



19 July 2001

**INITIAL WRITTEN ASSESSMENT OF  
MODIFICATION PROPOSAL P026 -  
Market - Driven Trading Neutrality Band**

Prepared by ELEXON Limited

<b>Document Reference</b>	IWA026
<b>Version no.</b>	1.0
<b>Issue</b>	FINAL
<b>Date of Issue</b>	19 July 2001
<b>Reason for Issue</b>	Issue for Panel Meeting
<b>Author</b>	ELEXON

## I DOCUMENT CONTROL

### a Authorities

Version	Date	Author	Signature	Change Reference
0.1	4/7/01	Mandi Francis		
0.2	5/7/01	Mandi Francis		
0.3	10/7/01	Mandi Francis		
1.0	11/7/01	Mandi Francis		

Version	Date	Reviewer	Signature	Responsibility
0.1	4/7/01	John Williamson		ELEXON Trading
0.1	4/7/01	John Lucas		ELEXON Trading
0.1	4/7/01	Gwilym Rowlands		ELEXON Trading
0.1	4/7/01	Clive Cushen		ELEXON Performance Management
0.1	4/7/01	Richard Haigh		ELEXON Trading
0.1	4/7/01	Chris Rowell		ELEXON Trading
0.2	5/7/01	As for 0.1		
0.3	11/7/01	As for 0.1		
1.0	19/07/01	Justin Andrews		ELEXON Trading

### 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

### c Intellectual Property Rights and Copyright

This document contains materials the copyright and other intellectual property rights in which are vested in ELEXON Limited or which appear with the consent of the copyright owner. These materials are made available for you to review and to copy for the purposes of the establishment, operation or participation in electricity trading arrangements in Great Britain under the BSC. All other commercial use is prohibited. Unless you are a person having an interest in electricity trading in Great Britain under the BSC you are not permitted to view, download, modify, copy, distribute, transmit, store, reproduce or otherwise use, publish, licence, transfer, sell or create derivative works (in whatever format) from this document or any information obtained from this document otherwise than for personal academic or other non-commercial purposes. All copyright and other proprietary notices contained in the original material must be retained on any copy that you make. All other rights of the copyright owner not expressly dealt with above are reserved.

## **II CONTENTS TABLE**

<b>I</b>	<b>Document Control.....</b>	<b>2</b>
a	Authorities.....	2
b	Distribution.....	2
c	Intellectual Property Rights and Copyright.....	2
<b>II</b>	<b>Contents Table .....</b>	<b>3</b>
<b>1</b>	<b>Summary .....</b>	<b>4</b>
<b>2</b>	<b>Introduction.....</b>	<b>5</b>
<b>3</b>	<b>Purpose and Scope of the Report .....</b>	<b>6</b>
<b>4</b>	<b>Description of the Modification Proposal.....</b>	<b>7</b>
<b>5</b>	<b>Impact on BSC Systems and Processes.....</b>	<b>8</b>
<b>6</b>	<b>Impact on Other Systems and Processes Used by Parties.....</b>	<b>10</b>
<b>7</b>	<b>Impact on Documentation .....</b>	<b>11</b>
7.1	Impact on Balancing and Settlement Code .....	11
7.2	Impact on Code Subsidiary Documents .....	14
7.3	Impact on Core Industry Documents.....	16
<b>8</b>	<b>Impact on Other Configurable Items .....</b>	<b>17</b>
<b>9</b>	<b>Impact on ELEXON.....</b>	<b>18</b>
<b>10</b>	<b>Impact on Financial Arrangements and Budget .....</b>	<b>20</b>
<b>11</b>	<b>Impact on BSC Agent Contractual Arrangements .....</b>	<b>21</b>
<b>12</b>	<b>Process and Timetable for Progressing the Proposal.....</b>	<b>22</b>
<b>13</b>	<b>Issues .....</b>	<b>23</b>
13.1	Assessment Issues.....	23
13.2	Definition Issues.....	23
<b>Annex 1 –</b>	<b>Modification Proposal.....</b>	<b>25</b>

## 1 SUMMARY

Modification Proposal P026 was submitted on 25<sup>th</sup> June 2001 by BizzEnergy.com Limited. The Modification Proposal seeks to introduce a 'Trading Neutrality Band' in to the calculation of Imbalance payments. The intent of such Trading Neutrality Band is to enable a small, defined, volume of energy imbalance to be cashed out at a neutral price. The Modification Proposal also proposes that such Trading Neutrality Band be reviewed and amended annually by the BSC Panel to take into consideration changes in the liquidity and granularity of spot markets.

