

April 2002

**MODIFICATION REPORT
MODIFICATION PROPOSAL P59**

**The Acceptance of Bids and Offers to Honour a BM Unit's
Dynamic Parameters Beyond the Balancing Mechanism Window**

Prepared by ELEXON Limited on behalf of the
Balancing and Settlement Code Panel

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I DOCUMENT CONTROL

a Authorities

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0.3	27/03/02	Trading Development		Final Draft
0.4	12/04/02	Trading Development		Final Draft Report

Version	Date	Reviewer	Signature	Responsibility
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0.2	21/03/02	Mods Group Panel Rep		Draft Review
0.3	27/03/02	Parties		Consultation
0.4	12/04/02	Panel		Panel Decision

b Distribution

Name	Organisation
Each BSC Party	Various
Each BSC Agent	Various
The Gas and Electricity Markets Authority	Ofgem
Each BSC Panel Member	Various
Energywatch	Energywatch
Core Industry Document Owners	Various

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d Related Documents

The following documents are referenced using the following convention [RD/x]:

- 1 Initial Written Assessment of Modification Proposal P59, Version 1.0, 7 December 2001
- 2 Panel Paper 40/025 – 14 February 2002
- 2a Panel Paper 40/025a - Modification Proposal P59 – First Consultation , Version 1.0, 6 February 2002
- 3 Panel Paper 41/031 – 14 March 2002
- 3a Panel Paper 41/031a - ELEXON letter to the Authority requesting their provisional thinking on Modification Proposal P59 (22 February 2002)
- 3b Panel Paper 41/031b - The Authority's provisional thinking on Modification Proposal P59 (26 February 2002)

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1 SUMMARY AND RECOMMENDATIONS

1.1 Recommendation

The Panel recommends to the Authority that:

The Proposed Modification P59 should not be made.

This decision is based on Panel's consideration of:

- the provisional thinking provided by the Authority in relation to the Modification and the Alternative Modification;
- the guidance provided to the Panel that the provisional thinking of the Authority would be unlikely to change in the absence of new arguments;
- the Authority had on 26 February 2002 authorised NGC to make a change to the BPS that had similar effects to the draft Alternative Modification; and
- completion of the assessment of the Modification and Alternative Modification would involve significant expenditure.

1.2 Background

Modification Proposal P59 was raised by Innogy on 3 December 2001. It aimed to formalise the procedure for issuing Bid Offer Acceptances (BOA) for Balancing Mechanism Units (BMU) with dynamic parameters that extend beyond the Balancing Mechanism window, or as it is informally known "beyond the wall" (BTW).

The Modification Proposal was submitted to the Assessment Procedure with an interim report to be presented to the Panel on 14 March 2002 to allow the Panel to request the Authority's provisional thinking on the governance issues. The request from the Panel was sent on 22 February 2002 and a reply was received from the Authority on 26 February 2002. This response indicated that, based on the Interim Report, the Authority did not believe a change to the Balancing and Settlement Code (BSC) was required. The Authority believed that the changes that it had authorised on the same date, to the Balancing Principles Statement (BPS), were adequate.

1.3 Rationale for Recommendations

The Panel considered, whether in light of the Authority's provisional thinking, the Pricing Issues Modification Group (PIMG) should be asked to continue the assessment of the modification, in particular the Alternative Modification. The Authority's representative at the meeting stated that, whilst their provisional thinking was without prejudice to their final decision, it was believed that new arguments would need to be presented in order to alter that decision. It was also suggested that sending the Modification back to the PIMG could be regarded as an inefficient process as it was unlikely that new arguments would be forthcoming.

As a result of the provisional thinking from the Authority, the representation made by the Authority at the Panel meeting, and consideration of the difficulty the PIMG would face in finding new arguments, and mindful that the Authority had on 26 February 2002 authorised NGC to make a change to the BPS that had similar effects to the proposed Alternative Modification and further mindful that completion of the assessment of the Modification and Alternative Modification would involve significant expenditure, the majority view of the Panel was that, although the Modification group and a majority of consultation

responses had indicated that the Alternative Modification would better achieve the Applicable Objectives, the Modification Proposal and the draft Alternative Modification Proposal each had a very low probability of being accepted by the Authority and, consequently, that the Assessment of P59 should be stopped and P59 sent to the Report Phase with a recommendation that the Modification should not be made.

