets Advisory Council

Agenda:

1. Introduction and Recap
2. Claire Dykta – Intro
3. Update on ESO activities
4. Octopus: Wholesale market reform and low carbon flexibility
5. EU Market Reform
6. GB Gas/Electricity price decoupling proposals
7. AOB

Topics Discussed

1. Chair's Opening Remarks

Steve Jennings shared his perspectives on what the MAC had achieved over the year (2022) and the positive feedback received. He outlined some ideas for reshaping the format of future meetings to add further value including providing more time to understand wider stakeholder perspectives.

2. Claire Dykta – Intro

ESO's new Head of Markets gave reflections on her first few months in the role. She noted that there has been significant evolution in recent years in what ESO procures for system balancing and its procurement approach. She also highlighted that how ESO engages with demand side assets is changing quickly.

3. Update on ESO activities

The purpose of this session was for ESO senior managers to update the MAC on the progress of key Markets workstreams.

The major topics covered were:

1. Winter and gas crisis:
 - The Demand Flexibility Service (DFS) has been tested six times. Results from events in mid-November found that providers delivered more response than anticipated.
 - The council voiced strong support for the successful quick development of DFS so far, noted its significance for unlocking demand side participation in GB markets and expressed hope that this product will be a platform for future growth. They encouraged ESO to advocate more strongly for the product. Members also noted that the relatively high prices set during the tests will evolve as the product matures.

- There was feedback that there is some inconsistency between ESO teams in what they request from industry to resolve implementation issues.
 - The council expressed support that ESO has begun planning for winter 2023/4.
2. Balancing Reserve market:
- ESO updated members on the rollout of the new product and ongoing cost-benefit assessment.
 - Some stakeholders fed back that they were concerned that the Balancing Reserve market excludes smaller assets. They also pointed to some ESO published materials which appeared to suggest excluding the c.5GW of smaller asset capacity would not impact liquidity of the new market.
 - ESO noted that it is assessing the impact of the new product on wholesale market liquidity and that it would follow up offline to these challenges.
3. Market Strategy:
- ESO noted that it would provide a more detailed update on its Distributed Flexibility strategy and Provider Capability project at the next meeting.
 - Some members expressed concern that the stakeholder engagement process run for Phase 4 of Net Zero Market Reform was not set up to fully encourage stakeholder feedback. ESO took an action that it will examine whether there are further opportunities for stakeholders to engage.
 - There was a suggestion that ESO could undertake a meta-analysis of the various studies that have been commissioned on REMA solutions, especially on locational pricing.
 - Regarding REMA, several council members noted that the Inflation Reduction Act in the US and similar subsidy mechanisms in the EU are drawing investor capital away from the UK, and that focus should be given to ensure REMA does not disrupt pace of investment.

4. Octopus: Wholesale Market Reform and Low Carbon Flexibility

The purpose of this session was for council member Rachel Fletcher, from Octopus, to discuss her recent [blog](#) on the relationship between locational energy pricing and investment in REMA.

Following the presentation, the discussion covered:

- Does Octopus think that nodal/zonal prices would provide sufficient investment incentive for flexible assets, or are additional signals needed. One council member noted that 16.5GW of storage has been cleared in the next T-1 Capacity Market auction, suggesting the current design is providing strong investment signals.
- Council members discussed whether or not a purist view of locational pricing should be pursued (i.e whether zonal or nodal is better). Also, whether locational pricing at transmission was sufficient, or whether solutions such as dynamic charging at distribution level is also required.
- Some council members questioned to what extent the future value of flexibility was locational versus temporal. They also emphasised that, once the future state of the system is agreed, identifying investor-friendly transitional arrangements will be critical.

5. EU Market Reform

In this session, Christian Daggard-Mikkelsen, an economist from Danish TSO Energinet and member of the ENTSO-E market design working group updated council members on the objectives of EU market reform.

The presentation covered the policy options being considered in response to the European gas crisis; the focus in Europe on emergency interventions to reduce the influence of high gas prices on power prices; and the extent to which these market splitting proposals have political support.

Council member Rob Gross then presented on how GB policy proposals for ‘market splitting’ compare with similar EU policy options.

The subsequent discussion covered:

- Undermining the clarity of the short-term wholesale price is incredibly risky – the purpose for future policy should be getting more information into the wholesale market.
- Agreement from members that there is a risk reforming wholesale markets to reduce the impact of gas prices as it may prevent the markets achieving their existing roles, such as signalling the value of generation scarcity.
- There was consensus among council members that market splitting was a ‘sideshow’ in the market reform debate, and that 2-sided CfDs largely deliver the same outcome.
- Discussion on the potential for cross-border flows to be disrupted this winter if some nations pursue a protectionist policy. This was held to be unlikely but would cause significant damage to the market. The discussion moved on to how bulky, long-term flexibility can be delivered to the system at the lowest cost of capital.
- There was agreement that a more sophisticated discussion on what kind of flexibility will be required to play what roles in the future system will be required at the next MAC meeting.

6. Actions:

Offline:

- Balancing Reserve market: ESO will follow up on the concerns raised around impact on wholesale market liquidity and exclusion of smaller assets
- Net Zero Market Reform: ESO to examine whether there are further opportunities for stakeholders to engage.

7. Topics for future meetings:

- Dispatch efficiency and dispatch transparency including a deep dive on metering.
- Flexibility including definition and purpose.