

Modification Proposal P90 'Improving the Representation of Energy Balancing Actions in Cashout Prices'
Second Assessment Consultation
Document reference P090AC10B
Issue FINAL 27 September 2002

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The following consultation is the second issued during the Assessment Procedure for Modification Proposal P90.

There are a number of supporting documents available on the BSC Website (www.elexon.co.uk), which provide further information on Modification Proposal P90, as follows:

Modification Proposal P90 - www.elexon.co.uk/ta/modifications/modsprops/P090/P90.pdf

Modification Proposal P90 Annex - www.elexon.co.uk/ta/modifications/modsprops/P090/P90_Att.pdf

Modification Proposal P90 was submitted to a two month Assessment Procedure at the Panel meeting of 18 July 2002, with the assessment to be undertaken by the Pricing Issues Modification Group (PIMG), now referred to as the Pricing Standing Modification Group (PSMG).

The assessment issues under consideration by the PSMG for Modification Proposal P90 were similar to those identified for Modification Proposal P74 'Single Cost – reflective Cash-out Price' and Modification Proposal P78 'Revised Definition of System Buy Price and System Sell Price', which were assessed in parallel. Documentation relating to these Modifications is available on the BSC Website, as follows: www.elexon.co.uk/ta/modifications/mods_docs.html (Select either P74 or P78 from the list).

During the Assessment Procedure for P90, the PSMG were constrained to considering P90 (Proposed and any Alternative) against the current baseline (i.e. the current baseline plus any Modification Proposals approved by the Authority and pending implementation). Therefore, the PSMG acknowledged that any Authority decision to approve either of Modification Proposals P74 and P78 would materially change the baseline against which P90 had been assessed.

An additional consideration was the formulation of the Alternative Modification for P90. The PSMG had initially identified five options for consideration as an Alternative to P90, (as set out in the documentation supporting the first assessment consultation), but disregarded these as the PSMG did not believe that any of the options were better than the Proposed Modification at facilitating achievement of the Applicable BSC Objectives. The PSMG identified a sixth option (option 6), resulting from a suggestion made in the consultation responses, which was the same as Alternative Modification P78, but with disaggregated Transmission Company forward trades interleaved into the Bid – Offer Acceptance stack, i.e. Net Imbalance Volume derived main price, with the reverse price derived from the least extreme Bid – Offer Acceptance / Transmission Company forward trade, as defined in the draft Assessment Report for P90 (P090AR v0.3, 12 September 2002), and the Modification Report for P78 (P078RR V1.0, 16 August 2002).

The PSMG had insufficient time to fully assess option 6 as the potential Alternative, but believed that, on initial consideration, it had some merit, and could be better than Proposed Modification P90 at better facilitating achievement of the Applicable BSC Objectives. Therefore the PSMG agreed to recommend option 6 as the Alternative to Modification Proposal P90.

The PSMG therefore attempted to assess Modification Proposal P90 (Proposed and Alternative) against the potential baselines (i.e. all of Proposed Modifications P74 and P78 and their Alternatives). However, the Authority representative on the PSMG indicated that any such consideration could not be taken into

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account by the Authority when considering the assessment of the Modification. The Authority representative on the PSMG also indicated that a decision on Modification Proposals P74 and P78 would be made by 6 September 2002 (as required by the Modification Reports for P74 and P78).

Therefore the PSMG agreed to request the Panel for a one month extension to the Assessment Procedure, such that Modification Proposal P90 (Proposed and Alternative) could be assessed in light of the Authority decision letters, i.e. against any new baseline, and considering any issues raised by the Authority decision letters on Modification Proposals P74 and P78.

The PSMG acknowledged that such extension may not be granted by the Panel, and therefore a draft Assessment Report was prepared which set out the deliberations of the PSMG in the assessment of P90 to date (i.e. 3 September 2002). This draft Assessment Report is available on the BSC Website, as follows:

www.elexon.co.uk/ta/modifications/mods_docs.html - Select P90 from the list.

