ANNEX 9 – RESPONSES TO INITIAL CONSULTATION ON MODIFICATION PROPOSAL

Representations were received from the following Parties:

No	Company	File Number
1.	NGC	P27_ASS_001
2.	Edison Mission Energy	P27_ASS_002
3.	Dynegy	P27_ASS_003
4.	British Energy plc	P27_ASS_004
5.	SEEBOARD	P27_ASS_005
6.	Powergen	P27_ASS_006
7.	Scottish and Southern Energy	P27_ASS_007
8.	ScottishPower UK Plc	P27_ASS_008
9.	Enron	P27_ASS_009

P27_ASS_001 - NGC

RESPONSE FROM NATIONAL GRID MP27 AMENDMENT TO THE DERIVATION OF IMBALANCE PRICES

We agree with the Proposer that reverse prices can be inconsistent with the prevailing system conditions. However, we are concerned with the proposed modification for the following reason: -

• The modification as drafted does not remove the short stack price from the influence of National Grid actions eg. if there are no National Grid sales or purchases then the Reverse-flow Unit Offset Price must be zero.

As an alternative, consideration could be given to using a short stack price, which is based on some function of the Power Exchange prices. The incentive to contract could be retained by using a price deliberately offset from the mean, for example the upper/lower quartile prices or ± 1 standard deviation from the mean. Before adopting this suggestion, consideration should be given to the possibility of Power Exchange prices being gamed.

Yours faithfully Richard Lavender Market Issues Analyst

P27_ASS_002 – Edison Mission Energy

Comments on Modification P27 - Amendment to the derivation of imbalance prices

I am pleased to provide comments on Modification P27. These comments are provided by Edison Mission Energy (EME) on behalf of three companies Edison First Power Ltd., First Hydro Company and Lakeland Power Ltd.

Existing modification proposals will dampen imbalance prices and will reduce the cost of being out of balance. It seems premature to be suggesting more changes until the effect of those already under consideration can be seen following their implementation. At this point, a decision can be made as to whether Modification P27 is still necessary.

Modification P27 will further soften the penalties for being out of balance in the opposite direction to the net system imbalance. It will reduce the spread between the SSP and the SBP and move the pricing mechanism much closer to a single imbalance price This will reduce incentives to balance, counter to the market fundamentals on which NETA was designed.

I hope you have found these comments useful. Please do not hesitate to contact me if you wish to discuss them further.

Yours faithfully Libby Glazebrook Industry Liaison Manager

P27_ASS_003 - Dynegy

Modification Proposal P27: Amendment to the derivation of imbalance prices.

The modification proposal does not better fulfil condition 7A.3(c) of NGC's Transmission Licence. A more constructive means would be to implement an in-depth price review.

Yours sincerely,

Rekha Patel

Power Regulatory Analyst

P27_ASS_004 – British Energy plc

P27 - Amendment to the Derivation of Imbalance Prices - Comments

The proposal states that "when the pricing mechanism was conceived, it was intended that parties who were out of balance should bear the full cost of resolving the imbalance". British Energy believe that whilst this was an initial intention, by the time of implementation the overriding concern of Ofgem was to incentivise forward contracting ahead of gate closure by making "imbalance cashout" particularly unattractive. The "correct" allocation of imbalance costs is an elusive goal and there was only sufficient time to develop an approximate method.

The main contention of the proposal appears to be that a participant whose imbalance is in the same direction as the net system requirement should obtain a "better" cash-out price than one flowing against it. British Energy agrees with the proposer that under a "dual price" cashout regime it appears counter-intuitive to levy shortfall imbalance charges at implicitly high System Buy Price on a party which is short of energy and "topping up" when the system as a whole has surplus energy, and similarly to pay a party implicitly low System Sell Price for spilling energy when the system has a shortfall. Intuitively, it seems correct that imbalance flows apparently "helping" the System Operator balance the system should receive a "better" cash-out price than those in the opposite direction.

