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Assessment Consultation

MODIFICATION PROPOSAL P95

**Transitional Amelioration of Barriers to Licence
Exempt Generators' Market Participation**

Prepared by the P95 Modification Group

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1	Modification Proposal P95		12/07/02	1.0
2	P95 Initial Written Assessment (P95IR10)	ELEXON	17/07/02	1.0
3	P95 Definition Report (P95DR10)	ELEXON	06/09/02	1.0
4	P95 Requirements Specification (P095AS10)	ELEXON	11/10/02	1.0

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1 SUMMARY

The purpose of this document is to provide context and supporting information on the issues being considered by the P95 Modification Group (P95MG) during its assessment of Modification Proposal P95 'Transitional Amelioration of Barriers to Licence Exempt Generators' Market Participation' (P95). It is intended that this document be used as a basis for responding to the attached consultation questions. This consultation seeks to obtain market participants' views on whether P95 better facilitates achievement of the Applicable BSC Objectives and whether any Alternative Modification would better facilitate the Applicable BSC Objectives over and above the Proposed Modification in relation to the issue or defect identified in the Modification Proposal.

This document sets out the interpretation of and implementation method for the Proposed Modification P95 and the potential Alternative Modification discussed by the P95MG. It also provides details of the P95MG discussions on the issues surrounding the assessment of P95.

Market participants are asked to review the issues presented in this document and respond to the questions in Annex 1, in order to assist the P95MG in reaching a recommendation for the Proposed Modification or the potential Alternative Modification. Market Participants are asked to provide a response by 17:00 on Friday 22 November 2002.

1.1 Structure of Document

The document is structured as follows:

- Section 2 provides background to P95;
- Section 3 provides an overview of the Proposed Modification including the implementation method, the costs and impacts identified in the high level impact assessment and the P95MG views on the proposed neutral price;
- Section 4 provides a summary of the potential Alternative Modification that has been discussed by the P95MG including the implementation method, the costs and impacts identified in the high level impact assessment and the P95MG views on the proposed alternative neutral price;
- Section 5 provides a summary of the assessment issues considered by the P95MG and also gives details of the P95MG views on assessment against the Applicable BSC Objectives; and
- Annex 1 contains the consultation questions to be answered by market participants and additional questions for the Transmission Company.

2 BACKGROUND

Slough Energy Supplies Ltd submitted P95 on 12 July 2002 (reference 1). The Initial Written Assessment (IWA), reference 2, was submitted to the Panel at their meeting on 18 July 2002. The Panel agreed to submit P95 to the Definition Procedure, with a Definition Report to be presented at the September Panel meeting. At the September Panel meeting the Panel agreed to submit P95 to a 3-month Assessment Procedure with a report due to be presented to the December Panel meeting.

P95 seeks to ameliorate perceived failings in the market that the Proposer believes are damaging the economic viability of both existing and potential Licence Exempt Generators (LEGs). It is suggested that a neutral cash-out price, calculated as an average of System Sell Price (SSP) and System Buy Price (SBP) should be applied to all imbalances attributable to each LEG.

The Proposer suggests that there exist currently the following barriers to LEGs' market participation and that allowing a LEGs' imbalance to be treated at a neutral price will reduce the balancing risk associated with the

LEGs output that a BSC Party faces when trading with a LEG in its portfolio. The result would be to ameliorate the effects of the barriers for LEGs therefore better facilitating competition in the generation and supply of electricity.

The barriers to market participation suggested by the Proposer are:

- Cost reflectivity, namely, the imbalance charges imposed upon LEGs are excessive in comparison to the imbalance costs which they impose on the system;
- Difficulties in realising the value of embedded benefits;
- Illiquidity / granularity of in the market preventing LEGs from trading small volumes of energy; and
- Administrative burden of trading in the short term markets.

During the Definition Procedure the P95MG agreed that the Proposed Modification should be defined as follows:

- P95 should be applied to all Exemptable plant based on the definition within section K 1.2.2 (c) and K 1.5 of the Balancing and Settlement Code (the Code), but that the definition should be extended to apply to both CVA and SVA Generating Plant. The P95MG believed that this definition was more equitable and was easier to identify than Licence Exempt Generating Plant would be;
- P95 should be seen as an enduring solution and should not have a 'sunset' clause included within it. The P95MG agreed that P95 should be seen as the enduring solution until such time that a different Modification Proposal is raised, should P95 be seen to better facilitate the Applicable BSC Objectives in relation to the current baseline;
- The neutral cash-out price is described within the Modification Proposal as the average of SSP and SBP. The P95MG believed this was a clear definition and noted that the Assessment Procedure was the appropriate phase for other potential alternatives to be considered; and
- The process for implementing P95 would be to allow BSC Parties to have the ability to register Exemptable BM Units against a LEG energy account in addition to a Production or Consumption energy account in central systems. The imbalance of the LEG account would then be settled at the neutral price up to a capped limit for each BM Unit. Any imbalance above that limit would be cashed out at SSP or SBP as is currently the case. The business processes for implementing this option and any cap to be applied was to be assessed further during the Assessment Procedure.