On 9 September 2002 the Authority issued their decision letters in respect of Modification Proposals P74 and P78 (available on the BSC Website, with the P74 and P78 documentation referenced above). The Authority determined that Proposed Modification P78 should be made, thus materially changing the baseline against which Modification Proposal P90 had been assessed. This effectively rendered the provisional recommendations made in respect of Modification Proposal P90 (Proposed and Alternative) invalid, as they were made against a materially different baseline.

Therefore the Panel granted a one month extension to the Assessment Procedure for Modification Proposal P90 at the Panel meeting of 12 September 2002, in order that the PSMG could consider Modification Proposal P90 against the new baseline, and in light of the issues raised by the Authority decision letters in respect of Modification Proposals P74 and P78, and amend their assessment and recommendations accordingly.

The PSMG met on 17 September 2002 to continue the assessment of Modification Proposal P90. The PSMG considered Modification Proposal P90 (Proposed and Alternative) against the new baseline.

The PSMG considered Proposed Modification P90, and the majority of the PSMG believe that Proposed Modification P90 may not create a better differentiation between system and energy balancing than the new baseline (Proposed Modification P78). The new baseline uses existing differentiation of system and energy balancing (application of the Continuous Acceptance Duration Limit (CADL) to Bid – Offer Acceptances, and Transmission Company assessment for Transmission Company forward trades, i.e. judgements), overlaid by the Net Imbalance Volume calculation, to create the differentiation between system and energy balancing.

Proposed Modification P90 would seek to replace these judgements with an entirely mechanistic approach, i.e. stacking all Bid – Offer Acceptances and Transmission Company forward trades, and netting them off to differentiate between energy and system balancing.

The PSMG agreed that support, or not, for Proposed Modification P90 results from whether it is believed that judgements (i.e. CADL and Transmission Company assessment) as to what constitutes system and energy balancing are better than reliance on a mechanistic approach to derive system and

energy differentiation. Proposed Modification P90 asserts that the current judgements are arbitrary and non transparent, and that it is better to have a transparent mechanistic approach to making the energy system differentiation, resulting in more cost-reflective Energy Imbalance Prices.

However, the majority of the PSMG believe that the current mechanisms for energy – system differentiation are less arbitrary than the mechanism proposed by Proposed P90, and that therefore Proposed Modification P90 may decrease cost-reflectivity of the Energy Imbalance Prices. However, it should be noted that the majority of the PSMG support the increase in transparency resulting from the use of disaggregated Transmission Company forward trades.

The PSMG then considered the potential Alternative (option 6) against the new baseline. The PSMG noted that the Authority decision letter regarding Modification Proposal P78 raised several objections to the reverse price proposed by Alternative Modification P78, i.e. the least extreme Bid – Offer Acceptance or Balancing Services Adjustment Data (BSAD) in the main (Net Imbalance Volume) stack.

Therefore the PSMG defined a potential Alternative to Proposed Modification P90, based on the (Proposed P78) baseline, but with disaggregated Transmission Company forward trades interleaved into the Bid – Offer stack. This Alternative Modification would use the mechanism being implemented by Proposed Modification P78, but instead of using Net System and Net Energy Balancing Services Adjustment Data in the Net Imbalance Volume (NIV) calculation, the disaggregated Transmission Company forward trades would be included individually in the Net Imbalance Volume calculation.

The mechanism proposed by Alternative Modification P90 would replace the Transmission Company system – energy differentiation of forward trades, with differentiation into system and energy balancing by the Net Imbalance Volume calculation, i.e. all Transmission Company forward trades that are NIV Tagged are deemed to have been taken for system purposes, and all Transmission Company forward trades that are NIV Untagged are deemed to have been taken for energy purposes.