An initial assessment of Modification Proposal P026 has identified the following potential areas of impact and issues to be considered. These are expanded further in Sections 5 to 13:

- The interaction of this Modification Proposal with existing Modifications. Existing Modifications may mitigate the requirement for this Modification Proposal by meeting its objectives.
- The impact on the market / trading trends of the introduction of an 'Imbalance buffer zone'. An assessment of the incentives and the impact on trading needs to be undertaken to understand the impact this Modification Proposal potentially has on market operation.
- The impact on the BSC Agent Systems, specifically the significant impact on the Settlement Administration Agent (SAA).
- The scope of the Modification Proposal, and its impact on consequential processes, such as Credit Cover calculations.
- The definition of the mechanism for setting the Trading Neutrality Band, potentially this could be a fixed volume or a percentage based variable.
- The definition of the mechanism for setting the neutral price(s), which could be fixed, or market based and therefore, variable.

It is recommended that the Modification Proposal is progressed as follows:

- Modification Proposal P026 should be submitted to the Definition procedure in accordance with Section F 2.5 of the Balancing and Settlement Code, in order to enable a Modification Group to consider and define further the Modification Proposal, and any Alternative Modifications that might achieve the aims of the Modification more effectively and economically.
- The Definition Report for Modification Proposal P026 should be submitted to the BSC Panel for the meeting of the 23<sup>rd</sup> August 2001.

## **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.

An electronic copy of this document can be found on the BSC website, at [www.elexon.co.uk](http://www.elexon.co.uk)

### 3 PURPOSE AND SCOPE OF THE REPORT

Section F of the BSC sets out the procedures for progressing proposals to amend the BSC (known as 'Modification Proposals'). These include procedures for proposing, consulting on, developing, evaluating and reporting to the Authority on potential modifications.

The BSC Panel is charged with supervising and implementing the modification procedures. ELEXON provides the secretariat and other advice, support and resource required by the Panel for this purpose. In addition, if a modification to the Code is approved or directed by the Authority, ELEXON is responsible for overseeing the implementation of that amendment (including any consequential changes to systems, procedures and documentation).

When a new proposal to modify the BSC is made, it is the responsibility of the Panel to determine how it should be progressed. Options include submitting the proposal to a Definition Procedure<sup>1</sup>, submitting it to an Assessment Procedure<sup>2</sup>, amalgamating the proposal with another proposal<sup>3</sup>, or proceeding directly to the Report Phase<sup>4</sup>. With a view to assisting the Panel in taking this decision, ELEXON prepares this initial written assessment of the implications of the Modification Proposal as soon as reasonably practicable after the proposal is made<sup>5</sup>. ELEXON endeavours to complete this initial assessment such that it can be reviewed by the Panel at the Panel meeting at which the relevant Modification Proposal is first to be considered.

This initial assessment provides a preliminary view on the following:

- the potential impact of the proposed modification on BSC systems and processes;
- the potential impact of the proposed modification on other systems and processes used by Parties;
- the potential impact of the proposed modification on the BSC, Code Subsidiary Documents and Core Industry Documents;
- the potential impact of the proposed modification on ELEXON;
- the potential impact of the proposed modification on BSC financial arrangements and budget;
- the potential impact of the proposed modification on BSC Agent contractual arrangements;
- The process and timetable that should be adopted for the progression of the Modification Proposal, in light of its complexity, importance and urgency; and
- Issues that will need to be considered and addressed in progressing the Modification Proposal (including the potential need for impact assessments, consultation and analyses).

It should be noted that, as this document only represents a preliminary assessment of the Modification Proposal, the information contained herein will, in most cases, be superseded by the subsequent analysis and reports produced by the Modification Group to which the Panel assigns the proposal for consideration.

---

<sup>1</sup> see BSC F2.5

<sup>2</sup> see BSC F2.6

<sup>3</sup> see BSC F2.3

<sup>4</sup> see BSC F2.7

<sup>5</sup> see BSC F2.1.8

#### **4 DESCRIPTION OF THE MODIFICATION PROPOSAL**

The Modification Proposal is seeking to amend the methodology for the application of Energy Imbalance Prices on Energy Imbalance volumes by the introduction of a 'Market - Driven Trading Neutrality Band'. The intent of such a Trading Neutrality Band is to allow, for each BSC Party and each Settlement Period, a defined volume of Energy Imbalance to be cashed out at a neutral price, with the remaining Energy Imbalance cashed out under existing arrangements, i.e. subject to either the System Buy Price or the System Sell Price, as appropriate.