During the Assessment Procedure the P95MG met 6 times to discuss the issues and implementation details of the Proposed Modification and any potential alternative options. The views of the P95MG on these are detailed in sections 3, 4 and 5. A requirements specification (reference 4), which gave details of the implementation methods for all options considered, was written and issued with the high level impact assessment to BSC Parties, and BSC Agents. The costs and impacts associated with each option have been discussed by the P95MG and details are also within sections 3, 4 and 5.

3 THE PROPOSED MODIFICATION

The P95MG expanded upon the discussions held in the Definition Procedure and described the Proposed Modification in more detail during the Assessment Procedure. The P95MG also agreed that there was potentially an Alternative Modification that is better than the Proposed Modification. However, the P95MG has not yet reached agreement on whether the Proposed Modification better facilitates the BSC Objectives and will do so with the aid of the consultation responses. This section describes the Proposed Modification in more detail as discussed in the Assessment Procedure.

3.1 To whom does it apply?

The P95MG noted that, from the experience of the members, “spill” energy was treated as a different “product” by BSC Parties when negotiating contracts as compared to a demand site with internal Exemptable generation. However in order that P95 should be seen to be as fair and equitable as possible, the P95MG agreed it should not be restricted to “spill” plants or “spill” energy but would also include Exemptable Generating Plant embedded within a demand site.

Some argued against including demand sites with Exemptable generation and no “spill” energy, on the grounds that it is difficult to determine what makes a demand site with Exemptable generation differently to those without any generation. It was questioned whether the intent of P95 was to treat these two types of site differently or not. While this issue was not fully resolved, it was agreed that any Exemptable plant should be allowed to be considered for P95.

The P95MG also agreed that P95 should not be restricted by the size of the Export or the Import on the premises and therefore it should address premises in both the CVA and SVA markets, and within the SVA market both Half Hourly and Non Half Hourly sites. It was noted that under the current baseline it is not possible to have NHH Export energy taken into account for Settlement purposes. However, Modification Proposal P81 ‘Removal of the Requirement for Half Hourly Metering on Third Party Generating Plant at Domestic Premises’ is currently being assessed and may address this issue, if approved.

The P95MG agreed that under NETA it was not appropriate to distinguish between predictable and unpredictable Exemptable generating plant, any more than is currently the case for any type of generating plant.

A further issue raised by the P95MG was whether an Exemptable plant should be allowed to participate in the P95 mechanism if they only generate once a year, or only very occasionally. The P95MG agreed that all plants should have the option to be included in the P95 mechanism but that the amount of imbalance that can be settled at a neutral price should be considered as part of the implementation method. This is discussed further in sections 3.3 and 4.2.

3.2 Neutral Price Definition

During the Definition Procedure the P95MG discussed the neutral price definition and agreed that as it was clearly described within the Modification Proposal as the average of SSP and SBP, this would be used as the Proposed Modification definition. Any changes to this would be considered as potential alternatives.

During the Assessment Procedure for P95 the baseline changed, as the Proposed Modification P78 ‘Revised Definition of System Buy Price and System Sell Price’ was approved by the Authority. This meant that the definitions of SSP and SBP were updated such that only one of the energy imbalance prices (i.e. SSP or SBP), depending on Net Imbalance Volume (NIV) of the system, will be calculated from energy balancing actions taken by the Transmission Company. The other price (P78 reverse price) will be calculated from the forwards and spot markets.

The P95MG sought legal advice on how the change in baseline affects the proposed neutral price definition and whether the definition could be altered. The legal advice indicated that the new definitions of SSP and SBP as altered by P78 should be used for P95 and that it would not be appropriate to change the Proposed Modification definition of neutral price. Any change to the neutral price should be considered as an Alternative Modification.

The P95MG agreed that as P78 significantly changes the prices that will be seen as SSP and SBP the average would no longer be an appropriate neutral price. The rationale for this was that the SSP / SBP average would be higher than a neutral price when the market was short, and lower than a neutral price when the market was long. The P95MG therefore considered an alternative definition of the neutral price to be used

by the P95 settlement mechanism to be more appropriate. Details of the alternative neutral price can be found in section 4.1.

3.3 LEG Account

Having discussed the implementation method, the arguments for and against, the costs and impacts associated with the LEG Account implementation method, the P95MG agreed that the preferred implementation method was the LEG Neutral Band and it would be considered as a potential Alternative Modification. The details of these discussions and the rationale for the P95MG decision can be found in the following subsections.

3.3.1 Implementation Method

During the Definition Procedure the P95MG discussed several implementation methods and agreed that the LEG Account option would be taken forwards as the Modification Proposal implementation solution. The rationale for this decision is given in the Definition Report (reference 3).

The P95MG discussed the implementation in further detail during the Assessment Procedure and a full description of the solution is given in the requirement specification (reference 4). The implementation method can be summarised as having the following key aspects:

- Registration of LEG Account

If a BSC Party wished to participate in the P95 mechanism it would be able to register a LEG account and against that account register BM Units that contained Exemptable Generating Plant. The BM Units registered to a LEG Account must only contain Metering Systems that are related to premises containing Exemptable Generating Plant, however they can be registered in both SVA or CVA systems.

