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24 January 2002

The National Grid Company, BSC Signatories and  
Other Interested Parties

Your Ref:  
Our Ref : MP No: P25

Dear Colleague,

**Modification to the Balancing and Settlement Code - Decision and Notice in relation to  
Modification Proposal P25: “Commissioning Status in NETA”**

The Gas and Electricity Markets Authority (the “Authority”) has carefully considered the issues raised in Modification Proposal P25 “Commissioning Status in NETA”.

The Balancing and Settlement Code (“BSC”) Panel (the “Panel”) recommended to the Authority that:

- (i) the original Modification Proposal, as defined by the Modification Group (the “Group”) in the Definition Report, be rejected; and
- (ii) the Alternative Modification Proposal, as developed by the Group and defined in the Assessment Report, be rejected.

The Authority agrees with the Panel’s recommendation. This letter explains the background to the Modification Proposal and sets out the Authority’s reasons for its decision.

**Background to the proposal**

Under the rules of the Pooling and Settlement Agreement at the day ahead stage, generators bid into the Pool the prices at which they were willing to generate electricity and their available output for the following day. NGC as the System Operator (SO) would stack the bids until the required generation for the estimated demand was met. The price of the marginal bid would form the basis of the payments that all generators within the stack would receive (System Marginal Price (SMP)) plus a Capacity Payment<sup>1</sup> (SMP plus the Capacity

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<sup>1</sup> The Capacity Payment was essentially a payment designed to ensure that enough generating capacity was kept available for times of peak demand.

Payment equalled the Pool Purchase Price (PPP)). Under the Pool commissioning generators could bid in at zero and if they were able to generate they would be guaranteed the PPP. In addition generators received Availability Payments to encourage them to make plant available beyond that necessary to meet demand, therefore by making themselves available they had a guaranteed income.

The new electricity trading arrangements are based on bilateral trading between market participants through forward and futures markets and short-term power exchanges. The Settlement Process assesses the position of all BSC Parties to determine whether their metered output or consumption of electricity matches their contracted position. If it does not then they will be 'out of balance'. The imbalance price paid or charged to 'out of balance' market participants varies depending on whether they are over-contracted (or long) or under-contracted (or short). These different charges reflect the additional costs incurred by the SO in instructing generators, suppliers or customers to vary their output or consumption at short notice to meet unanticipated imbalances between overall demand and supply. Energy Imbalance Prices are designed to be reflective of the Energy Balancing costs that the SO has incurred in taking balancing actions both in the Balancing Mechanism<sup>2</sup> and in the forwards markets.

The treatment of commissioning plant in the NETA was considered as part of the general consultation surrounding the introduction of the new trading arrangements.

On 25 June 2001 BP Gas Marketing submitted Modification Proposal P25: Commissioning Status under NETA. The Proposer argued that under the Pool, commissioning plant were essentially subsidised by the rest of the industry but at present the BSC does not recognise this concept nor unpredictability of commissioning plants. It was also argued that commissioning plants are much more vulnerable to exposure to Energy Imbalance Prices than any other generator as without the knowledge of how the plant will perform, these stations are not in a position to accurately determine or control their imbalance exposure. Therefore based on the perceived extreme nature of Energy Imbalance Prices since the start of NETA and the unreliability of brand new power stations it will be virtually impossible for commissioning plants to gain positive revenues for their generation, let alone cover production costs. The Proposer believes that the substantial risks of the commissioning phase will be a major disincentive to building new plant.

## **The Modification Proposal**

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<sup>2</sup> The Balancing Mechanism is used by NGC at Gate Closure (3½ hours before real time) to match demand and supply in real time. The Balancing Mechanism enables NGC to keep the system in energy balance by adjusting levels of generation and demand in the light of the Bids and Offers submitted. The Balancing Mechanism accounts for less than 5% of all electricity demand.

Modification Proposal P25 seeks to allow the Lead Party of the commissioning BM Unit to apply to the Panel to be given "Commissioning Status" to become a "Commissioning BM Unit". The Trading Party for each Commissioning BM Unit would be able to nominate to ELEXON up to 90 Settlement Days, giving 24 hours notice before the start of the Settlement Day, to be treated as "Commissioning Settlement Days". On Commissioning Settlement Days, any shortfall (or surplus) against the Final Physical Notification (FPN) (as modified by any Accepted Offer or Bid) would be priced at a "Market Price" rather than the relevant Energy Imbalance Price. The Market Price would be derived from prices in publicly-traded markets.