The Modification Proposal defines the issue requiring the introduction of such Trading Neutrality Band as being one of market liquidity, granularity and efficiency, in that a BSC Party's ability to fine tune their trading position is dependent upon their ability to contract for small volumes of energy close to Gate Closure. Currently the power exchanges have an implied minimum contract volume of 20 MWh as a result of the transaction costs for contracting for smaller volumes being too high to warrant the transaction. Similarly, aggregation services, where a BSC Party can buy a small portion of a power exchange trade, are available, but again the transaction costs are uneconomic for new entrants / small players.

The Modification Proposal indicates that the perceived lack of granularity in the spot markets is one of the contributing factors to the market being long, in that BSC Parties cannot buy / sell small enough quantities of energy to come closer to being in balance. Therefore, the Modification Proposal seeks to introduce a mechanism to effectively account for the unavailability of smaller contract volumes by allowing any subsequent imbalance, within the limit defined by the Trading Neutrality Band to be subject to a neutral price. Such neutral price could be market based, utilising costs of trades from a power exchange, or another neutral price representing the value of short term energy.

The Modification Proposal proposes that the Trading Neutrality Band be set annually by the BSC Panel, and that the volume so defined be representative of the liquidity and granularity of the spot market.

A copy of the Modification Proposal, as submitted by its proposer, can be found at Annex 1 to this report.

## 5 IMPACT ON BSC SYSTEMS AND PROCESSES

BSC System / Process	Potential Impact of Proposed Modification
<b>Registration</b>	No Impact Identified at this time
<b>Contract Notification</b>	No Impact Identified at this time
<b>Credit Checking</b>	Potential Impact re Credit Cover calculations
<b>Balancing Mechanism Activities</b>	No Impact Identified at this time
<b>Collection and Aggregation of Metered Data</b>	No Impact Identified at this time
<b>Supplier Volume Allocation</b>	No Impact Identified at this time
<b>Settlement</b>	<p>The Modification Proposal impacts the way in which the Energy Imbalance Prices (SSP and SBP) and the neutral price(s) (required under the Modification Proposal), are applied to Energy Imbalance Volumes, and therefore the Settlement calculations to determine the Energy Imbalance Price for a BSC Party for a Settlement Period. Consequently, it is expected that there will be no impact on the calculation of the Energy Imbalance Prices (SSP and SBP).</p>
<b>Clearing, Invoicing and Payment</b>	No Impact Identified at this time
<b>Reporting</b>	<p>The Settlement Report (SAA-I014 – all sub flows) may be impacted if it is determined that the detail of the Energy Imbalance Price application is required to be reported to BSC Parties, ELEXON and the Transmission Company.</p> <p>A new interface may be required from the BSC Panel (/ ELEXON) to SAA (and BSC Parties) to notify them of the Trading Neutrality Band volume. An alternative for the notification to SAA only, is to amend the existing 'System parameters' interface – SAA-I023 to include this information.</p> <p>Depending upon the mechanism for determining the neutral price(s) to be applied to the Trading Neutrality Band volume, there may be a requirement for a new interface to notify such price to BSC Parties and SAA. An alternative for the notification to SAA only, is to amend the existing 'System parameters' interface – SAA-I023 to include this information.</p>

<b>BSC System / Process</b>	<b>Potential Impact of Proposed Modification</b>
<b>Contingencies</b>	No Impact Identified at this time
<b>Dispute Resolution</b>	No Impact Identified at this time

## 6 IMPACT ON OTHER SYSTEMS AND PROCESSES USED BY PARTIES

System / Process	Potential Impact of Proposed Modification
<b>BSC Parties</b> <b>Transmission Company</b>	If the Settlement Report (SAA-I014, all sub flows) is amended to include reporting of the Energy Imbalance Price application to Energy Imbalance volumes, then BSC Parties, ELEXON and Transmission Company processes and systems for receipt of this interface may be impacted.
<b>BSC Parties</b>	A new interface may be required from the BSC Panel (/ ELEXON) to BSC Parties to notify them of the Trading Neutrality Band volume. Therefore BSC Parties may need to amend processes and systems to account for this interface.
<b>BSC Parties</b>	Depending upon the mechanism for determining the neutral price(s) to be applied to the Trading Neutrality Band volume, there may be a requirement for a new interface to notify such price to BSC Parties. Therefore BSC Parties may need to amend processes and systems to account for this interface.

