Responses from P194 Draft Report Consultation

Consultation Issued 14 November 2004

Representations were received from the following parties

No	Company	File number	No BSC Parties Represented	No Non-Parties Represented
1.	EDF Energy	P194_dMR_001	9	0
2.	Barclays Bank Plc	P194_dMR_002	1	0
3.	E.ON	P194_dMR_003	15	0
4.	RWE Trading	P194_dMR_004	10	0
5.	BGT	P194_dMR_005	1	0
6.	Scottish Power	P194_dMR_006	6	0
7.	Uskmouth Power Limited	P194_dMR_007	1	0
8.	Scottish and Southern	P194_dMR_008	5	0
9.	National Grid	P194_dMR_009	1	0
10.	Alcan Smelting and Power UK	P194_dMR_010	0	1
11.	British Energy	P194_dMR_011	5	0

NB: The Chemical Industries Association indicated they were not able to provide a formal response but referred to their views as expressed during the Assessment Consultation.

P194 REPORT PHASE CONSULTATION QUESTIONS

BSC Parties ("Parties") and other interested parties are invited to respond to this consultation expressing their views or provide 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:	Stephen Moore
Company Name:	EDF Energy
No. of BSC Parties Represented	9
Parties Represented	EDF Energy Networks (EPN) plc; EDF Energy Networks (LPN) plc EDF Energy Networks (SPN) plc; EDF Energy (Sutton Bridge Power) EDF Energy (Cottam Power) Ltd; EDF Energy (West Burton Power) Ltd; EDF Energy plc; London Energy plc; Seeboard Energy Limited
No. of Non BSC Parties Represented	0
Non Parties represented	N/A
Role of Respondent	Supplier/Generator/ Trader

Q	Question	Response	Rationale
1.	Do you agree with the Panel's views on P194 and the provisional recommendation to the Authority contained in the draft Modification Report that P194 **should not** be made? Please give rationale.	Yes	We have not changed our view that P194 would be detrimental to competition by introducing more penal imbalance charges and is likely to lead to less efficient operation of the market by incentivising parties to go long.
2.	Do you agree with the Panel's view that the legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal? Please give rationale.	Yes	

© ELEXON Limited 2005

Q	Question	Response	Rationale
3.	Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P194? Please give rationale.	Yes	The system changes required for this modification, if approved, are such that a long lead time is necessary.
4.	Are there any further comments on P194 that you wish to make?	Yes	It was our original contention that no defect actually exists and the evidence of high SBP on 14 November 2005 in response to a NISM issued by NG seems to bear this out. In addition, there is growing evidence of high constraint costs caused by the limitations of the England – Scotland interconnector with NG having to Bid off large volumes of generation at times of system scarcity. As not all of this volume is tagged as System actions these volumes are already feeding through into cashout prices, this would only be exacerbated by P194.

Please send your responses by **17:00 on Monday 28 October 2005** to modification.consultations@elexon.co.uk and please entitle your email 'P194 **Report Phase Consultation**'. Please note that any responses received after the deadline may not receive due consideration by the Panel.

Any queries on the content of the consultation pro-forma should be addressed to Tom Bowcutt on 020 7380 4309, email address thomas.bowcutt@elexon.co.uk.

© ELEXON Limited 2005

P194 REPORT PHASE CONSULTATION QUESTIONS

BSC Parties ("Parties") and other interested parties are invited to respond to this consultation expressing their views or provide 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:	Paul Dawson, Barclays Bank plc
No. of BSC Parties Represented	1
BSC Parties Represented	Barclays Bank plc
No. of Non BSC Parties Represented	0
Non BSC Parties represented	0
Role of Respondent	Trader