- Registration of LEG Capacity (LC):

The Lead Party for a LEG BM Unit must provide a value of LC on initial registration, and then again prior to the beginning of each BSC Season. The LC is defined as the meter registrant's estimate (in MWh) of the aggregate of the maximum gross generation (and not Export from the Premises) expected from each item of Exemptable Generating Plant within that BM Unit during the season. It should be noted that gross generation, unlike Export from premises, is not necessarily metered. For this reason, the Lead Party may have to seek the advice of the generator(s) operating the plant when setting the LC value.

In the case of 'meter splitting' (i.e. splitting the energy at an SVA metering system between more than one Metering System Registrant in accordance with BSCP550), it is proposed that the LC should be shared between the BSC Parties. This means that they cannot both claim the full LC, even if both of them will be receiving 100% of the generation at some point in the Season.

- Changes to Contract Notification Process

Once a Party has a LEG account (see 3.1 above), they will be able to authorise agents to submit Energy Contract Volume Notifications (ECVNs) and Metered Volume Reallocation Notifications (MVRNs) to the Energy Contract Volume Aggregation Agent (ECVAA). Under the current rules, an ECVN Agent Authorisation can relate to any two Accounts, while an MVRN Agent Authorisation can only relate to two Accounts with the same value of the Production / Consumption flag e.g. two LEG Accounts, or two Production Accounts. It should be noted that an MVRN will transfer the energy associated with a BM Unit from one Account to another, but not the LEG Capacity associated to that BM Unit.

It should also be noted that the contract volumes notified need not necessarily correspond to the anticipated physical output of the LEG BM Units registered to that Account.

- Changes to Settlement Calculations

For each LEG Account, the Settlement Administration Agent will sum the LEG Capacity values of the BM Units registered to that Account, to derive an Account LEG Capacity value. The Neutral price will also be calculated as the average of SSP and SBP. For each LEG Account and Settlement Period, the SAA will apply the Neutral Price to any imbalance volume, up until the Account LEG Capacity value. Any imbalance on the LEG Account greater than the LEG Capacity will be settled at the SBP or SSP as currently.

- Changes to Settlement Reports

The following additional data items will be added to the Settlement Report (SAA-I014) and will be used to calculate the overall Party imbalance:

- (i) the Neutral Price that has been used for calculating LEG Account imbalances;
- (ii) Account LEG Capacity i.e. the maximum amount of imbalance volume to which the neutral price could apply;
- (iii) The amount of Energy Imbalance Volume to which the neutral price was applied, this will always be less than the Account LEG Capacity; and
- (iv) The amount of Energy Imbalance Volume to which the neutral price was not applied (i.e. the amount settled at SSP or SBP).

3.3.2 Arguments For and Against

The arguments for and against the Proposed Modification implementation method as compared to the preferred alternative implementation method were discussed by the P95MG and are detailed below.

For LEG Account	Against LEG Account
The LEG Account implementation method only takes into account the imbalance that can be attributed to Exemptable Generating Plant, whereas the LEG Neutral Band will settle imbalance up to a LEG Capacity at a neutral price, regardless of whether the imbalance can be attributed to an Exemptable Generating Plant.	The BSC Agent implementation cost is higher than that of the LEG Neutral Band option, and BSC Party costs are a lot higher than the LEG Neutral Band option.
The LEG Neutral Band option will reduce BSC Party's incentive to balance, however some P95MG members believed that in a long market it may encourage BSC Parties to be less long. The Leg Account option will reduce balancing incentives to a lesser degree.	There will be an increase in the administration needed for the LEG Account option compared to the LEG Neutral Band as for example new BM Units will need to be registered and Physical Notifications may need to be submitted. It was also noted that both options will lead to increased administration costs to deal with the LEG cap.
The LEG Neutral Band option will be more open to gaming compared to the LEG Account option as the LEG Neutral Band gives BSC Parties a predictable capacity that will be settled at a neutral price regardless of the Exemptable Generating Plant imbalances.	Additional contract notification will need to take place to ensure that the energy from the LEG Account is traded.
	Under the LEG Account option BSC Parties trading with Exemptable Generating Plant in their portfolio will lose the benefit of aggregating the Exemptable Generating Plant imbalances with other portfolio

	imbalances.
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3.3.3 Costs / Impacts

A summary of the costs and impacts for the LEG Account option, identified from the BSC Party, BSC Agent, BSCCo and the Transmission Company responses to the high level impact assessment are detailed below.

	Cost	Timescale
BSC Parties	£200k	6 months
BSC Agent + BSCCo (implementation)	£600k + 3 months BSCCo man days	9 months (6+3)
BSC Agent (operational)	£7k / month	
NGC		3 months (after February 2003)

Under the current timetable for P95, the Modification Report is due to be presented to the Authority at the end of January 2003. Therefore the P95MG noted an indicative implementation date of 4 November 2003 if a decision is received by 4 February 2003, or February 2004 if a decision is received by June 2003. This will be refined during the remainder of the Assessment Procedure.