## 7 IMPACT ON DOCUMENTATION

### 7.1 Impact on Balancing and Settlement Code

BSC Section	Potential Impact of Proposed Modification
A: Parties and Participation	No Impact Identified at this time
B: The Panel	No Impact Identified at this time
C: BSCCo and its Subsidiaries	No Impact Identified at this time
D: BSC Cost Recovery and Participation Charges	No Impact Identified at this time
E: BSC Agents	No Impact Identified at this time
F: Modification Procedures	No Impact Identified at this time
G: Contingencies	No Impact Identified at this time
H: General	No Impact Identified at this time
I: Not Used	No Impact Identified at this time
J: Party Agents	No Impact Identified at this time
K: Classification and Registration of Metering Systems and BM Units	No Impact Identified at this time
L: Metering	No Impact Identified at this time
M: Credit Cover and Credit Default	Assuming that a BSC Party's calculation of Credit Cover is not to be impacted by the introduction of such Trading Neutrality Band and neutral price(s) – i.e. the calculations are not required to take this 'buffer' into account, then there is no identified impact. However, if it is determined that such Credit Cover calculations should take into consideration such Trading Neutrality Band and associated neutral price(s), then there may be a significant impact.

<b>BSC Section</b>	<b>Potential Impact of Proposed Modification</b>
N: Clearing, Invoicing and Payment	No Impact Identified at this time
O: Communications	No Impact Identified at this time
P: Energy Contract Volumes and Metered Volume Reallocations	No Impact Identified at this time
Q: Balancing Mechanism Activities	No Impact Identified at this time
R: Collection and Aggregation of Metered Data from CVA Metering Systems	No Impact Identified at this time
S: Supplier Volume Allocation	No Impact Identified at this time
S: ANNEX S-1 Performance Levels and Supplier Charges	No Impact Identified at this time
S: ANNEX S-2 Supplier Volume Allocation Rules	No Impact Identified at this time
T: Settlement and Trading Charges	<p>The Modification Proposal impacts the way in which the Energy Imbalance Prices (SSP and SBP) are applied to Energy Imbalance Volumes, and therefore the Settlement calculations to determine the Energy Imbalance Price for a BSC Party for a Settlement Period. Consequently, it is expected that there will be no impact on the calculation of the Energy Imbalance Prices (SSP and SBP).</p> <p>The Balancing and Settlement Code may have to be updated to include reference to the provisions for setting and notifying such Trading Neutrality Band and associated neutral price(s) to BSC Parties and SAA.</p>
U: Provisions Relating to Settlement	The Balancing and Settlement Code may have to be updated to include reference to the provisions for setting and notifying such Trading Neutrality Band to BSC Parties and SAA.

<b>BSC Section</b>	<b>Potential Impact of Proposed Modification</b>
V: Reporting	<p>The Settlement Report (SAA-I014 – all sub flows) may be impacted if it is determined that the detail of the Energy Imbalance Price application is required to be reported to BSC Parties, ELEXON and the Transmission Company. This may need to be reflected in this Section of the BSC.</p> <p>A new / amended interface may be required from the BSC Panel (ELEXON) to SAA and BSC Parties to notify them of the Trading Neutrality Band volume, and this may need to be represented in this Section of the BSC.</p> <p>Depending upon the mechanism for determining the neutral price(s) to be applied to the Trading Neutrality Band volume, there may be a requirement for a new / amended interface to notify such price to SAA and BSC Parties, and this may need to be reflected in this Section of the BSC.</p>
W: Trading Queries and Trading Disputes	No Impact Identified at this time
X: Definitions and Interpretation	No Impact Identified at this time
X: ANNEX X-1 General Glossary	No Impact Identified at this time
X: ANNEX X-2 Technical Glossary	<p>A new definition may be required to define the Trading Neutrality Band variable.</p> <p>A new definition may be required to define the neutral price(s) variable(s).</p>