The Group argued that a Market Price would be used to remove any incentive to Commissioning BM Units to over declare FPN's and contract against the additional Credited Energy Volume. BM Units that shortfall against FPN will still incur an increased Trading Charge of the difference between the Market Price and the System Sell Price (SSP). However, this is the same revenue that a non-commissioning BM Unit would forego by generating that quantity and spilling rather than contracting. It was suggested that the Panel would, from time to time, consult on and designate the basis of the Market Price.

It was proposed that the Panel would have certain criteria that the BM Unit would have to satisfy to be given Commissioning Status and the subsequent imbalance price relief. To qualify, any Plant or Apparatus that the BM Unit comprises must have been the subject of a Commissioning Qualifying Event, with the list of such Events being as follows:

- a consent under Section 36 of the Electricity Act (1989)<sup>3</sup>;
- a consent under Section 14 of the Energy Act (1976)<sup>4</sup>; or
- any other event that the Panel may designate from time to time as being a Commissioning Qualifying Event.

The Commissioning Status may only be granted to a BM Unit comprising Plant and Apparatus on a single site, such that a Supplier BM Unit covering a whole Grid Supply Point (GSP) Group could not be granted Commissioning Status as a consequence of the addition of Plant or Apparatus within that GSP Group requiring Section 14 consent.

Commissioning Status would be terminated the earlier of:

- one year after the first Commissioning Settlement Day;

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<sup>3</sup> Section 36 of the Electricity Act (1989) requires that "a generating station shall not be constructed, extended or operate except in accordance with a consent granted by the Secretary of State"

<sup>4</sup> Section 14 of the Energy Act (1976) requires that "a person who proposes to carry out works for the establishment of an electricity generating station to be fuelled by crude liquid petroleum, any petroleum product or natural gas; or for the conversion of an electricity generating station with a view to its being so fuelled" must notify the Secretary of State, who may direct that the proposal is not carried out;

- one year after the Settlement Day of first export;
- the 90th Commissioning Settlement Day; or
- the Initial Settlement Run when it is established that any “Commissioning Status Exit Criterion” is met.

The Commissioning Status Exit Criteria would apply to a Commissioning BM Unit when its cumulative output over a Commissioning Settlement Day deviated from its expected output (FPN as modified by any accepted Offers or Bids) by less than 5% or by more than 50% for 7 consecutive Commissioning Settlement Days. The Commissioning Status Exit Criteria puts incentives on Commissioning BM Units not to deviate significantly and consistently from their FPN at the risk of losing Commissioning Status. Once Commissioning Status for a BM Unit has been terminated, Commissioning Status cannot be granted again unless there has been another Commissioning Qualifying Event.

The Modification proposes that any imbalance costs incurred by Commissioning BM Units would be funded through the Residual Cashflow Reallocation Cashflow (RCRC). It was suggested that Credit Energy Volume associated with Commissioning BM Units on Commissioning Settlement Days should not count towards the pro-rating of RCRC. This was on the grounds that it is inappropriate that Commissioning BM Units, being immune from exposure to Energy Imbalance Prices, should attract payments arising from the exposure of others.

During the Assessment Phase, the Group considered that only a few BM Units would have this Commissioning Status and therefore developed an Alternative Modification Proposal to minimise the changes required to settlements systems. The Alternative Modification Proposal minimises the impact on settlement systems by achieving the required changes to the Daily Party Energy Imbalance Cashflows by adjusting Account Energy Imbalance Volumes of the affected Trading Parties in the affected Settlement Periods. The adjustment uses a process separate from existing settlement systems by adjusting the Account Bilateral Contract Volumes between Energy Contract Volume Aggregation Agent and Settlement Aggregation Agent. Therefore the Alternative Modification Proposal allocates RCRC payments to Commissioning BM Units.

The original Modification Proposal would allow Commissioning Status to be granted, and Commissioning Settlement Days to be declared retrospectively to Go Live from when the Modification Proposal were implemented.<sup>5</sup> The Alternative Modification proposes a prospective Implementation Date.

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<sup>5</sup> The date of NETA ‘Go Live’ was 27 March 2001.