2 INTRODUCTION

This Report has been prepared by ELEXON Ltd., on behalf of the Balancing and Settlement Code Panel ('the Panel'), in accordance with the terms of the Balancing and Settlement Code ('BSC'). The BSC is the legal document containing the rules of the balancing mechanism and imbalance settlement process and related governance provisions. ELEXON is the company that performs the role and functions of the BSCCo, as defined in the BSC.

This Modification Report is addressed and furnished to the Gas and Electricity Markets Authority ('the Authority') and none of the facts, opinions or statements contained herein may be relied upon by any other person.

An electronic copy of this document can be found on the BSC website, at www.elexon.co.uk

3 HISTORY OF PROPOSED MODIFICATION

Modification Proposal P59 was raised by Innogy on 3 December 2001. It aimed to formalise the procedure for issuing BOA for BMU with dynamic parameters that extend BTW.

At their meeting on 13 December 2001, the Panel agreed that the issues associated with Modification Proposal P59 were sufficiently clear to allow the Modification Proposal to be submitted to the Assessment Procedure, and that assessment of P59 should be undertaken by the PIMG. The Panel noted that:

- a proposal was being progressed by NGC on "Formalising the current gentlemen's agreement" within the BPS (under the Transmission Licence); and
- there were governance issues raised by this modification, as it proposed placing a formal obligation within the BSC on the Transmission Company to return a BMU to its Final Physical Notification (FPN).

Therefore, the Panel agreed that an Interim Report be presented to the Panel meeting on 14 February 2002 in order that the Authority's provisional thinking could be sought in respect of the PIMG provisional findings¹. The Authority's representative agreed to provide a view, without prejudice to the final decision, on an Interim Report.

Three Modification Group meetings were held where the precise definition of the Proposed Modification was discussed. As a result of the discussions the PIMG agreed (majority view) that:

- a solution under the BSC offered additional benefits for balancing and also settlement, which were not offered by the NGC BPS solution. The PIMG also felt that the BPS based solution was not sufficiently binding on the Transmission Company;
- the Proposed Modification for an automatic solution would not better achieve the Applicable BSC Objectives on the grounds of efficiency; and

¹ In accordance with paragraph F2.6.10 of the Balancing and Settlement Code (BSC).

- an Alternative Modification, which simply placed the obligation on the Transmission Company within the governance of the BSC, would better achieve the Applicable BSC Objectives.

ELEXON prepared a consultation document on behalf of the PIMG [RD/2a], which invited views on the findings of the PIMG. This document was sent out for consultation by BSC Parties on 06 February 2002 with responses due by the 13 February 2002.

At the Panel meeting on 14 February 2002 an Interim Report [RD/2] was presented documenting the PIMG progress in the assessment of P59. In addition a verbal update was provided on the results of the consultation, in particular that the majority of respondents² agreed with the PIMG findings. The Panel also agreed to allow the PIMG additional time to complete the Assessment Procedure following publication of any view from the Authority.

The Panel instructed ELEXON to seek the Authority's provisional thinking [RD/3a] on the appropriateness of the governance structure proposed by the Modification Proposal. This was received from the Authority on 26 February 2002 [RD/3b] and stated that the Authority believed that the identified defect was sufficiently addressed by the BPS changes proposed by NGC. The Authority also authorised NGC to make these changes to the BPS on the 26 February 2002.

At the Panel meeting on 14 March 2002 a second interim report [RD/3] was presented containing the Authority's provisional thinking with regard to the assessment of P59. As a result of this provisional thinking the Panel decided to stop the assessment of P59 and recommend to the Authority that P59 be rejected. The Panel instructed ELEXON to prepare a Draft Modification Report for the Panel Meeting 18 April 2002.

A Draft Modification Report was prepared and sent to Parties and interested third parties on 27 March 2002 for consultation by 9 April 2002. Subsequently ELEXON amended the Draft Modification Report in the light of the representations received, together with a summary of those representations.

4 DESCRIPTION OF PROPOSED MODIFICATION

The key features of the Proposed Modification are to require the Transmission Company to issue BOA for the minimum volume of Bids and/or Offers to return the BMU to its FPN level:

- in accordance with the Dynamic data set applicable at the time of the original BOA; and
- at prices submitted for the Settlement Period preceding the "wall".