However, a number of factors should be taken into consideration:

- Implementation of a proposal such as this could provide incentives for some participants to provide their own balancing actions independently of the normal balancing mechanism. This could aid selfbalancing of the system and could reduce overall imbalance costs and prices. However, the System Operator has consistently stated that it requires control over balancing actions taken after gate closure ((and in some cases before gate closure) in order to securely balance the system. The SO has to take into account more than simple short term national energy balancing. Factors such as locational constraints, reserve requirements and bid-offer dynamic constraints could be disturbed by independent balancing actions, to the disadvantage of all other participants.
- Because actual energy flows are only recorded in half-hour periods, actual imbalance in real time
 may bear little relationship to imbalance over a half-hour. A participant could be flowing counter to
 the system requirement for some or even most of a half-hour, and yet still appear to be flowing
 with the system requirement when aggregated over the whole half-hour. Similarly, calculated
 imbalance prices for a half-hour may bear no relation to the system or an individual's imbalance
 during some or most of the half-hour. All parties are subject to these approximations. The point
 here is that the "benefit" of a flow in a particular direction is not as clear-cut as at first sight.
- The proposal states that "The Imbalance Cash-Out Price for imbalances in the opposite direction to net system imbalances should be based on the imbalance price faced by those who are out of balance in the direction of national imbalance but adjusted for the cost of managing such reverse flow imbalances.". Taken together with the algebra in Annex 2 on page 23 of the Initial Assessment, we interpret this as meaning that:
- when the system is short and the System Operator is net buying energy in the form of accepted
 offers, spill imbalance by individuals would receive System BUY Price MINUS an adjustment for the
 difference between "market price" and System Sell Price (provided the "market price" is higher),

instead of System SELL Price. (The minus sign arises from the sign of acceptances in the explicit algebra).

The adjustment appears to represent the additional revenue the SO would have received by selling the energy it sold in the Balancing

Mechanism (against the overall net requirement to purchase) at market price instead of at SSP. It is not clear whether the energy involved is before or after "trade-tagging". This additional revenue is converted into a price to be charged per unit of spill energy.

 Similarly, when the system is long and the System Operator is net selling energy in the form of accepted bids, top-up imbalance taken by individuals would be paid for by them at System SELL Price PLUS an adjustment for the difference between System Buy Price and "market price" (provided the "market price" is lower), instead of System BUY Price.

ie. Receive System Buy Price - (market price - System Sell Price)*total accepted bid volume/spill parties volume for "beneficial spill" when system short and pay System Sell Price + (System Buy Price - market price)*total accepted offer volume/shortfall parties volume for "beneficial top-up" taken when system long.

The basic idea is to pay SBP (instead of SSP) to parties in spill when the system is short, and charge SSP (instead of SBP) to parties topping-up when the system is long, with some adjustments related to SO trades also in the opposite direction to the overall requirement. We consider that the detail of this proposal requires further explanation and justification, particularly in relation to the adjustments.

• The proposer suggests that improved allocation of costs within the Balancing Mechanism could encourage the development of spot markets, but provides no firm argument as to why this should be the case. British Energy would welcome further explanation.

In summary, British Energy agree that the allocation of imbalance costs in the Balancing Mechanism includes significant approximations and can probably be improved, but note that a wholly accurate allocation is unlikely ever to be achieved. The issue of imbalances in the same direction as the overall system requirement for balancing energy justifies further consideration. However, a number of other factors to be considered, and British Energy considers that the proposal in its current form may not be the most appropriate way forward, given general industry concerns relating to imbalance prices and charges. We believe that this issue could be included in a wider review of the imbalance mechanism.