## 7.2 Impact on Code Subsidiary Documents

Code Subsidiary Document	Potential Impact of Proposed Modification
BSC Procedures	No Impact Identified at this time
Codes of Practice	No Impact Identified at this time
BSC Service Descriptions	<p>The Service Description for the Settlement Administration Agent (SAA) may need to be amended to include reference to the application of Energy Imbalance Prices.</p> <p>The Service Description for the Funds Administration Agent (FAA) may need to be amended to include reference to the application of Trading Neutrality Band and associated neutral price(s) to the Credit Cover calculation, if required.</p>
Party Service Lines	No Impact Identified at this time
<p>Data Catalogues</p> <p>NETA Data File Catalogue (NDFC)</p>	<p>The Modification Proposal may have an impact on the NETA Data File Catalogue where there is a requirement to amend the Settlement Report to reflect the amendments to the Energy Imbalance Price application for BSC Parties.</p> <p>A new / amended interface may be required from the BSC Panel (ELEXON) to SAA (and BSC Parties) to notify them of the Trading Neutrality Band volume, and this may need to be represented in the NETA Data File Catalogue.</p> <p>Depending upon the mechanism for determining the neutral price(s) to be applied to the Trading Neutrality Band volume, there may be a requirement for a new / amended interface to notify such price to BSC Parties and SAA, and this may need to be represented in the NETA Data File Catalogue.</p>
Communication Requirements Documents	No Impact Identified at this time

Code Subsidiary Document	Potential Impact of Proposed Modification
Reporting Catalogue	<p>The Settlement Report (SAA-I014 – all sub flows) may be impacted if it is determined that the detail of the Energy Imbalance Price application is required to be reported to BSC Parties, ELEXON and the Transmission Company. This may need to be reflected in the Reporting Catalogue.</p> <p>A new / amended interface may be required from the BSC Panel (ELEXON) to SAA (and BSC Parties) to notify them of the Trading Neutrality Band volume, and this may need to be represented in the Reporting Catalogue.</p> <p>Depending upon the mechanism for determining the neutral price(s) to be applied to the Trading Neutrality Band volume, there may be a requirement for a new / amended interface to notify such price to BSC Parties and SAA, and this may need to be represented in the Reporting Catalogue.</p>

### 7.3 Impact on Core Industry Documents

Core Industry Document	Potential Impact of Proposed Modification
Grid Code	No Impact Identified at this time
MCUSA	No Impact Identified at this time
Supplemental Agreements	No Impact Identified at this time
Ancillary Services Agreements	No Impact Identified at this time
Master Registration Agreement	No Impact Identified at this time
Data Transfer Services Agreement	No Impact Identified at this time
British Grid Systems Agreement	No Impact Identified at this time
Use of Interconnector Agreement	No Impact Identified at this time
Pooling and Settlement Agreement	No Impact Identified at this time
Settlement Agreement for Scotland	No Impact Identified at this time
Distribution Codes	No Impact Identified at this time
Distribution Use of System Agreements	No Impact Identified at this time
Distribution Connection Agreements	No Impact Identified at this time

## 8 IMPACT ON OTHER CONFIGURABLE ITEMS

Item	Potential Impact of Proposed Modification
Settlement Administration Agent (SAA) User Requirements Specification (URS)	The Modification Proposal has a significant impact on the SAA URS and associated SAA documentation in order to reflect the changes to Energy Imbalance Price and neutral price(s) application to Energy Imbalance volumes for a Settlement Period and BSC Party.
Funds Administration Agent (FAA) User Requirements Specification (URS)	If the Modification Proposal requires that the Credit Cover calculations take into account the Trading Neutrality Band and associated neutral price(s), then there may be a significant impact on the FAA URS and associated FAA documentation.

## 9 IMPACT ON ELEXON

Area of Business	Potential Impact of Proposed Modification
ELEXON Systems	<p>If the Settlement Report (SAA-I014, all sub flows) is amended to include reporting of the Energy Imbalance Price application to Energy Imbalance volumes, then ELEXON processes and systems for receipt of this interface may be impacted.</p> <p>A new / amended interface may be required from the BSC Panel (/ ELEXON) to BSC Parties to notify them of the Trading Neutrality Band volume. Therefore ELEXON may need to amend processes and systems to generate this interface.</p> <p>Depending upon the mechanism for determining the neutral price(s) to be applied to the Trading Neutrality Band volume, there may be a requirement for a new / amended interface to notify such price to BSC Parties. It is expected that such neutral price determination and notification be undertaken by the BSC Panel / ELEXON. Therefore ELEXON may need to amend processes and systems to generate this interface.</p>
ELEXON Procedures	<p>If the Settlement Report (SAA-I014, all sub flows) is amended to include reporting of the Energy Imbalance Price application to Energy Imbalance volumes, then ELEXON processes and systems for receipt of this interface may be impacted.</p> <p>A new / amended interface may be required from the BSC Panel (/ ELEXON) to BSC Parties to notify them of the Trading Neutrality Band volume. Therefore ELEXON may need to amend processes and systems to generate this interface.</p> <p>Depending upon the mechanism for determining the neutral price(s) to be applied to the Trading Neutrality Band volume, there may be a requirement for a new / amended interface to notify such price to BSC Parties. It is expected that such neutral price determination and notification be undertaken by the BSC Panel / ELEXON. Therefore ELEXON may need to amend processes and systems to generate this interface.</p>
ELEXON Contracts (Excluding BSC Agent Contracts)	No Impact Identified at this time
Other (e.g. costs, staffing, etc.)	The ELEXON resource required to support a Modification Proposal through the Definition Phase is