Q	Question	Response	Rationale
1.	Do you agree with the Panel's views on P194 and the provisional recommendation to the Authority contained in the draft Modification Report that P194 **should not** be made? Please give rationale.	No	The modification will ensure that cash-out prices better reflect the marginal cost associated with balancing the system. Consequently, cash-out prices will send a more economically efficient signal to market participants about the opportunity cost of imbalances and, hence, provide an appropriate and efficient incentive to balance. This will both promote effective competition in the generation, supply, sale and purchase of electricity (applicable objective, c) and promote the efficient, economic and coordinated operation by the Transmission Company of the Transmission System (applicable objective, b). Consequently, the Panel should recommend to the Authority that the modification should be made. As to the specific details of the Panel's views summarised in section 5 of the Draft Modification Report, we agree with the Panel's view that a PAR volume of 100 MWh would be appropriate. However, we find the reasoning relating to the predicted impact on competition seriously deficient in several respects. Specifically:

© ELEXON Limited 2005

Q	Question	Response	Rationale
			• An imbalance has the same economic cost to the system whether it results on the generation or the supply side of the market (not least because "supply-side" responses may be derived from generation embedded in the distribution systems); • The statement that suppliers "are not able to predict or manage demand in order to manage demand in order to avoid exposure to imbalance charges" is not true. Suppliers both predict their loads and have the option to contract at a level which – given their particular risk preferences - optimises their exposure to high balancing charges (for shortfalls) or low balancing charges (for surpluses). This position is also clearly at odds with the Panel's majority view that P194 would lead to participants – including suppliers – to take a longer contractual position to avoid exposure to high imbalance charges. • Even if it were true that suppliers (and/or small market participants) were not able to respond to balancing signals, this is irrelevant to the assessment as to whether P194 results in a more appropriate incentive to balance. Imbalance prices which reflect the appropriate opportunity cost caused by participant imbalances provide the correct incentives for market participants to balance. The fact that some participants may subsequently choose not to balance or not to take actions to protect themselves from imbalances does not detract from the appropriateness of this incentive. Far from being a cogent argument against marginal pricing, the logical conclusion to this argument would be to set imbalance prices at an arbitrary fixed level since no–one will actually respond to an economic balancing incentive in any case. • The "ability to price at the margin within the balancing mechanism" is irrelevant to the mitigation of a party's imbalance exposure since the acceptance of a balancing mechanism offer (or bid) simultaneously result in a corresponding delivery obligation such that there is no net impact on imbalance.

© ELEXON Limited 2005

Q	Question	Response	Rationale
			• The stated factors which limit the ability of parties to balance their positions (eg, gate closure) etc exist within the current cash-out framework and are not relevant to assessing whether P194 represents an improvement on that baseline. With respect to the judgement on whether or not the modification achieves the applicable objectives we would also note that: • P194 would also be expected to reduce market participant's length at times when the system is long which would reduce inefficient length in the market at these times. • Although P194 might lead to participants seeking to increase their length at times of system shortage, this is largely the intent of the modification. The real question is whether or not a marginal derivation for the imbalance price provides a better incentive to balance than the current average derivation. If it does provide a better incentive, then any resulting additional length would be an economic and efficient response to the likelihood of shortage. Given the strong theoretical backing for a marginal price and the historical data which demonstrates that average prices do not adequately reflect the marginal cost of balancing, there is clear, objective evidence that P194 would result in a more economic balancing signal. Consequently, the assessment of the modification's impact should be based on more than a "subjective judgement" on the "balance of the arguments expressed" and the Panel should articulate why a marginal derivation does <u>not</u> better reflect the opportunity cost of balancing the system than the current weighted average calculation.

© ELEXON Limited 2005

Q	Question	Response	Rationale
2.	Do you agree with the Panel's view that the legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal? Please give rationale.	Yes	The legal text correctly delivers the intent of the modification.
3.	Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P194? Please give rationale.	Yes	The implementation timescales seem appropriate.
4.	Are there any further comments on P194 that you wish to make?	No	See response to question 1 above.

Please send your responses by **17:00 on Monday 28 October 2005** to modification.consultations@elexon.co.uk and please entitle your email 'P194 **Report Phase Consultation**'. Please note that any responses received after the deadline may not receive due consideration by the Panel.

Any queries on the content of the consultation pro-forma should be addressed to Tom Bowcutt on 020 7380 4309, email address thomas.bowcutt@elexon.co.uk.