P59 would require BSC Systems to have the ability to calculate the BMU Cashflows, and subsequent Imbalance Prices, using Bid-Offer Prices submitted for a prior Settlement Period. P59 would primarily require changes Section T (Settlement and Trading Charges) of the BSC .

The Proposer believes that P59 is required as, without a formal obligation on the Transmission Company to return a BMU to its FPN, there is a material risk of a Party's BMU being left out of balance BTW. The Proposer also believes that removal of this risk would improve transparency and encourage participation in the Balancing Mechanism.

P59 states the obligation to return plant to its FPN should be within the BSC and that in addition, the governance of the modification and consultation process should be under the BSC.

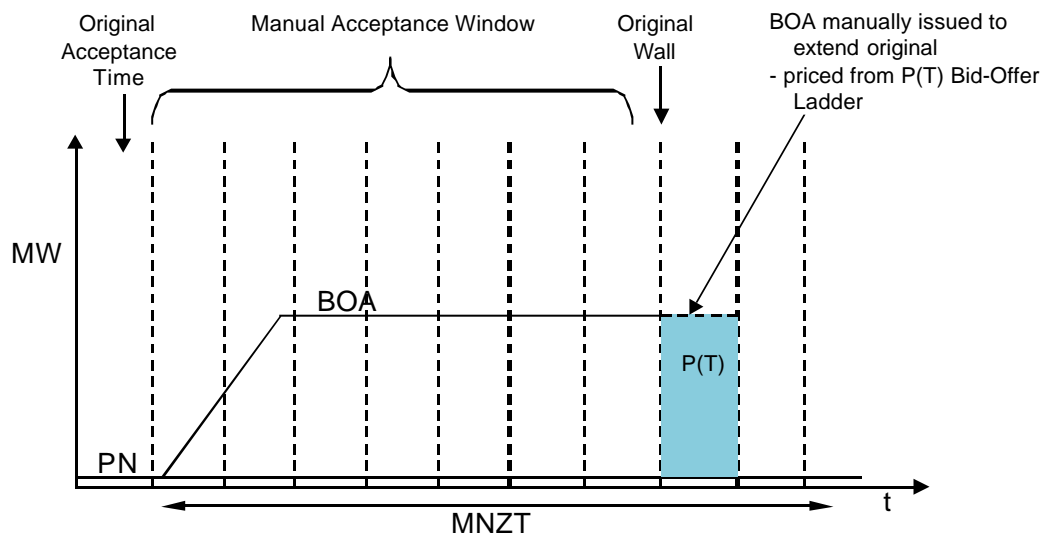
At the Panel Meeting 13 December 2002, the Proposer provided details on an automatic mechanism for achieving the objectives of P59:

² See Section 8 and Annex A

- an initial BOA should be issued to the end of the Balancing Mechanism window (i.e. as would currently occur);
- at any point up to [2] minutes before the end of that BOA the Transmission Company can issue a new BOA to extend the original BOA, at the prices and levels offered for the target Settlement Period (i.e. as would currently be possible). This BOA must itself respect the dynamics in force at that time;
- if no extension is issued by the [2] minute limit, then an automatic instruction should be issued to take the BMU back to its predicted FPN, using the dynamics applicable when the initial BOA was first taken. This may initially mean remaining at the current level, to respect the minimum non-zero time (MNZT) or minimum zero time (MZT).