	estimated at ten man days. Furthermore, the ELEXON resource required to support a Modification Proposal through the Assessment Phase is estimated at between thirty and forty man days.
--	---

## **10 IMPACT ON FINANCIAL ARRANGEMENTS AND BUDGET**

No Impact Identified at this time

## 11 IMPACT ON BSC AGENT CONTRACTUAL ARRANGEMENTS

BSC Agent Contract	Potential Impact of Proposed Modification
Logica (BMRA, CRA, CDCA, SAA, ECVAA, TAA(CVA))	The Modification Proposal has a contractual impact on the SAA, as a result of the impact on the SAA System functionality and associated documentation.
EPFAL (FAA)	The Modification Proposal may have an impact on the FAA, depending upon whether the Credit Cover calculations are required to be amended as a consequence of this Modification Proposal, i.e. to take account of the Trading Neutrality Band and associated neutral price(s)
ESIS (TAA(SVA))	No Impact Identified at this time
Cap Gemini (SVAA)	No Impact Identified at this time
PwC (BSC Auditor, Certification Agent)	No Impact Identified at this time
EASL (Teleswitch Agent, Profile Administrator)	No Impact Identified at this time

## **12 PROCESS AND TIMETABLE FOR PROGRESSING THE PROPOSAL**

The Initial Assessment of this Modification Proposal indicates that further work is required to define the amendments required under the provisions of the Modification Proposal. ELEXON therefore recommends that this Modification Proposal P026 Market – Driven Trading Neutrality Band be submitted to the Pricing Issues Modification Group (PIMG) for Definition. The Pricing Issues Modification Group should be actioned to provide its Definition Report to the Panel by the Panel Meeting of the 23<sup>rd</sup> August 2001.

## 13 ISSUES

The following issues will need to be considered and addressed by the Modification Group in progressing the Modification Proposal P026.

### 13.1 Assessment Issues

- Interaction with other existing Modification Proposals. There are a number of Modification Proposals which may have a degree of interaction with P026. Namely:
  - Those aimed at reducing volatility in the System Buy and System Sell Prices – **P008** 'Introduction of a Price Adjuster to Reflect Option Fees for Balancing Services Contracts in Setting the System buy Price and System Sell Price', **P015** 'Removal of Price Spikes Associated with System Balancing from System Prices and **P018** 'Removing / Mitigating the Effect of System Balancing Actions in the Imbalance Price' (it should be noted that P015 and P018 have been amalgamated).
  - Those aimed at increasing liquidity in the spot market(s), namely **P004** 'Dual Energy Contract Notification' and **P012** 'Reduction of Gate Closure from 3.5 Hours to 1 Hour'.

These associated Modification Proposals may have the effect of mitigating the issues which have lead to the requirement for Modification Proposal P026, and therefore such interaction needs to be assessed and defined.

- Further assessment and definition of the impact of the introduction / implementation of this Modification Proposal on the market as a whole, i.e. the impact the introduction of such 'buffer zone' could have on the way in which BSC Parties trade. The effect on trading may be detrimental or beneficial to the market, but needs to be assessed in order to determine the potential impact. This is not a straightforward change to the way in which Imbalance prices are calculated and applied, the potential ramifications of doing so need to be clarified.
- Further assessment and definition of the impact of this Modification Proposal on the Settlement Calculations, with particular consideration for 'cash out' mechanisms and any impact on other Settlement calculations resulting from the implementation of this Modification Proposal. For example, there may be considerable impact on the Residual Cashflow Reallocation calculations as a result of any implementation of this Modification Proposal, and it may be deemed appropriate to exclude any volume in the Trading Neutrality Band from the Residual Cashflow Reallocation.
- Further assessment of the 'granularity' of spot markets referred to in the Modification Proposal. It is not clear whether this refers to BSC Parties having to buy / sell energy in 20MWh 'chunks', in which case every BSC Party is similarly disadvantaged, or that it is difficult / expensive to buy / sell smaller volumes than 20MWh, in which case only smaller players are disadvantaged. It is believed that it is the latter, but some assessment of the spot markets with regards to such granularity would be required in order to understand the implications of the implementation of this Modification Proposal more thoroughly.