The PSMG looked at the possibility of undertaking analysis of the potential Energy Imbalance Prices resulting from the mechanism being implemented by Proposed Modification P78 and by Alternative Modification P90, in order to enable a comparison of the resulting Energy Imbalance Prices, i.e. Proposed Modification P78 using net reported system and energy BSAD and Alternative Modification P90 using disaggregated Transmission Company forward trades, in the Net Imbalance Volume calculation.

The PSMG noted that the Energy Imbalance Price calculation analysis undertaken as part of the Assessment Procedure for Modification Proposal P78 used a vastly simplified mechanism to provide an approximation of the Energy Imbalance Prices resulting from P78. The simplification was verified at the time of the analysis as providing a relatively good approximation of the Energy Imbalance Price calculation which would result from the implementation of Proposed Modification P78.

However, operational behaviour of BSC Parties and the Transmission Company has changed, potentially materially, since the implementation of one hour Gate Closure, and it is expected that the simplistic approach used during the P78 assessment would not yield results as close to those obtained for the P78 analysis at this time. Since there is no valid approximation of the mechanism to be implemented by Proposed Modification P78, the affect on the Energy Imbalance Prices resulting from use of disaggregated Transmission Company forward trades in the Net Imbalance Volume derivation and

Energy Imbalance Price calculation cannot be determined. It is expected that obtaining such analysis would require a material amount of resource and take some considerable time for ELEXON.

The PSMG also queried whether the results of such analysis would be sufficiently robust. The mechanism being implemented by Proposed Modification P78 relies on the Transmission Company deriving a net volume of forward trades, and then making an assessment as to the portion of the net volume attributable to system balancing and the portion attributable to energy balancing, in order to notify a system volume and an energy volume.

Use of disaggregated trades would remove the Transmission Company's assessment, as the Net Imbalance Volume calculation would effectively deem certain trades to have been for system purposes (i.e. those NIV Tagged trades), and other to have been for energy balancing purposes (NIV Untagged trades).

Any difference in the Energy Imbalance Prices resulting from Proposed Modification P78 and Alternative Modification P90 must be attributable to the use of disaggregated Transmission Company forward trades in the calculation for Alternative Modification P90. Therefore, in order to validate and compare any resulting Energy Imbalance Price, an assessment would be required to be undertaken to determine the reason(s) for the Transmission Company taking specific forward trades, in order to verify their contribution, or not, to Energy Imbalance Prices under Alternative Modification P90, i.e. to assess whether the forward trade was taken for system or energy balancing purposes.

The PSMG recognised that such an assessment would, necessarily, be subjective, and therefore, validation and comparison of the Energy Imbalance Prices resulting from P78 and Alternative P90 could not be easily achieved. A number of the PSMG believed that use of disaggregated Transmission Company forward trades in the mechanism being implemented by Proposed Modification P78 would provide marginal benefits in terms of the improvement in transparency, and the affect on the Energy Imbalance Prices, and therefore, such benefits may be outweighed by the relatively material cost of implementing Modification Proposal P90.

It should be noted that the majority of the PSMG believe that there is some merit in amending the new baseline to incorporate reporting of disaggregated Transmission Company forward trades, thus improving transparency. The Transmission Company representative on the PSMG noted that it was the intention of the Transmission Company to issue a consultation to industry on the Procurement Guidelines specifically in the area of transparency.

Furthermore, a number of the PSMG also believed that replacement of the Transmission Company assessment as to whether a forward trade was taken for system or energy balancing purposes, with the reliance on the (mechanistic) Net Imbalance Volume Tagging process to make the differentiation, had similar issues associated with it as Proposed Modification P90, namely that the perception of the majority of the PSMG is that current mechanisms for energy – system differentiation are less arbitrary than the mechanism proposed by Alternative P90, and that therefore Proposed Modification P90 may decrease cost-reflectivity of the Energy Imbalance Prices.

Conversely, a number of the PSMG believed that Alternative Modification P90 could be considered to be implementing a better approach to the differentiation of system and energy balancing actions by

removal of the Transmission Company assessment as to whether the purpose of the forward trade was for system or energy balancing.