4 POTENTIAL ALTERNATIVE MODIFICATION

The P95MG discussed the effect of the approval of P78 on P95 and the consequent need for an Alternative Modification should it be shown to better facilitate the Applicable BSC Objectives (see section 3.2). The P95MG have not yet agreed if this potential Alternative Modification better facilitates the BSC Objectives and will use the consultation responses to reach a decision.

The potential Alternative Modification is the same as the Proposed Modification, but with changes to the implementation method and Neutral Price as detailed below:

4.1 Neutral Price Definition

During the Assessment Procedure of P95 the baseline of the Code changed, as the Proposed Modification P78 'Revised Definition of System Buy Price and System Sell Price' was approved by the Authority. This meant that the definitions of SSP and SBP were updated such that only one of the energy imbalance prices (i.e. SSP or SBP), will be calculated from energy balancing actions taken by the Transmission Company. The other price (P78 reverse price) will usually be a market based price calculated from the forwards and spot markets.

The P95MG agreed that as P78 significantly changes the prices that will be seen as SSP and SBP, the average would no longer be an appropriate neutral price. The P95MG therefore considered an alternative definition of Neutral Price (NP_j) that would use the reverse price as calculated under the P78 rules. This will generally be the market price and will be calculated as follows:

- If the market is long (i.e. Net Imbalance Volume NIV_j is zero or negative), then NP_j = SBP_j
- If the market is short (i.e. Net Imbalance Volume NIV_j is positive), then NP_j = SSP_j

4.2 LEG Neutral Band Implementation Method

Having discussed the implementation method, the arguments for and against and the costs and impacts associated with the LEG Neutral Band implementation method, the P95MG agreed that as this was the

preferred implementation method it should be considered as a potential Alternative Modification. The details of these discussions and the rationale for the P95MG decision can be found in the following subsections.

4.2.1 Implementation Method

During the Definition Procedure the P95MG discussed several implementation methods and agreed that the LEG Neutral Band option would be taken forwards as a potential alternative implementation solution. The rationale for this decision is given in the Definition Report (reference 3).

The P95MG discussed the implementation in further detail during the Assessment Procedure and a full description of the solution is given in the requirement specification (reference 4). The main difference between this implementation method and the LEG Account option is that it does not create a separate Energy Account for Exemptable Generating Plant. Instead it allows the Neutral Price to be applied to the existing Production and Consumption accounts, if they have Exemptable Generating Plant registered to them. The implementation method can be summarised as having the following key aspects:

- Registration of LEG Capacity

As for the LEG Account implementation method, values of LC will be provided on initial registration of a BM Unit with Exemptable Generating Plant within it, and then again prior to the beginning of each BSC Season. However, unlike the LEG Account option this requirement applies to BM Units registered to the Production and Consumption Accounts, and does not require new BM Units to be registered. Whilst considering the legal drafting the P95MG will need to consider how the addition or withdrawal of an Exemptable Generating Plant to or from a BM Unit during a season will alter the LC and how often the LC can be recalculated.

- Changes to Settlement Calculations

The Settlement Administration Agent will calculate the total LEG Capacity of a BSC Party for each Energy Account and will apply the Neutral Price to any imbalance volume, up until the Account LEG Capacity value.

- Changes to Settlement Reports

As for the LEG Account option the following additional data items will be added to the Settlement Report (SAA-I014) and will be used to calculate the overall Party imbalance:

- (i) The Neutral Price that has been used for calculating LEG Account imbalances;
- (ii) Account LEG Capacity i.e. the maximum amount of imbalance volume to which the neutral price could apply;
- (iii) The amount of Energy Imbalance Volume to which the neutral price was applied, this will always be less than or equal to the Account LEG Capacity; and
- (iv) The amount of Energy Imbalance Volume to which the neutral price was not applied (i.e. the amount settled at SSP or SBP).

4.2.2 Arguments For and Against

See section 3.3.2 for details of the discussions held on the arguments for and against the LEG Account implementation method and the LEG Neutral Band implementation method when compared to each other.

4.2.3 Costs / Impacts

A summary of the costs and impacts for the LEG Account option, identified from the BSC Party, BSC Agent, BSCCo and the Transmission Company responses to the high level impact assessment are detailed below.

	Cost	Timescale
BSC Parties	£30k	3 months
BSC Agent + BSCCo (implementation)	£500k + 3 months ELEXON man days	8 months (5 + 3)
BSC Agent (operational)	£6K / month	
NGC		3 months (after February 2003)

Under the current timetable for P95, the Modification Report is due to be presented to the Authority at the end of January 2003. Therefore the P95MG noted an indicative implementation date of 4 November 2003 if a decision is received by 2 March 2003, or February 2004 if a decision is received by July 2003. This will be refined during the remainder of the Assessment Procedure.

The P95MG agreed that as the BSC Party implementation costs identified in the impact assessment responses are cheaper than those for the LEG Account option it would be reasonable to assume that the percentage of benefit that would be passed back to the Exemptable Generating Plant would be greater.