### 13.2 Definition Issues

- Further assessment and definition of the appropriateness of the proposal that the initial Trading Neutrality Band be set to 20MWh per Settlement Period. If an assessment indicates that this may not be appropriate for all BSC Parties potentially disadvantaged by the lack of granularity of the spot markets, than an alternative mechanism for determining the volume to comprise the Trading

Neutrality Band could be proposed. For example, this could be a recommendation that this is a fixed volume for all Settlement Periods, or a percentage of FPN for each Settlement Period, or a percentage of Metered Volume for each Settlement Period, or a combination of these approaches.

- Further assessment and definition of the mechanism for determining the neutral price(s). For example:
  - Are there to be two neutral prices – a Buy Price and a Sell Price? The Modification Proposal indicates that there should be a single neutral price, but consideration could be given to there being a buy and sell prices reflecting the nature of the market, as the Modification Proposal states that consideration should be given to ‘any other neutral price that reflects the value of short term energy’ and this may mean that there is a Buy and Sell price, if this is what the market is indicating.
  - Are the neutral price(s) variable, and if so, what mechanism is there to be for the calculation and subsequent notification of the neutral price(s)?
  - If the neutral price(s) are variable, and are calculated from power exchange prices, as suggested in the Modification Proposal, then what is the mechanism for obtaining the neutral price(s)? Is this a breach of confidentiality, as it requires prices from trades?
  - If the neutral price(s) are fixed over a period, are they to be Settlement Period based, or merely fixed on a Settlement Day, or longer, basis? What mechanism should exist for setting these and notifying them? How often should it / they be reviewed and amended?
- Further assessment and definition of the mechanism for implementing the Trading Neutrality Band within Imbalance Price Calculations. These two options represent an initial view of the mechanism of application, there may be other mechanisms which would be identified under the Definition Phase:
  1. A ‘phased’ application – i.e. Energy Imbalance Volumes for a BSC Party for a Settlement Period up to the Trading Neutrality Band volume are cashed out at the neutral price, Energy Imbalance volumes over the Trading Neutrality Band volume are cashed out at either the System Buy or System Sell Price, as appropriate.
  2. An ‘all or nothing’ application – i.e. Energy Imbalance volumes for a BSC Party for a Settlement Period totalling a volume equal to, or less than the Trading Neutrality band volume are cashed out at the neutral price. However, where the total Energy Imbalance volume for a BSC Party and Settlement Period exceeds the Trading Neutrality Band, then the entire Energy Imbalance volume is cashed out at the System Buy or System Sell Price, as appropriate.
- Further assessment and definition of the scope of the Modification Proposal, for example, the application, or not, of amendments to Credit Cover calculations resulting from the implementation of the Trading Neutrality band and associated neutral price(s).