The Group considered that the Alternative Modification Proposal was a better solution than the original Modification Proposal. However the Group was unable to reach a consensus on whether the Alternative Modification Proposal better facilitated the relevant BSC Objectives as set out in Condition C3.3 of NGC's Transmission licence. Therefore the Group concluded that if the Panel considered that the consequences of exposure to Energy Imbalance Prices, as currently calculated are unreasonable, then the Panel should recommend to the Authority that the Alternative Modification Proposal be made. Alternatively, if the Panel considered that the consequences of exposure to imbalance prices, as currently calculated, is reasonable, then the Panel should recommend to the Authority that the Alternative Modification Proposal be rejected.

The Panel considered the Assessment Report at its meeting of 18 October 2001. The Panel decided to proceed to the Report Phase with the recommendation that both the original Modification Proposal and the Alternative Modification Proposal should be rejected. ELEXON published a draft Modification Report on 29 October 2001 that invited respondents' views.

### **Respondents' views**

In total, ELEXON received 8 responses to the consultation on the draft Modification Report. Of the responses, one expressed support for the Alternative Modification Proposal and the remaining 7 did not support the original Modification Proposal or the Alternative Modification Proposal.

Respondents that did not support the original Modification Proposal or the Alternative Modification Proposal commented that providing only commissioning plant with relief from Energy Imbalance Prices constitutes a cross-subsidy to one class of BSC Parties at the expense of another which is discriminatory and therefore does not promote competition. One respondent commented that it is unlikely that imbalance prices alone will dictate the decision on whether to commission a new plant.

The respondent who supported the Alternative Modification Proposal suggested that the Panel had not made their decision as to whether the modification better facilitated the BSC Objectives on the basis of if the consequences of exposure to imbalance prices did or did not reasonably reflect costs imposed on the System by energy imbalances as the Group had recommended.

### **Panel's Recommendation**

The Panel met on 15 November 2001 and considered the Modification Report, the views of the Group and the consultation responses received.

The Panel recommended to the Authority that:

- (i) the original Modification Proposal, as defined by the Group in the Definition Report, be rejected; and
- (ii) the Alternative Modification Proposal, as developed by the Group and defined in the Assessment Report, be rejected.

The Panel recommended that the Alternative Modification Proposal should be rejected on the grounds that the relief from energy imbalance charges provided by the Alternative Modification Proposal constituted a cross-subsidy to one class of BSC Parties at the expense of other BSC Parties. The Panel considered that such a cross-subsidy would be discriminatory, and that hence the Alternative Modification Proposal (and by implication the original Modification Proposal also) would not promote effective competition. Some of the other points made by the BSC Panel were:

- if some members of the Modification Group believed that the Energy Imbalance Prices are calculated unfairly, then they are permitted to submit a Modification Proposal specifically to cover this issue;
- that whilst a commissioning generator was exposed to considerable risk if it chose to contract and risk exposure to SBP, it had the option not to contract and take SSP for its spill, which was far less risky; and
- the Proposal was discriminatory as it did not propose to extend the status to embedded generators and the demand side had not been taken into account.

### **Ofgem's view**

Ofgem<sup>6</sup> considers that Modification Proposal P25 does not better facilitate the relevant objectives of the BSC, in particular the promotion of effective competition in the electricity markets, and efficiency in the implementation and arrangements of balancing and settlement arrangements.

Ofgem agrees with the Panel and the majority of respondents that providing commissioning plant with relief from energy imbalance charges constitutes a cross-subsidy to one class of BSC Parties at the expense of other BSC Parties. Ofgem also agrees with the Panel, that the original Modification Proposal and the Alternative Modification Proposal are discriminatory, as they do not make provisions for commissioning embedded generators that are not BM Units or for demand side participants. Therefore Ofgem believes that the original

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<sup>6</sup> Ofgem is the office of the Authority. The terms "Ofgem" and "the Authority" are used interchangeably in this letter.

Modification Proposal and the Alternative Modification Proposal do not better facilitate the BSC Objective of promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) such competition in the sale and purchase of electricity.

Ofgem notes that there are other Modification Proposals being progressed which could, if approved, reduce the risk of imbalance exposure to all Parties.

Ofgem agrees with the Panel that Parties who believe that Energy Imbalance Prices are not calculated correctly can submit a Modification Proposal to modify the BSC if they consider that a modification will better facilitate the relevant BSC Objectives.

### **The Authority's decision**

The Authority agrees with the Panel's recommendation that Modification Proposal P25 should not be made.

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 as set out in Modification Proposal P25.

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the above number.

Yours sincerely,

**Sonia Brown**  
**Head of Electricity Trading Arrangements**

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