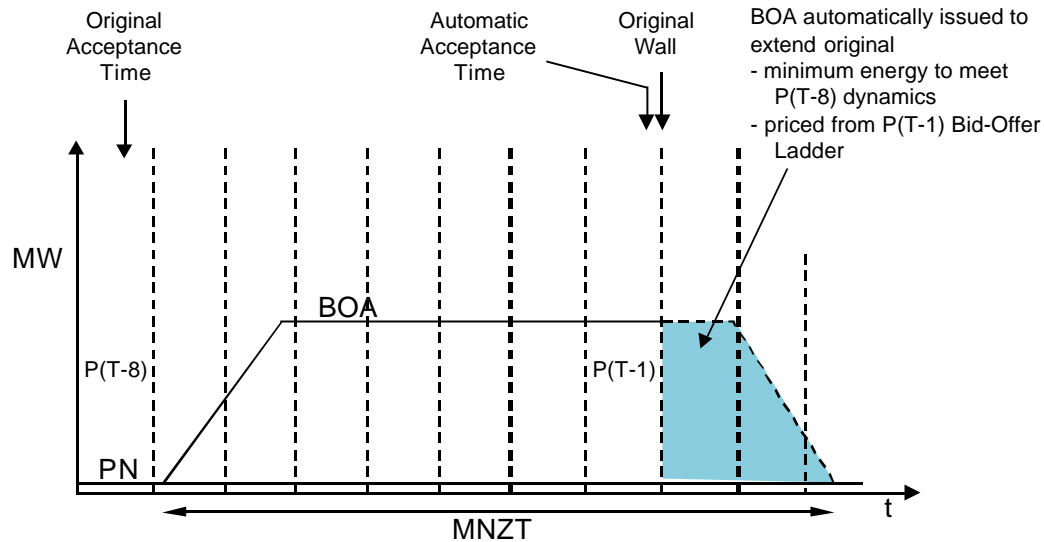
An example of the first two steps are shown in figure 4.1. In this case the Transmission Company manually issues a BOA for the next period and its volume is costed at the price for that period (i.e. $P(T)$). In this example the Transmission Company would also need to issue another BOA at a later point to start to return the plant to its predicted FPN.

Figure 4.1 – Proposed P59 Mechanism - Manual BOA



However, should the Transmission Company not issue the manual BOA then, [2] minutes before the end of the original instruction, an automatic BOA would be issued, as shown in figure 4.2. In this case the BOA would be costed at the last submitted price for period $P(T-1)$. The profile of the BOA would be in line with the dynamics when the first BOA was issued (i.e. $P(T-8)$).

Figure 4.2 – Proposed P59 Mechanism - Automatic BOA



Such an automatic BOA would need to be prepared and issued by the Transmission Company to ensure the Party was aware of the instructed profile.

The Proposer recognised that in practice the mechanism would be more complex, but that the PIMG should be allowed to refine the solution further.

5 RATIONALE FOR PANEL RECOMMENDATIONS

At their meeting on 14 March 2002, the Panel considered the Authority's provisional thinking in respect of the work performed to date by the PIMG.

The Panel recognised that during normal operation there was no difference between an obligation being within the BPS or the BSC. In addition the NGC representative informed the Panel that there had been no instances of NGC not respecting a BMU's dynamic parameters and that they had always returned such BMU to their predicted FPN.

However the Panel were concerned that the BPS change was not sufficiently binding, and just because an exception had not occurred in the past, that it did not indicate it would not occur in the future. In such circumstances it was clear that the only avenue open to the Party would be for the Party to appeal to the Authority, and that even then it was not clear how any error could be rectified³. The Panel noted that the governance issues with Modification Proposal P59 were very similar to those faced with Modification Proposals P34 and P36.

The Panel considered, whether in light of the provisional thinking, the PIMG should be asked to continue to progress the modification, in particular the Alternative Modification. The Authority's representative at the meeting stated that, whilst their provisional thinking was without prejudice to their final decision, it was believed that new arguments would need to be presented in order to alter that decision. It was also suggested that sending the Modification back to the PIMG could be regarded as an inefficient process as it was unlikely that new arguments would be forthcoming. The Panel did not raise any new arguments that had not already been considered by the PIMG.

³ This point was explicitly raised in the letter to the Authority [RD/3a] and the response from the Authority [RD/3b] stated that this situation would not occur.

As a result of the provisional thinking from the Authority, the representation made by the Authority at the Panel meeting, and consideration of the difficulty the PIMG would face in finding new arguments, the majority view of the Panel was that the Assessment of P59 should be stopped⁴ and P59 sent to the Report Phase with a recommendation that a change to the BSC should not be made.

6 LEGAL TEXT TO GIVE EFFECT TO THE PROPOSED MODIFICATION

The Panel stopped the assessment of this modification prior to the formal completion of the Assessment Procedure, based on the provisional thinking obtained from the Authority. At that time no legal text had been fully developed for either the Proposed Modification or potential Alternative Modification.

The Authority confirmed that no legal text would be required for this Modification Proposal.

7 ASSESSMENT

Three Modification Group meetings were held (8 January 2002, 22 January 2002 and 4 February 2002). The majority of the PIMG believed the Proposed Modification addressed a real defect and that an obligation in the BSC would be more binding and transparent than the proposed BPS change.