Rachel Ace for British Energy Power & Energy Trading Ltd British Energy Generation Ltd Eggborough Power Ltd

P27_ASS_005 - SEEBOARD

We do not support this proposal, as we do not feel that these changes would better facilitate BSC objectives. Our reasons being:

- Imbalance cash-out process does not in itself recover costs. Its purpose is to provide incentives to
 participants to contract ahead and to do so as accurately as possible. There is no over-recovery as
 suggested in this modification because surpluses are redistributed evenly, via Residual Cash-flow
 Reallocation Charges (RCRC). Therefore, those that balance their physical positions most
 accurately pay the least net balancing costs.
- 2. This proposal suggests that those participants with reverse-flow imbalances are assisting the system operator in balancing energy requirements. Therefore, they should effectively be rewarded or take a greater share of RCRC. We believe that this assumption is fundamentally flawed. System Operator will manage the system most efficiently if participants adhere to their Final Physical Notifications. This proposal actively encourages participants in the Balancing Mechanism to over or under contract depending on their view as to whether the system is likely to be short or long. The consequences of this behaviour at best would make the system more difficult to run and increase costs to all participants. At worst it could result in unmanageable energy surpluses or deficits.
- 3. We do not understand the assertion that a large buy/sell spread hampers development of spot markets. We would assume that a more punitive cash-out price would increase the desire to contract ahead of gate closure. Consequently this should result in greater activity in spot markets.

Dave Morton SEEBOARD 0190 328 3465

P27_ASS_006 – Powergen

Proposed Variation to BSC – Modification Proposal No: 27 – Amendment To The Derivation Of Imbalance Prices

Powergen UK plc ('Powergen') welcomes the opportunity to make initial comments on modification P27. Powergen provides this response on behalf of itself and the following BSC Parties: Powergen Energy plc, Diamond Power Generation Limited, and Cottam Development Centre Limited.

In response to the modification proposal Powergen have the following points to raise :-

- Powergen do not support this proposal to modify the imbalance pricing regime.
- This modification proposes yet another level of complexity to NETA BM price setting & is in danger of becoming more complicated & less understandable than the pool.
- Powergen believe that the proposal needs further explanation and also needs to be considered in conjunction with other modifications that have been raised. It is unclear how the proposal would affect the distribution of prices. Powergen would like to see this modification proceed to further definition or to final report with a recommendation to reject in light of the comments below.
- Powergen would seek clarification on the determination of the market price.
- Powergen believe that this proposal would lessen the incentives on participants to balance accurately. The emphasis should remain for participants to balance, with the existing arrangements continuing to resolve system imbalances.
- In addition Powergen do not believe that there is merit in making additional changes to the imbalance pricing regime until the effects of the changes and potential changes under P3 and P18 have been assessed. We believe that there have been too many modifications raised in this area without due consideration / assessment of the impact of the previous changes.
- Powergen would question the applicability of the calculations described in the proposal with the publication of prices via the BMRA.

Yours Sincerely James Hawkins Strategy & Regulation Energy Trading Powergen 02476 42 4737.

P27_ASS_007 – Scottish and Southern Energy

Modification Proposal P27 - Amendment to Derivation of Imbalance Prices

Response on behalf of Southern Electric, Scottish and Southern Energy, Keadby Generation Limited and SSE Energy Supply Limited.

In principle Scottish and Southern Energy supports this modification proposal. We agree that the charges imposed on participants with an energy imbalance in the opposite direction to the system are not reflective of the costs being incurred by the System Operator and that this is an unnecessary inefficiency in current arrangements. We believe it would be more appropriate for the price paid or received for imbalances which are in the opposite direction to the system to be more closely related to a market price. We believe a suitable market price could be derived from a power exchange such as UKPX. It would be envisaged that since UKPX stops trading before Gate Closure that the current Reference Price Data for each half hour period could be calculated in such time to be made available in near real time along with SSP and SBP. Should the issues with designating and publishing Market Price data be insurmountable, then consideration could be given to the use of average SSP/SBP, or applying the opposite cash-out price when helping the system. As the buy-sell spread reduces, through the combination of current Modification proposals, these would approach a market price in any event.

