



Direct Dial: 020-7901-7412
7 March 2003

The National Grid Company, BSC Signatories and
Other Interested Parties

Your Ref:
Our Ref: MP No: P79

Dear Colleague

Modification to the Balancing and Settlement Code ("BSC") - Decision and Notice in relation to Modification Proposal P79: "Revised Rules for Default Energy Imbalance Pricing"

The Gas and Electricity Markets Authority (the "Authority")¹ has carefully considered the issues raised in Modification Report² in respect of Modification Proposal P79 "Revised Rules for Default Energy Imbalance Pricing".

The BSC Panel (the "Panel") recommended to the Authority that Proposed Modification P79 should not be made.

The Authority has decided not to direct a modification to the BSC. This letter explains the background to the Modification Proposal and sets out the Authority's reasons for its decision.

Background to the proposal

There can be occasions when there are no relevant accepted Offers and/or Bids or relevant NGC forward contracts from which to calculate the Energy Imbalance Prices. In these circumstances default Energy Imbalance Prices apply, which are based typically on the lowest-priced Offer not accepted or highest-priced Bid not accepted for System Buy Price (SBP) and System Sell Price (SSP) respectively. When there are no unaccepted Offers the SBP defaults to the SSP, and when there are no unaccepted Bids the SSP defaults to the SBP. In extreme situations, where there are no unaccepted Offers and no unaccepted Bids, both Energy Imbalance Prices default to zero.

On 12 April 2002, London Electricity Group (the "Proposer") submitted Modification Proposal P79 "Revised Rules for Default Energy Imbalance Pricing".

¹ Ofgem is the office of the Authority. The terms "Ofgem" and "the Authority" are used interchangeably in this letter.

² ELEXON document reference P079RR, Version No. 1, dated 24 October 2002.

The Proposer considered that the rules for calculating default Energy Imbalance Prices are not robust or cost-reflective, as when selecting the lowest-priced Offer or highest-priced Bid, they do not take account of the underlying volume. Currently a Bid or Offer may set the default Energy Imbalance Price where it has no available volume for the Transmission Company to actually accept. The Proposer suggested that the current default Energy Imbalance Price rules should be amended, as they could result in an Offer or Bid setting default Energy Imbalance Prices which may be infeasible for NGC to have accepted. The Proposer suggested that the Modification Proposal would lead to default Energy Imbalance Prices that would be more cost reflective and robust which would better facilitate the achievement of Applicable BSC Objectives³ (c) promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity and (d) promoting efficiency in the implementation of the balancing and settlement arrangements.

The Modification Proposal

The Modification Proposal seeks to modify the BSC to amend the rules for calculating the default Energy Imbalance Prices so that a Bid or Offer with no available volume is not eligible to set the default Energy Imbalance Prices. In addition, the modification proposes to include in the calculation of default Energy Imbalance Prices the Price Adjustment element of Balancing Services Adjustment Data ("BSAD"), in the same way as non-default Energy Imbalance Prices⁴.

In the Assessment Procedure the Modification Group (the "Group") considered the interaction between Modification Proposal P79 and Modification Proposals P74 "Single Cost-reflective Cash-out Price" and P78 "Revised Definition of System Buy Price and System Sell Price". The Group considered that if either of Modification Proposals P74 or P78, or their Alternatives, were approved for implementation by the Authority, there would be no requirement to implement Modification Proposal P79, or any Alternative. This is because Modification Proposals P74 and P78 would significantly alter the default price rules. On 9 September 2002 the Authority approved Proposed Modification P78 with an Implementation Date of 25 February 2003⁵.

Approved Modification P78

Approved Modification P78 changes the derivation of Energy Imbalance Prices such that there will be a main and reverse price. The reverse price will be derived from a market price based on short-term energy trades on the forwards and spot markets. The main price will be derived from

³ The Applicable BSC Objectives are contained in Condition C3.3 of NGC's Transmission Licence and are:

- (a) the efficient discharge by the licensee of the obligations imposed upon it by this licence;
- (b) the efficient, economic and co-ordinated operation by the licensee of the licensee's transmission system;
- (c) promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity;
- (d) promoting efficiency in the implementation and administration of the balancing and settlement arrangements;
- (e) without prejudice to the foregoing objectives and subject to paragraph 3A, the undertaking of work by BSCCo (as defined in the BSC) which is:
 - (i) necessary for the timely and effective implementation of the proposed British Electricity Trading and Transmission Arrangements (BETTA); and
 - (ii) relevant to the proposed GB wide balancing and settlement code;
 and does not prevent BSCCo performing its other functions under the BSC in accordance with its objectives.

⁴ Energy Imbalance Prices include a Price Adjustment notified by the System Operator as part of BSAD. This allows the Energy Imbalance Prices to reflect the cost of option fees paid by the System Operator for the purpose of Electricity Balancing.