© ELEXON Limited 2005

P194 REPORT PHASE CONSULTATION QUESTIONS

Respondent:	E.ON UK
Company Name:	
No. of BSC Parties Represented	15
Parties Represented	E.ON UK plc, Powergen Retail Limited, Cottam Development Centre Limited, Enizade Ltd, E.ON UK Drakelow Limited, E.ON UK Ironbridge Limited, E.ON UK High Marnham Limited, Midlands Gas Limited, Western Gas Limited, TXU Europe (AHG) Limited, TXU Europe (AH Online) Limited, Citigen (London) Limited, Severn Trent Energy Limited (known as TXU Europe (AHST) Limited), TXU Europe (AHGD) Limited and Ownlabel Energy.
No. of Non BSC Parties Represented	N/A
Non Parties represented	N/A
Role of Respondent	Supplier, Generator, Trader, Consolidator & Exemptable Generator

Q	Question	Response	Rationale
1.	Do you agree with the Panel's views on P194 and the provisional recommendation to the Authority contained in the draft Modification Report that P194 **should not** be made? Please give rationale.	Yes	We agree with most of the Panel's reasoning, although we disagree with the Panel's assessment that the level of 100MWh is not arbitrary. We note the Panel's view that setting PAR to 100MWh avoids the price being set by a single action for a significant amount of the time and that this is an aim of the modification. However, this is based on a historic analysis and cannot be relied upon to hold for future actions. Additionally, the important issue is whether the resultant prices would better reflect the costs of energy balancing compared with the present methodology. There has not been a satisfactory explanation put forward as to why setting the PAR to 100MWh achieves a price which is more reflective of the cost of energy balancing, compared say with setting the PAR to 50MWh or 150MWh. Therefore, in the absence of such a rationale the level of 100MWh must be considered as arbitrary.

Q	Question	Response	Rationale
2.	Do you agree with the Panel's view that the legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal? Please give rationale.	Yes	
3.	Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P194? Please give rationale.	Yes	
4.	Are there any further comments on P194 that you wish to make?	No	

P194 REPORT PHASE CONSULTATION QUESTIONS

BSC Parties ("Parties") and other interested parties are invited to respond to this consultation expressing their views or provide 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:	*Name: Bill Reed*
Company Name:	*RWE Trading*
No. of BSC Parties Represented	*10*
Parties Represented	*Please list all BSC Party names of Parties responding on behalf of (including the respondent company if relevant).* RWE Trading GmbH, RWEnpower, Npower Cogen Trading Ltd; Ltd, Npower Commercial Gas Ltd, Npower Direct Ltd, Npower Ltd, Npower Northern Ltd, Npower Northern Supply Ltd, Npower Yorkshire Ltd, Npower Yorkshire Supply Ltd
No. of Non BSC Parties Represented	
Non Parties represented	*Please list all non Parties responding on behalf of (including the respondent company if relevant).*
Role of Respondent	*(Supplier/Generator/ Trader / Consolidator / Exemptable Generator / BSC Agent / Party Agent / Distributors / other – please state [1]) Supplier/Generator/ Trader / Consolidator / Exemptable Generator / BSC Agent / Party Agent*

Q	Question	Response	Rationale
1.	Do you agree with the Panel's views on P194 and the provisional recommendation to the Authority contained in the draft Modification Report that P194 **should not** be made? Please give rationale.	Yes	We support the argument that P194 could increase the impact of imperfections in the tagging mechanism on Energy Imbalance Prices and result in prices less reflective of the cost of energy balancing. Notwithstanding the Panel's views that the PAR volume "*would avoid a single balancing action setting Energy Imbalance Prices in a significant portion of Settlement Periods*" we continue to believe that the basis for setting the value is essentially arbitrary and not cost-reflective.

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

© ELEXON Limited 2005

Q	Question	Response	Rationale
2.	Do you agree with the Panel's view that the legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal? Please give rationale.	Yes	
3.	Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P194? Please give rationale.	Yes	
4.	Are there any further comments on P194 that you wish to make?	No	

Please send your responses by **17:00 on Monday 28 October 2005** to modification.consultations@elexon.co.uk and please entitle your email 'P194 **Report Phase Consultation**'. Please note that any responses received after the deadline may not receive due consideration by the Panel.