Some members of the P95MG believed that the overall costs for both implementation options are large and there was little or no benefit to be gained from the Modification or potential Alternative Modification, so it could be said that there is no cost benefit to doing the changes. Other members believed that implementation of either the Modification or the potential Alternative Modification would introduce extra competition and this is not easy to quantify for a cost benefit analysis. The P95MG noted that the benefits from facilitating competition should be weighted against the other Applicable BSC Objectives when reaching their recommendations

The P95MG also acknowledged that as the cash-out prices that will be used under the P78 baseline are not currently available a more thorough cost benefit analysis could not be undertaken at this time.

5 ASSESSMENT ISSUES

The P95MG discussed several issues when assessing P95 and any potential alternatives. Details for the discussions and the views expressed are detailed below.

5.1 Discrimination

The Panel agreed that one of the terms of reference of the P95MG should be to address the issue of whether or not P95 was discriminatory.

The legal advice that the P95MG received indicated that although the Panel must ensure that the Code is given effect without undue discrimination between Parties or classes of Parties, it is not limited in the type of Modification that it can make to the Code. In effect, a Modification can introduce discrimination into the Code, as long as it can be shown to better facilitate one or more of the BSC objectives. Therefore assessment of P95 and any alternative should be wholly against whether it better facilitates one or more of the Applicable BSC Objectives as set out in Condition C3 of the Transmission Licence.

Some members of the P95MG felt that the issue of discrimination should still be considered when determining whether or not the Proposed Modification or potential Alternative Modification better met the BSC Objectives, as discriminatory arrangements can distort competition. Other members of the group felt that LEGs were already discriminated against elsewhere in the trading arrangements and that the P95 would compensate for this.

5.2 Cost Reflectivity / Competition Issues

The majority of the P95MG agreed the only barrier that would be directly addressed by P95 was the issue of non cost reflective imbalance prices and that the other barriers, listed in section 2, are secondary barriers

that make it relatively difficult for Exemptable Generating Plant to manage non cost-reflective imbalance prices.

Other members believed that P95 also addresses the barrier seen by Exemptable Generating Plant when realising the value of embedded benefits and will address the effects of illiquidity and administrative burdens by reducing the need for LEGs to escape the consequences of the first two barriers by trading in the NETA Markets.

The P95MG agreed that in order to assess if P95 better facilitates one or more of the applicable BSC Objectives, the issue of cost reflectivity had to be addressed in a logical sequence. Therefore, the P95MG agreed the following questions assess whether P95 better facilitates the applicable BSC Objectives.

5.2.1 Are the baseline cash-out prices likely to be reasonable cost reflective under P78?

The P95MG believe that the cash-out prices once P78 has been implemented, should be more cost reflective than they currently are. However, it is unlikely that they will be completely cost reflective. They noted that currently the cash-out prices that will be produced under P78 are not exactly known.

Some members of the P95MG argued that as prices neither current, nor Post P78 implementation are or will be not totally cost reflective, something further needs to be done to promote competition in the Exemptable Generation market. Providing a more cost reflective and neutral price for a certain sector of the market would enable such competition to develop. Other members argued that the key issue is size and a 1MW imbalance is a 1MW imbalance irrespective of where it comes from and will cost the System Operator the same amount. Therefore, it was also argued that it was inappropriate to settle imbalances at different prices simply because one was associated with imbalance caused by Exemptable Generating Plant. It was also noted that one of the Applicable BSC Objectives relates to competition in generation and supply. Therefore, the relevant consideration is not whether premises with Exemptable Generating Plant are treated differently to those without, but whether competition between Exemptable Generating Plant and other generating plant is better facilitated.

Some members of the P95MG expressed the view that if the cash-out prices are not cost reflective under P78 then they will be so for all Parties. Therefore, the Code should not be changed to only compensate a certain type of plant. Other members of the P95MG believed that P95 is simply seeking to ensure that the different characteristics of Exemptable Generating Plant, compared to other generating plant are reflected, and changing the cash-out prices for them will achieve this. It was suggested that if the issue is one of unfair contract pricing between BSC Parties and Exemptable Generating Plant then this is not an issue to be solved by a modification to the Code. The Proposer explained that it was not accusing any Party of unfair or uncompetitive behaviour in putting forward the case for P95. Rather, the behaviour of Parties simply reflects the current market structure and in particular the barriers complained of. The P95MG noted these views and agreed that the Assessment Procedure should assess the Modification against the applicable BSC Objectives and the P95MG would then reach a decision on if it should be recommended for approval or not.

5.2.2 Do any non cost reflective charges differentially and adversely affect Exemptable Generating Plant?

Some members of the P95MG believe that the introduction of NETA has had a differential and adverse effect on smaller generators. DTI statistics were reviewed by the P95MG and do indicate a significant fall in smaller generator output in 2001, compared to the previous year. However it is not easy to tell from the DTI statistics (or Ofgem's survey of NETA's first year) precisely how the causes of this are divided between changes in gas prices, the general impact of NETA on electricity prices or any potential adverse effect specifically focused on smaller generators. Whatever the degree of impact to date, the P95MG recognised that an important issue for assessing P95 was the likely impact of P95 against the current baseline including P78 rather than just against the historic baseline. As noted above it is believed that P78 will probably be more cost reflective than currently, but may not be completely cost reflective.