An additional issue was raised by a number of members of the PSMG, as to whether Alternative Modification P90 was a viable Alternative to Modification Proposal P90. The PSMG considered the intent of Modification Proposal P90 (Proposed and Alternative) and the defects being addressed by the Modification Proposal against the new baseline. A number of the PSMG believe that any Alternative developed, which, by definition, must address the same defects as the Proposed Modification, is too far removed from the new baseline to be considered as an Alternative to Modification Proposal P90.

At the PSMG meeting of 17 September 2002, the majority of the PSMG agreed to recommend rejection of Proposed Modification P90, recommend that no Alternative Modification be proposed and recommend that no further assessment work be undertaken on Modification Proposal P90 (Proposed or Alternative). However, since the meeting, responses have been received from members of the PSMG, not present at the meeting, indicating that there is some support for the provisional Alternative Modification.

Therefore, taking all the above points into consideration, the PSMG, on balance, agreed that Proposed Modification P90 should be rejected, and the Alternative Modification proposed, provisional upon the results of this consultation. However, the PSMG were fairly evenly split as to the recommendations to be made, therefore the PSMG further agreed that, dependent upon the outcome of this consultation, they should recommend that the issues raised during the consideration of Modification Proposal P90 (Proposed and Alternative) should be provided to the Pricing Standing Modification Group for further consideration.

The following is a summary of the rationale for the PSMG recommendation:

- Analysis of the resulting Energy Imbalance Price is not (easily) available;
- Alternative Modification P90 could be considered to be implementing a more arbitrary approach to energy – system balancing action differentiation by removing the Transmission Company assessment;
- Conversely, Alternative Modification P90 could be considered to be implementing a better approach to the differentiation of system and energy balancing actions by removal of the Transmission Company assessment as to whether the purpose of the forward trade was for system or energy balancing;
- Some members of the PSMG believe that the costs associated with implementation of Modification Proposal P90 (Proposed or Alternative) are relatively high, appearing to outweigh any, potentially marginal, benefits from the application of disaggregated Transmission Company forward trades on the resulting Energy Imbalance Prices, and on transparency;
- However, other members of the PSMG believe that the implementation of the Alternative Modification (Proposed P78 with disaggregated BSAD) provides benefits in terms of increased transparency, and more cost-reflective Energy Imbalance Prices, which outweigh the potential implementation and development costs; and

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- The issues raised by Modification Proposal P90 can be considered by the PSMG without being fettered by the constraint of considering the detail of a Modification Proposal.

However, the PSMG believed it appropriate to seek industry views before making their final recommendations, and therefore requested that this consultation be undertaken.

The attached consultation questionnaire consists of 5 questions, and BSC Parties are requested to provide rationale where relevant.

Please provide responses to Modifications@exon.co.uk, by 17:00 on Monday 7 October 2002.

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Responding on Behalf of (please list all BSC Parties):

| Q | Question | Response (Please provide rationale where possible) |
|----------|--|---|
| 1. | The PSMG have recommended that Proposed Modification P90 be rejected, for the reasons set out in this consultation document. Do you support this recommendation? | YES / NO Rationale: |
| 2. | The PSMG have provisionally recommended an Alternative Modification to Modification Proposal P90, for the reasons set out in this consultation document. Do you support this approach? | YES / NO Rationale: |
| 3. | Given that the baseline is Proposed Modification P78, would you recommend approval of the Alternative to Modification P90 set out in this consultation document? | YES / NO Rationale: |
| 4. | With specific regards to Transmission Company forward trades, do you support the approach of differentiating between system and energy balancing purely by use of mechanistic tagging (Alternative P90) over the use of Transmission Company assessment plus NIV Tagging (Proposed P78)? | YES / NO Rationale: |
| 5. | Are there any further comments you would like to add, or points you would like to make? | Comments: |