The PIMG tried to further refine the Proposed Modification and establish how to define an automatic solution capable of meeting the requirements of the modification. The PIMG recognised such a solution faced a number of architectural obstacles:

- how to specify a BOA that would adequately define the action the Transmission Company should have taken. The main issue was that this could only be accurately achieved using pre-Gate Closure data, not currently contained with the BSC Systems;
- even with access to this information it was still relatively easy to construct scenarios which would result in BOA that require the BMU to take actions neither they, nor the Transmission Company would have anticipated;
- consideration of a 1 Hour Gate Closure (1HGC) suggested that in some circumstances multiple BOA would be required in order to return a BMU back to its FPN. These automatic BOA could also interact with any plans NGC may have for the Pre Gate Closure BMU Transactions⁵;
- after a BOA has been constructed, it would be necessary for the Transmission Company systems to automatically issue the BOA, such that the BMU would be informed of the instruction in time for it to respond correctly;
- it was still considered beneficial to forward the pre-Gate Closure data to the BSC Systems to aid monitoring of the automatic BOA and also inform the market of the actions being taken (i.e. transparency).

In light of the complexity of defining a suitable automatic solution, the PIMG recognised that any resulting solution would be cumbersome. The PIMG also believed it would be not efficient and hence would not better facilitate the Applicable BSC Objectives.

⁴ In accordance with paragraph F2.2.11 of the Balancing and Settlement Code (BSC).

⁵ Creating an automatic BOA BTW relies on the Party not changing their predicted FPN and Offer stacks. However, the new pre Gate Closure BMU Transaction (previously referred to as the new BS Energy Trade) actually requires the BM Unit to make such changes to reflect the pre-gate contract.

The PIMG also considered a potential Alternative Modification, which would simply place an obligation on the Transmission Company to honour dynamics which extend BTW. The PIMG believe placing this obligation within the BSC offered a number of benefits over the NGC proposed changes to the BPS and could better facilitate the Applicable BSC Objectives in that:

- an obligation in the BSC was seen as more binding than the equivalent in the BPS;
- there is a material risk to Settlement for a Party, by being left out of balance due to balancing actions taken by the Transmission Company, this could affect Settlement;
- it was more transparent to have the obligation within the BSC;
- the BSC Modification process ensures that any further changes to the rules governing the honouring of BMU dynamics would better facilitate the achievement of the Applicable BSC Objectives;
- the process for disputing a BOA is clearer within the BSC, and would allow Settlement data to be amended if necessary.

The above information formed the basis of the first consultation [RD/2a].

At the Panel Meeting on 14 March 2002 the Panel received the Authority's provisional thinking and in light of this stopped the Assessment Procedure.

The termination of the Assessment Procedure means that no Impact Assessments have yet been undertaken for either the modification as originally proposed, or any potential Alternative Modification that was being considered by the PIMG.

8 SUMMARY OF FIRST CONSULTATION REPRESENTATIONS

The first consultation received 16 responses from 60 Parties. In addition one response was received from a non BSC Party.

The consultation asked 6 Yes/No questions, along with a request for supporting rationale. The responses to these are summarised below. The column "%Responses" indicates the % of the responses which agreed with the "Majority Response", in addition the "%Parties" indicates the % of the represented Parties which agreed with the "Majority Response".

Table 8.1 Consultation Responses

Question/Description	Majority Response	% Responses	% Parties
1 Do you believe that a Party should be left at the end of the Balancing Mechanism window facing the risk of imbalance, due to dynamic parameters which stop them immediately returning to their notified FPN?	N	94%	98%
2 Do you agree with the Modification Group that an automatic solution to accommodate changes in the data, as proposed by the original modification proposal, is not an appropriate solution and would not better meet the Applicable BSC Objectives, as it could not be considered to be efficient?	Y	88%	83%
3 Do you believe that the Transmission Company should be obliged honour dynamics BTW when:			
a) There are no changes to any of the submitted data items for that BMU	Y	100%	100%
b) There are no changes to any of the submitted data items for that BMU that have a material impact on the cashflow payments	Y	67%	47%
c) The change results in a decrease in the cashflow payment to the BMU	Y	73%	71%
d) The change results in an increase in the cashflow payment to the BMU	N	80%	84%
4 Do you believe it is appropriate to place such an obligation on the Transmission Company?	Y	100%	100%
5 Do you believe it is appropriate to place such an obligation on the Transmission Company within the BSC?	Y	87%	96%
7 Do you believe the potential Alternative Modification, as described in section 4.3, is capable of meeting the Applicable BSC Objectives?	Y	81%	90%

The majority of responses agreed that a Party should not face the risk of imbalance due to actions taken by the Transmission Company. One response disagreed with the majority view on the grounds that this was an infrequent occurrence and that the Transmission Company should be discouraged from taking BOA which extend BTW. In addition it does not address the real problem, which is that Parties are incentivised to avoid exposure to cashout rather than to balance. If Parties were incentivised to balance then less volume would be required to balance the network and this would reduce the need to synchronise or desynchronise plant.