Some members of the P95MG expressed the view that even if P78 were to lead to totally cost reflective imbalance prices, the other barriers mentioned in P95 would still cause Exemptable Generating Plant to be disproportionately and adversely affected, as they would still have imbalance risk imposed on them without the means to manage it.

It was suggested by some members, that the other barriers mentioned in P95 are secondary to the effects of cost reflectivity and are not directly addressed by P95. Other members believed that the barriers to directly participate in the market are a function of size, which applies equally to demand. This is the reason that demand is aggregated through a BSC Party in the wholesale market and this is the option that is open to LEGs.

A view discussed by the P95MG was that Energy Accounts (both Production and Consumption) with small contracted energy volumes, are not balanced as closely as Energy Accounts with larger volumes when measured as a proportion of the total Energy Account throughput. While no definitive reason for this was available, some members felt that it was because such Parties are not able to trade out the imbalances. This could indicate that there could still be a relative price penalty faced by an Exemptable Generating Plant that sought to trade on its own Energy Account as any lack of cost reflectivity in the cash-out regime could adversely affect such smaller generators when competing with larger ones.

Some members believed that Exemptable Generating Plant currently have an unfair burden placed upon them due to the non cost reflective cash-out prices passed on to them. They therefore believed that by implementing P95, Exemptable Generating Plant will get better energy prices from the BSC Parties with whom they are contracted. Other members believed that the basis on which Parties pass cash-out prices on to Exemptable Generating Plants is a contractual issue that would not be addressed by a change to the cash-out regime.

Other members suggested that as the energy volumes we are talking about are relatively small, and an administrative burden would be created by implementing P95 which could potentially be quite large for a BSC Party, the cost benefit that is passed back to the Exemptable Generating Plant would not be as great as expected.

The other barriers were discussed as follows:

Difficulties in realising the value of embedded benefits

Some members of the P95MG believed that currently there is a high risk associated with trading with Exemptable Generating Plant, as the imbalance prices are not cost reflective. Therefore if P95 were to be implemented this risk would be reduced.

It was also believed by some P95MG members that implementation of P95 would effectively be another embedded benefit for BSC Parties who would have no obligation to pass this benefit back on to the Exemptable Generating Plant.

Other members believed that if P95 were to be implemented there would potentially be an increase in competition, as more BSC Parties would be encouraged to trade with Exemptable Generating Plant in order to realise the benefits. This benefit would then by default be passed on to the Exemptable Generating Plant as it was expected that the contract prices would be better due to the nature of a competitive market.

Illiquidity in the market preventing LEGs from trading small volumes of energy

Some members of the P95MG believed even if Exemptable Generating Plant were to become BSC Parties and were therefore able to trade on the Power Exchanges, the low liquidity and insufficiently fine granularity of the markets would be a barrier.

It was also noted that consolidators provide an alternative to trading on the markets and it was agreed that independent consolidation services had not yet been developed materially in the market. Therefore, some members believed P95 was needed to help the Exemptable Generating Plant in the interim. Other members

of the P95MG felt that BSC Parties with a large portfolio are effectively acting as a consolidator when contracting with Exemptable Generating Plant and therefore the service did exist. However, no evidence of whether the consolidation effects were or were not being passed on to the Exemptable Generating Plant was presented to the P95MG.

It was noted that BSC Parties trading with Exemptable Generating Plant, who are realising this consolidation effect, may lose some of this benefit should the LEG Account option be implemented.

Administrative burden of trading in the short term markets

The P95MG agreed that there is currently a large cost associated with becoming a BSC Party. However it was argued that this is the same for any participant that wishes to be a BSC Party, not just participants that own Exemptable Generating Plant. Several members argued that the position was not the same for Exemptable Generating Plant as for larger generators, as the latter can manage their imbalance risk by trading in NETA markets. Nor was it the same for Exemptable Generating Plant and other parties such as licensed suppliers.

Some members of the P95MG suggested, that allowing BSC Parties with Exemptable Generating Plant to have their imbalance settled at a neutral price would encourage them to change their behaviour when dealing with Exemptable Generating Plant. This would therefore mean that Exemptable Generating Plant would not need to become BSC Parties and would not be faced with a high administrative burden.

5.2.3 What will the effect of introducing P95 be on the Exemptable Generating Plant and will there be any other, adverse effect on competition?

Some members believed that if P95 is implemented, although it may benefit smaller generators, it will have an adverse impact on competition because it will benefit some parties and not others. Specifically, it was noted that introducing P95 would have an effect on the Residual Cashflow Reallocation Cashflow (RCRC) which is either paid by or refunded to BSC Parties who have a physical position in a Settlement Period. Implementing P95 would mean that there is potentially less paid into the central system for balancing purposes and therefore the RCRC payments would be affected. This would therefore have an effect on any BSC Party that has a physical position in a Settlement Period.