Any queries on the content of the consultation pro-forma should be addressed to Tom Bowcutt on 020 7380 4309, email address thomas.bowcutt@elexon.co.uk.

© ELEXON Limited 2005

ELEXON Limited
4th Floor
350 Euston Road
London
NW1 3AW

Millstream East
Maidenhead Road
Windsor
Berkshire
SL4 5GD

Tel. (01753) 431137
Fax (01753) 431150
Our Ref.
Your Ref.
25 November 2005

Dear Sirs,

Re: Modification Proposal P194 – Revised Derivation of the main Energy Imbalance Price

Thank you for the opportunity of responding to this draft modification report considering Modification Proposal P194. British Gas Trading (BGT) agrees with the Panel's provisional recommendation that the Modification Proposal should not be approved.

BGT believe this modification proposal will increase the propensity for imbalance prices to be derived from system actions. There are acknowledged issues with the current tagging process and BGT believe these problems will be exacerbated by P194. Imbalance prices are intended to reflect the cost of energy balancing, targeting the calculation of imbalance prices at the top 100MWh and discarding the remainder of the stack will result in system actions increasingly polluting cash-out prices. Therefore BGT do not believe P194 will better facilitate the Applicable BSC Objectives.

BGT believes the legal text is fit for purpose and supports the proposed implementation date.

If you have any questions regarding this response please contact me 01753 431137.

Yours faithfully

Mark Manley
Contract Manager

P194 REPORT PHASE CONSULTATION QUESTIONS

BSC Parties ("Parties") and other interested parties are invited to respond to this consultation expressing their views or provide 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:	*John W Russell*
Company Name:	*SAIC Ltd for ScottishPower*
No. of BSC Parties Represented	*6*
Parties Represented	Scottish Power UK plc; ScottishPower Energy Management Ltd.; ScottishPower Generation Ltd; ScottishPower Energy Retail Ltd.; SP Transmission Ltd; SP Manweb plc.
No. of Non BSC Parties Represented	*0*
Non Parties represented	*Please list all non Parties responding on behalf of (including the respondent company if relevant).*
Role of Respondent	Supplier / Generator / Trader / Consolidator / Exemptable Generator

Q	Question	Response	Rationale
1.	Do you agree with the Panel's views on P194 and the provisional recommendation to the Authority contained in the draft Modification Report that P194 **should not** be made? Please give rationale.	**Yes**	*ScottishPower agrees with the provisional recommendation that P194* ***should not*** *be made as the Mod does not encourage capacity to be made available at times of system stress and will increase the risk that less reliable plant will not be made available due to the potentially damaging imbalance charges associated with unexpected plant failure.* *Acceptance of the modification would greatly increase the risk of generators going out of business and also significantly increase the cost to participants in managing the risk exposure and would be bad for promoting competition, as potential new entrants would be more reluctant to participate in such a market.* *While ScottishPower support the principle of sending clearer price signals to the market, we believe that this is unlikely to happen with this modification*

© ELEXON Limited 2005

Q	Question	Response	Rationale
2.	Do you agree with the Panel's view that the legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal? Please give rationale.	**Yes**	*Not withstanding the fact that ScottishPower do not agree with this modification, we agree that the legal text would appear to be appropriate.*
3.	Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P194? Please give rationale.	**Yes**	*Not withstanding the fact that ScottishPower do not agree with this modification, we agree that the implementation date would appear to be appropriate.*
4.	Are there any further comments on P194 that you wish to make?	**No**	

Please send your responses by **17:00 on Monday 28 October 2005** to modification.consultations@elexon.co.uk and please entitle your email 'P194 **Report Phase Consultation**'. Please note that any responses received after the deadline may not receive due consideration by the Panel.

Any queries on the content of the consultation pro-forma should be addressed to Tom Bowcutt on 020 7380 4309, email address thomas.bowcutt@elexon.co.uk.