⁵ On the 17 February 2003 the BSC Panel Chairman requested the Authority to extend the Implementation Date for Approved Modification Proposal P78 to the 11 March 2003. On the same day the Authority approved the request in accordance with Section F2.11.7 of the BSC.

NGC's Electricity Balancing actions to alleviate the Net Imbalance Volume ("NIV"). The NIV is calculated by netting off all System and Electricity Balancing purchase actions against all sell actions to give the imbalance of the overall transmission system. The default Energy Imbalance Price rules under Approved Modification P78 can be summarised as follows:

- if there is no Market Index Data available then the reverse price defaults to the main price (derived from the NIV);
- where there is a negative spread between the main and the reverse Energy Imbalance Prices (i.e. the SSP is greater than the SBP) then both the SSP and the SBP default to the main price;
- where the NIV is zero, then both the SBP and the SSP default to the reverse price calculated from Market Index Data;
- where the NIV is zero and there is no Market Index Data available then both the SBP and the SSP will be zero; and
- where NIV is not zero but only contains System Balancing actions which have no price attached and so are ineligible for use to derive the main price the main price will default to the reverse price⁶.

Following the Authority's acceptance of Proposed Modification P78, the Group agreed that the Assessment Procedure for Modification Proposal P79 should be halted and that Modification Proposal P79 should be sent to the Report Phase, with a recommendation for rejection.

At the Panel's meeting on 12 September 2002, the Panel determined to exercise its right, under the BSC, Section F 2.2.11, to halt the Assessment of Modification Proposal P79 and to send it directly to the Report Phase with a recommendation to reject.

ELEXON published a Draft Modification Report on 27 September 2002, which invited respondents' views by 8 October 2002.

Respondents' views

In total, ELEXON received nine responses to the consultation on the Draft Modification Report. Of the responses, eight agreed (including the Proposer) that the Proposed Modification should not be made. The remaining respondent was neither in favour of nor opposed to the Proposed Modification.

In general respondents considered that the perceived defect will be removed with the forthcoming implementation of Approved Modification P78 and that consequently Modification Proposal P79 is no longer relevant.

⁶ This default Energy Imbalance Price rule was introduced by Urgent Modification Proposal P104 "Amendments to the Solution to P78 'revised Definition of System Buy Price and System Sell Price'" which was approved by the Authority on the 11 December 2002.

Panel's Recommendation

The Panel met on 17 October 2002 and considered Modification Proposal P79, the Modification Report, the views of the Modification Group and the consultation responses received.

The Panel recommended that the Authority should reject the Proposed Modification.

The Panel considered that since default Energy Imbalance Prices under Approved Modification P78 will default to either the market based reverse price, the main price taken from actual balancing actions taken by the Transmission Company or zero, the perceived defects identified by Modification Proposal P79 are no longer relevant.

Ofgem's view

Ofgem considers, having had regard to its statutory duties, that Modification Proposal P79 does not better facilitate the achievement of the Applicable BSC Objectives.

Under Approved Modification P78 default Energy Imbalance Prices are not based upon any particular Bids or Offers. Where the default Energy Imbalance Price rules for Approved Modification P78 are invoked the default Energy Imbalance Price will be either the main price, reverse price or both Energy Imbalance Prices will be zero depending on the circumstances.

In addition, under Approved Modification P78 default Energy Imbalance Prices will include the Price Adjustment element of BSAD, in the same way as non-default prices in the event that the reverse price defaults to the main price. In the event that the main price defaults to the reverse price or both Energy Imbalance Prices are zero, default Energy Imbalance Prices will not include the Price Adjustment element of BSAD. However, this is consistent with the calculation of the reverse price, which is derived from a market price and situations where both Energy Imbalance Prices default to zero are expected to be rare.

Ofgem agrees with respondents (including the Proposer) and the Panel that Approved Modification P78, and the associated changes to the default Energy Imbalance Price rules, removes the perceived defects that Modification Proposal P79 sought to address. Therefore Ofgem considers that Modification Proposal P79 does not better facilitate the achievement of the Applicable BSC Objectives.

The Authority's decision

The Authority has therefore decided not to direct that Modification Proposal P79 should be made and implemented.

Having regard to the above, the Authority, in accordance with Section F1.1.4 of the BSC, hereby notifies NGC that it does not intend to direct NGC to modify the BSC.

Please do not hesitate to contact me on the above number if you have any queries in relation to the issues raised in this letter or alternatively contact Adam Higginson on 020 7901 7410.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Sonia Brown'.

Sonia Brown

Director, Electricity Trading Arrangements

Signed on behalf of the Authority and authorised for that purpose by the Authority