One of the aims of P95 is to enable Exemptable Generating Plant to be less disadvantaged than they currently are and it has been suggested that currently the contracts that are struck between a BSC Party and an Exemptable Generating Plant pass through unreasonable imbalance prices that are not reflective of the imbalance that the BSC Party is being charged by the system. It was argued that should P95 be implemented the nature of these contract would change as there would be less risk attached to the imbalance attributable to an Exemptable Generating Plant and therefore the terms of the contracts with them would be more favourable. There are three types of commercial contracts that are used:

- **Spill contracts** contracts used when an Exemptable Generating Plant is unable to accurately predict its output. It is assumed that the BSC Party calculates an imbalance risk cost (on the basis of the prevailing SSP/SBP prices) in £/MWh and discounts the currently market price accordingly. The consolidation effect of having a number of unpredictable Exemptable Generating Plant imbalances netting off each other in a large BSC Party portfolio could lead to a reduction in such discount and potentially a better price for the Exemptable Generating Plant.
- **Fixed volume contracts** contract used when an Exemptable Generating Plant can accurately predict its output could be to generate according to a pre-arranged forecast. Any deviations from this forecast will have to be notified to the BSC Party sufficiently far in advance for the BSC Party to take corrective balancing actions. Failure to notify such changes could cause the BSC Party to pass through the imbalance costs attributable to the unanticipated change. In this type of arrangement the

Exemptable Generating Plant would obtain an energy price which is closer to the market price and which is not discounted for imbalance, however the Exemptable Generating Plant would face exposure to SSP/SBP if it is unable to meet its contracted position.

- Demand contracts for those sites where the Exemptable Generating Plant is embedded within the site and will never export any energy. The P95MG did not consider this type of contract during their discussions.

The P95 investigated how these contracts might change for the implementation options detailed in sections 3 and 4 and reached the following conclusions;

LEG Account

Under this option the main advantage for BSC Parties is the reduction in imbalance exposure that being cashed out a neutral price on their Exemptable Generating Plants would provide. As a result the Exemptable Generating Plants may find that BSC Parties are more incentivised to contract with them in order to increase the portfolio volume to which the neutral price would apply. Exemptable Generating Plant would potentially receive better prices for their generation, which would be discounted less for imbalance risk than is currently the case.

LEG Neutral Band

Unlike the LEG Account option, under the LEG Neutral Band the BSC Party would know in advance the amount of imbalance, on its whole portfolio that could be settled at the neutral price, regardless of the performance of the Exemptable Generating Plant. The following effects could be seen on the different contract types.

- For spill contracts the contract would therefore potentially not be struck around a neutral price but on a percentage share of the BSC Party's total "rebate pot" e.g. a 10MW Exemptable Generating Plant knows that it will "earn" the BSC Party the neutral price on 10 MW of its total LEG Capacity and will therefore seek a percentage of that "benefit". This would effectively mean that the neutral price cash-out would effectively become another embedded benefit.
- For fixed volume contracts the LEG Neutral Band would diminish the BSC Party incentive to enter into such contracts unless the Exemptable Generating Plant was able to perform in such a way as to provide a tradable product in the BM window. As the BSC Party's neutral price "pot" is fixed by their total registered LEG Capacity the performance of the Exemptable Generating Plant to a fixed contract would no longer be relevant unless that volume was to be traded on as an energy product.

Under the LEG Neutral Band option, balancing of the LEG volumes is not required as the BSC Party is cashed out at the neutral price on the registered volume and not on the actual volume. This could be seen as diminishing the incentive to balance.

5.3 Effect of P95 on System Operation

The P95MG discussed the possible effect that implementation of P95 would have on the System Operator's ability to balance the system, and did not agree if there would or would not be an effect. Therefore the System Operator is asked to comment on this in their consultation response and a question has been added to this effect in Annex 1.

5.4 Cross Subsidy

The issue of whether P95 could be seen as a cross subsidy between BSC Parties trading with an Exemptable Generating Plant in their portfolio and a BSC Party trading without an Exemptable Generating Plant in their portfolio was discussed. The reason for this was that cross subsidy had been highlighted as a reason for

rejecting Modification Proposal P26 “Market Driven Trading Neutrality Band” which is similar to the principles of the LEG Neutral Band option.

The P95MG recognised that one of the reasons for rejection of P26 was that it did not accurately target imbalance prices at Parties who were out of balance. The P95MG discussed whether an imbalance caused by a Party without Exemptable Generating Plant requires more balancing actions to be taken than an identical imbalance caused by a Party with Exemptable Generating Plant in its portfolio. The P95MG agreed that if this were to be the case then it would be justifiable to target a greater proportion of the cost of those actions at Parties without Exemptable Generating Plant.

Some members of the P95MG commented that they did not see a difference between small imbalances be it from an Exemptable Generating Plant or any other premises and therefore had the view that it would indeed be a cross subsidy between BSC Parties.

Other members of the P95MG commented that as an Exemptable Generating Plant's current imbalance risk, passed on to them by their contracts with BSC Parties, is disproportionate in relation to their ability to manage it, the burden of that risk is currently higher than for Parties who can manage the risk effectively. The reasons that Exemptable Generating Plant cannot manage their own risk is because they cannot easily trade in the Balancing Mechanism and suffer from the barriers previously mentioned. Therefore reducing their imbalance risk will remove an excessive risk and this should not be seen as a cross subsidy.