The majority of responses agreed that an automatic solution could not be considered to be efficient. The Proposer, in their response, disagreed with the PIMG stating that a change to Section T would be the most rigorous method of achieving the aims of the modification, and without an assessment of the likely cost of the system changes, it was not possible at this stage to state whether the benefits would outweigh the costs. However, the Proposer also agreed that an Alternative solution may be more efficient in achieving the main aims of the modification.

The responses to question 3 provided a number of different views. The majority of respondents agreed that the Transmission Company should honour dynamics when there was no change in any data, and also that the Transmission Company should not be obliged to honour the dynamics if a change increased the cashflow payment to the Party. The answers to questions 3b and 3c indicated a range of views when changes would “not affect” or “reduce” the costs.

The responses were unanimous that there should be an obligation on the Transmission Company, although some respondents did not agree the BSC was the best location. One such response was from NGC, which stated they believed their BPS change was the most appropriate mechanism for dealing with the issue raised by the Modification Proposal. Another respondent believed this was a Grid Code issue. One respondent made the point that although there were problems with the transparency of the Transmission Company's balancing actions, that placing a limited scope fix within the BSC would only aggravate problems associated with split governance.

The majority of respondents agreed that the potential Alternative Modification was capable of meeting the Applicable BSC Objectives. One respondent who disagreed, believed it would remove volume from the short term energy markets and that bilateral contracting was more efficient than centralised contracting through BOA. Another respondent believed that the burden upon Parties to leave their submitted data unchanged would reduce BM liquidity and competitiveness. In addition they were concerned about how such an obligation would be rigorously enforced.

9 SUMMARY OF DRAFT MODIFICATION REPORT REPRESENTATIONS

The draft Modification Report consultation received 14 responses representing 49 Parties:

- 7 responses (3 unqualified, 3 based on Authority's provisional thinking and 1 reluctantly) supported the Panel's recommendation to send Modification Proposal P59 to the Report Phase with a recommendation that the Modification should not be made;
- 6 responses⁶ disagreed with the Panel's recommendation, with a further response stating "No Comment";
- 9 responses reiterated their support for P59, and that it was appropriate to place an obligation on the Transmission Company within the BSC, rather than within the BPS;
- 4 responses detailed concerns about the process of stopping the Assessment Procedure based on the Authority's provisional thinking.

No new substantive reasons were provided as to why P59 would better achieve the applicable BSC Objectives. However, a number expressed concern about not completing the Assessment Procedure:

- the precedent set that the Panel decision is (a) effectively steered by what they think the Authority will accept; (b) short-circuited by alternative Authority actions;
- taking a course of actions that appears to undermine the governance arrangements of the BSC;
- a belief that the basis on which the Panel is recommending rejection is outside the vires of the Panel;
- no reference as to whether P59 would better facilitate the Applicable BSC Objectives, in the Authority's provisional thinking, the Panel's rationale, or the Modification Report;
- a belief that the Panel has an obligation to recommend modifications to the Authority that it and the BSC Parties feel better fulfil relevant BSC Objectives, irrespective of the preliminary views of the Authority.

⁶ 2 responses stated they believed the PIMG should complete the Assessment Procedure and present the PIMG's considered recommendation, the other 4 responses did not express an opinion on the Panel's recommendation, but did reiterate their support for P59.

The Proposer believed the Panel should reconsider Modification P59 against the relevant objectives, as set out in the BSC, and the Modification Report should then be amended to reflect the conclusions of any further discussion.

ANNEX 1 – RESPONSES FROM P59 ASSESSMENT CONSULTATION

Attached as a separate document

ANNEX 2 – RESPONSES FROM P59 DRAFT MODIFICATION REPORT CONSULTATION

Attached as a separate document