© ELEXON Limited 2005

P194 REPORT PHASE CONSULTATION QUESTIONS

BSC Parties ("Parties") and other interested parties are invited to respond to this consultation expressing their views or provide 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:	Sam Murray
Company Name:	Uskmouth Power Limited
No. of BSC Parties Represented	1
Parties Represented	
No. of Non BSC Parties Represented	
Non Parties represented	
Role of Respondent	Generator

Q	Question	Response	Rationale

© ELEXON Limited 2005

Q	Question	Response	Rationale
1.	Do you agree with the Panel's views on P194 and the provisional recommendation to the Authority contained in the draft Modification Report that P194 **should not** be made? Please give rationale.	No	Uskmouth Power believes that the modification does better fulfil the BSC objectives and should be made. While we can understand concerns about prices, we feel that the modification would better incentivise parties to balance and would improve the efficiency of the system. The modification is also likely to result in some increased trading ahead of gate closure which would improve the efficiency of the market as a whole. The Panel member's questions about suppliers seems to ignore generators like ourselves who do have portfolios with which to self balance. We also believe suppliers could purchase more flexible supply products from generators and sell flexible supplies to their own customers. The market has been designed in such a way to empower players to manage their own risks and not to head the work on to NG, who should retain their residual role in matching supply and demand as efficiently as possible. We further note that Ofgem have expressed concern about cost reflectivity, but we fee that the modification would better reflect the price of "balancing" energy to the system.
2.	Do you agree with the Panel's view that the legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal? Please give rationale.	Yes	
3.	Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P194? Please give rationale.	Yes	Though our understanding is that the release for Feb 06 looks relatively light and it may be possible to pull forward implementation.
4.	Are there any further comments on P194 that you wish to make?	No	

© ELEXON Limited 2005

Please send your responses by **17:00 on Monday 28 October 2005** to modification.consultations@elexon.co.uk and please entitle your email 'P194 **Report Phase Consultation**'. Please note that any responses received after the deadline may not receive due consideration by the Panel.

Any queries on the content of the consultation pro-forma should be addressed to Tom Bowcutt on 020 7380 4309, email address thomas.bowcutt@elexon.co.uk.

© ELEXON Limited 2005

This response is sent on behalf of Scottish and Southern Energy, Southern Electric, Keadby Generation Ltd., Medway Power Ltd., and SSE Energy Supply Ltd.

In relation to the four questions contained within your notes of 14th November 2005, and the associated Consultation for P194, we have the following comments to make:-

Q1 Do you agree with the Panel’s views on P194 and the provisional recommendation to the Authority contained in the draft Modification Report that P194 should not be made? Please give rationale.

Yes, we agree with the proposed BSC Panel recommendation to the Authority that Modification Proposal P194 should not be made for the reasons outlined in the Modification Report. In particular we wish to associate ourselves with the "arguments identified not in support of P194" as summarised in section 4.1.1 of the consultation document.

In addition to the reasons outlined in section 4.1.1 and those outlined in section 5.1 by the Panel we would also refer you to our previous substantive comments provided earlier in the consultation process.

Q2 Do you agree with the Panel’s view that the legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal? Please give rationale.

It appears to.

Q3 Do you agree with the Panel’s provisional recommendation concerning the Implementation Date for P194? Please give rationale.

If the Modification Proposal P194 is approved, we agree with the proposed BSC Panel recommendation regarding the timing for the Implementation Date, as outlined in the Modification Report.

Q4 Are there any further comments on P194 that you wish to make?

Nothing further at this time.

Regards

Garth Graham
Scottish and Southern plc

nationalgrid

Respondent	Rob Smith
Company Name	National Grid
No of BSC parties Represented	1
Parties Represented	National Grid
Role of Participant	Transmission Company

Do you agree with the Panel's views on P194 and the provisional recommendation to the Authority contained in the draft Modification Report that P194 should not be made?

We do not agree with the Panel's view in relation to BSC modification proposal P194.