5.5 Cost Recovery Mechanism

The P95MG agreed that as the change could potentially be used by all BSC Parties and as it would be a change to the Settlement mechanism that the costs should be borne by all BSC Parties. This is also consistent with current charging mechanisms detailed in section D of the Code.

It was noted however that most Exemptable Generating Plants are not Parties to the Code and therefore may find that contract prices have a higher administration change within them as the BSC Party they trade with will have to update their systems to trade under the P95 mechanism.

5.6 Assessment Against the Applicable BSC Objectives

The P95MG discussed if the Proposed Modification better facilitated the BSC Objectives, however the P95MG did not reach a decision and will use market participants responses to the questions in Annex 1 of this paper to help reach a recommendation.

The P95MG also discussed if the potential Alternative Modification better facilitated the applicable BSC Objectives and did not reach a decision. The P95MG agreed that the potential Alternative Modification was better than the Proposed Modification but did not agree if it better facilitates the BSC Objectives. The P95MG will use market participants answers to the question in Annex 1 to help reach a recommendation.

It was noted that if the implementation costs are high then it could fail to facilitate BSC Objective (d), efficiency of operation of the trading arrangements. However, it was also noted that allowing Exemptable Generating Plant to be settled at a neutral price could be seen to be facilitating competition in Generation, BSC Objective (c).

ANNEX 1 CONSULTATION QUESTIONS

BSC Parties and other interested parties are invited to respond to this consultation expressing their views, or providing any further evidence, on any of the matters contained within this document. In particular views are sought in respect of the following questions. Parties are invited to supply the rationale for their responses.

Respondent:	<i>Name</i>
BSC Party	Yes/No ¹
No. of Parties Represented	
Responding on Behalf of	<i>Please list all Parties responding on behalf of (including the respondent company if relevant).</i>
Role of Respondent	<i>(Supplier/Generator/ Trader / Consolidator / Exemptable Generator – please state ¹)</i>

Q	Question	Response ¹	Rationale
1	Do you agree that the P78 Reverse Price is more appropriate as a Neutral Price for P95 than the SSP/SBP average defined in the Modification Proposal, under the P78 baseline? Please give rationale.	Yes / No	
2	Do you agree that the LEG Neutral Band is a more appropriate implementation method for P95 than the LEG Account method? Please give rationale.	Yes / No	
3	Do you believe that the baseline cash-out prices, once P78 has been implemented, are likely to be (compared with the pre-P78 cash-out prices): a) totally, or nearly totally cost reflective? b) more cost reflective? c) no change in cost reflectivity? d) less cost reflective? Please give rationale.	A B C D	

¹ Delete as appropriate – please do not use strikethrough, this is to make it easier to analyse the responses

Q	Question	Response ¹	Rationale
4	If you believe that prices will not be cost reflective, do you believe that non-cost reflective charges differentially and adversely affect the Exemptable Generators P95 is intended to assist, to a significant degree? Please give rationale.	Yes / No	
5	Do you believe that implementation of P95 or the potential alternative will ameliorate: (i) any effects identified in Q3 and Q4? (ii) the other barriers detailed in the Modification Proposal? Please give rationale.	Yes / No	
6	Do you believe that Exemptable Generating Plant have special difficulty in managing their imbalance? If so, has that had an adverse effect on their ability to sell their output? Please give rationale.	Yes/No	
7	Do you believe the implementation of P95 or the potential alternative would have an adverse impact on any parties? If so who and why?	Yes /No	
8	Do you believe that the Modification Proposal P95 better facilitates achievement of the Applicable BSC Objective(s)? Please give rationale and Objective(s)	Yes / No	
9	Do you believe that the potential alternative Modification as detailed in the consultation document better facilitates achievement of the Applicable BSC Objectives? Please give rationale and Objective(s)	Yes / No	
10	Do you have any further comments on P95 that you wish to make?	Yes / No	

Please send your responses by **17:00 on Friday 22 November 2002** to Modifications@elexon.co.uk and please entitle your email 'P95 Assessment Consultation 1'

Any queries on the content of the consultation pro-forma should be addressed to Joanne Ellis (020 7380 4316), email address joanne.ellis@elexon.co.uk.

TRANSMISSION COMPANY:

PLEASE RESPONSE TO THIS CONSULTATION IN ACCORDANCE WITH SECTION F2.8 OF THE CODE AND PROVIDE A RESPONSE TO THE FOLLOWING QUESTIONS IN ADDITION TO QUESTIONS 1 - 10:

Q	Question	Response ¹	Rationale
A	What effect will the implementation of P95 or the preferred alternative option have on the ability of the System Operator to balance the system? Please give rationale		
B	If you believe that implementing P95 may increase net imbalances then by what order of magnitude compared to current experience? Please give rationale.		

Please send your responses by **17:00 on Friday 22 November 2002** to Modifications@elexon.co.uk and please entitle your email 'P95 Assessment Consultation 1'

Any queries on the content of the consultation pro-forma should be addressed to Joanne Ellis (020 7380 4316), email address joanne.ellis@elexon.co.uk.