Consideration would need given to the interaction with other proposed Modifications, particularly Mod P26. It would be anticipated that the Market Price in both cases would be derived in the same way, we would suggest the average of the trades in the preceding 24 hours that the half hour is traded rather than a last-traded price, and that both Modifications would be complementary.

We believe the proposals would help reduce actions required by the System Operator, would help reduce some of the volatility currently associated with imbalance prices and the bias currently seen in long positions being taken in the market.

As such we believe the arrangements suggested would improve the efficiency of the current arrangements and help promote competition in generation and supply. We agree that the Modification should proceed to the Assessment phase.

P27_ASS_008 – ScottishPower UK Plc

On behalf of ScottishPower UK Plc, Manweb Plc and Emerald Power Ltd. I would like to submit the following response to Modification proposal P27 - Amendment to the Derivation of Imbalance Prices (Elec Direct): -

We are concerned that this Modification Proposal will result in Parties trying to second guess the direction of net imbalance, leading to an increase in activity in the BM. As the intention of penal dual imbalance pricing was to deter just that and to ensure that Parties had contracted for most of their energy going into the BM, we are concerned that this will have the opposite effect; with potentially serious consequences for system balancing. While we are of the opinion that the costs of balancing could be more efficiently and appropriately distributed amongst Parties, we do not feel that this Proposal represents the best method of achieving this. As previously indicated, we would welcome a general review of pricing issues, as we believe that this would be preferable to addressing specific pricing related concerns in isolation.

The extent of the changes to BSC and participant systems may have been underestimated by the proposer and we would question whether some of the elements (e.g. Market Price) can be delivered from external sources within the necessary timescales? We would further question whether a suitable difference factor can be calculated from available market data, or whether we will see a nominal fixed price adjustment, set by the Panel, applied to the primary imbalance price?

I hope that you will find these comments helpful. Should you wish to discuss any of the points raised, please do not hesitate to contact me.

Regards, James Nixon Design Authority, Deregulation Services Calanais Ltd for ScottishPower & Manweb Int - 700 2316 Ext - 0141 568 2316 http://asg.scottishpower.plc.uk <http://asg.scottishpower.plc.uk/> (Intranet)

P27_ASS_009 – Enron

Modification Proposal P27: Amendment to the Derivation of Imbalance Prices

Response by Enron Europe 17 August 2001

In principle we support modification proposal P27. However, we have reservations about the proposed calculation of prices for imbalances that are in the opposite direction to the net system imbalance. Specifically, the calculation requires the use of market prices that may not be robust, and without further explanation and analysis it is difficult to determine whether the calculation would result in efficient outcomes in all circumstances.

An efficient imbalance pricing rule should reflect the underlying supply and demand balance. With efficient pricing, both SBP and SSP would fall as the system surplus increases. Conversely both SBP and SSP would rise as the system deficit increases.

NETA has often been over 1GW long while SBP has been many hundreds of pounds per MWh. Such a price outcome does not reflect the underlying value of electricity and incentivises inefficient and perverse behaviour that is of little or no value to the system. For example, the asymmetrical risk between SBP and SSP drives participants to over-nominate generation. Also, imbalance prices that don't reflect fundamental are the main reason for illiquidity in within day contract markets. Unmanageable imbalance price risk deters participants from taking within day positions because they are nervous about being unable to trade out their positions prior to Gate Closure.

P27 proposes to improve the efficiency of the imbalance price calculation by setting prices to levels that better reflect the underlying value of electricity. We support P27 in principle because it would result in more efficient market outcomes. The system would be closer to balancing – requiring fewer BM actions thereby better achieving the applicable BSC objective of the efficient economic and co-ordinated operation of the transmission system. Also, imbalance prices that are less punitive would result in increased within day liquidity thereby better achieving the applicable BSC objective of promoting effective competition.

Several other modifications attempt to address either imbalance volume risk or imbalance price risk. Therefore, the assessment of P27 should take account of the potential impact of these modifications on imbalance prices and risks.