## ANNEX 1 – MODIFICATION PROPOSAL

<b>Modification Proposal</b>	<b>MP No: 26</b> <i>(mandatory by BSCCo)</i>
<b>Title of Modification Proposal</b> <i>(mandatory by proposer):</i> Market-Driven Trading Neutrality Band	
<b>Submission Date</b> <i>(mandatory by proposer):</i> 25 <sup>th</sup> June 2001	
<p><b>Description of Proposed Modification</b> <i>(mandatory by proposer):</i></p> <p>All participants in the market should be allowed a Trading Neutrality Band decided annually by the Panel. The initial band should be 20MWh per half-hour.</p> <p>Imbalances within this band should be cashed out at a single neutral price. This could be either:</p> <ol style="list-style-type: none"> <li>1 The closing (last-traded) price in an approved power exchange;</li> <li>2 The average exchange traded price in the the preceeding 24 hours (which reduces the possibility of market manipulation and incorporates the period when the market will have traded most liquidly);</li> <li>3 Any other neutral price that represents the value of short-term energy.</li> </ol> <p>Imbalances beyond the Trading Neutrality Band would be cashed out at the appropriate SSP or SBP.</p> <p>Annually, the Panel will consult on the level of liquidity in spot markets and will then recommend to the Authority as to whether there is a reduced level of granularity in such markets sufficient to enable participants to trade out of residual imbalances at reasonable cost. With approval of the Authority, such smaller Trading Neutrality Band will apply with 1 month's notice.</p>	
<p><b>Description of Issue or Defect that Modification Proposal Seeks to Address</b> <i>(mandatory by proposer):</i></p> <p>Participants have a strong incentive to balance their portfolio of contracts to their predicted metered output. This is made feasible by an ability to contract up until gate closure in spot markets. There is therefore a strong dependency on the liquidity and efficiency of the spot markets. This will take time to develop and, to an extent, is hampered by the degree to which flexible generation is in the control of a limited number of portfolio and vertically integrated participants.</p> <p>In particular, a high degree of liquidity and trading volume is required before products are offered on such markets that represent the small volumes of energy needed to fine tune small portfolios (be they supply or embedded generator type portfolios). A supplier with a 1% market share and a requirement for 3% extra energy in a half-hour would require 7MWh on an average half-hour. A new-entrant supplier would have much less that a 1% market share for some considerable time. Currently, the smallest volume of energy normally trading on current power exchanges is 20MWh, with the transaction cost for acquiring smaller volumes being very high. It is the lack of such liquidity that may be contributing to some participants going long because they cannot buy in quantities that would allow them to reach closer to balance.</p> <p>To an extent, parties are offering an aggregating service whereby suppliers can buy a portion of an aggregated power exchange trade. But, to set up such a function requires either a significant portfolio of flexible generation or else the development of a market-making function, which entails the absorption of imbalance risk. To date, the prices offered on such services have been uneconomic for new entrants.</p> <p>This Proposal seeks to ensure that, until such time as spot markets can provide the required variety and precision of energy contracts, new entrants and other niche players can, for an appropriate portion of energy,</p>	

<b>Modification Proposal</b>	<b>MP No: 26</b> <i>(mandatory by BSCCo)</i>
<p>avoid the excessive transaction costs required for a full imbalance avoidance strategy.</p> <p>In providing a neutral cash-out price for these residual imbalances, all players are able to contract to a reasonably tight level of balance at reasonable cost, without imposing excessive costs on other participants.</p>	
<b>Impact on Code</b> <i>(optional by proposer):</i>	
<b>Impact on Core Industry Documents</b> <i>(optional by proposer):</i>	
<b>Impact on BSC Systems and Other Relevant Systems and Processes Used by Parties</b> <i>(optional by proposer):</i>	
<b>Impact on other Configurable Items</b> <i>(optional by proposer):</i>	
<p><b>Justification for Proposed Modification with Reference to Applicable BSC Objectives</b> <i>(mandatory by proposer):</i></p> <p>Due to granularity and lack of liquidity in spot markets, new entrant suppliers and small generators cannot acquire or sell energy in volumes appropriate to their forecast balance position. This puts them at a competitive disadvantage relative to larger participants. By providing a neutral price for small imbalance positions, a barrier to entry into the supply market is removed. This therefore satisfies the Applicable BSC Objective of facilitating competition between generators and between suppliers.</p>	
<p><b>Details of Proposer:</b></p> <p style="padding-left: 40px;"><b>Name:</b> David Cave</p> <p style="padding-left: 40px;"><b>Organisation:</b> BizzEnergy.com Limited</p> <p style="padding-left: 40px;"><b>Telephone Number:</b> 01905 451120</p> <p style="padding-left: 40px;"><b>Email Address:</b> davec@bizzenergy.com</p>	
<p><b>Details of Proposer's Representative:</b></p> <p style="padding-left: 40px;"><b>Name:</b> Robert Barnett</p> <p style="padding-left: 40px;"><b>Organisation:</b> Campbell Carr Consultancy</p> <p style="padding-left: 40px;"><b>Telephone Number:</b> 01494 432323</p> <p style="padding-left: 40px;"><b>Email Address:</b> r_barnett@campbellcarr.co.uk</p>	

<b>Modification Proposal</b>	<b>MP No: 26</b> <i>(mandatory by BSCCo)</i>
<b>Details of Representative's Alternate:</b> <b>Name:</b> Maurice Smith <b>Organisation:</b> Campbell Carr Consultancy <b>Telephone Number:</b> 01494 432323 <b>Email Address:</b> m_smith@campbellcarr.co.uk	
<b>Attachments: NO</b> <b>If Yes, Title and No. of Pages of Each Attachment:</b>	