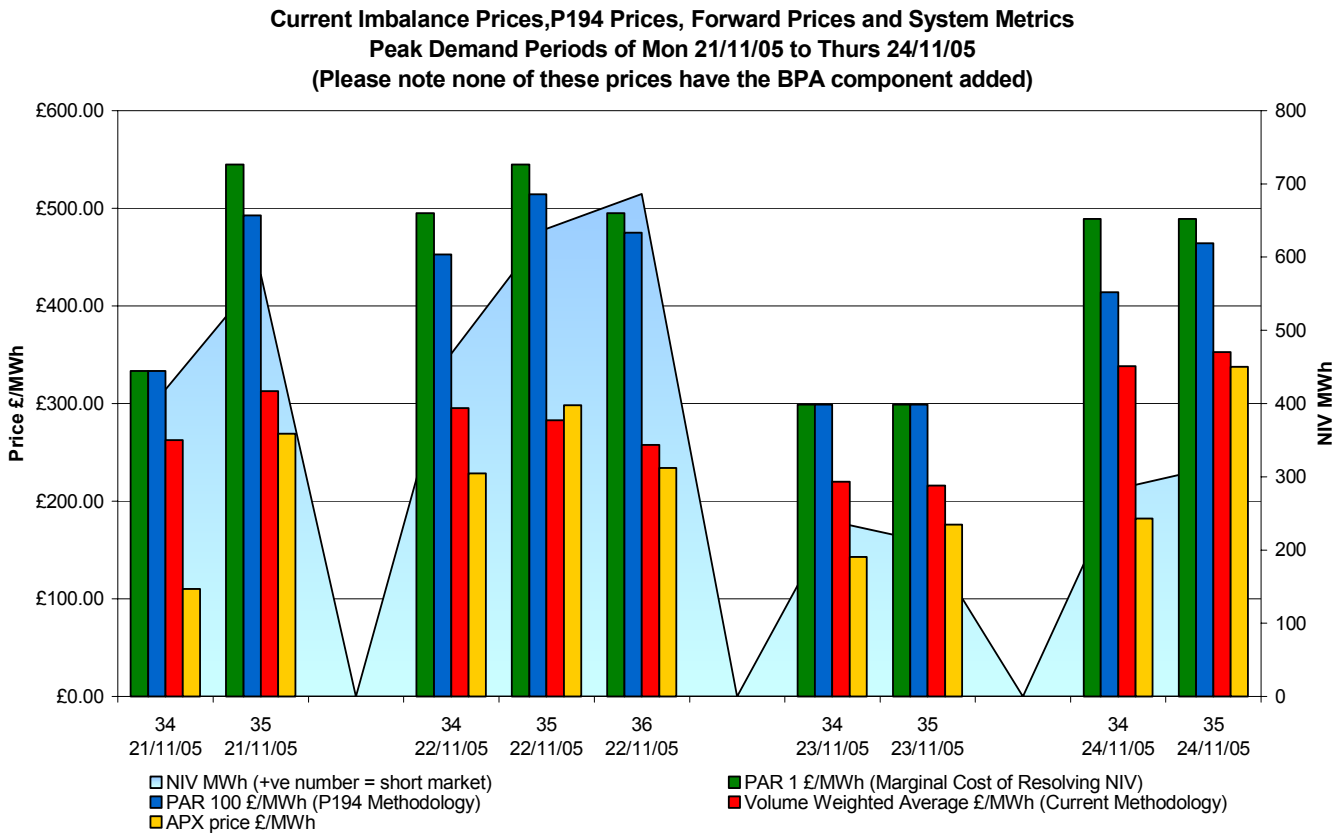
There is no firm obligation on BSC parties to contract sufficiently to cover their energy position prior to Gate Closure. The incentive to resolve their position in the forward market will be solely determined by the difference between likely exposure from imbalance prices and the cost of buying that energy forward. It is therefore imperative that, particularly at times of system stress, the incentives on all participants to cover their energy position are appropriate.

The current imbalance price methodology clears at the average cost of resolving energy imbalance (NIV) whilst the forward market clears at close to the marginal cost of energy traded. Given the observed price spread of offer submissions, the System Operator is likely to take a quantity of acceptances to resolve energy imbalance in a short market at a price greater than SBP. Within a market environment, it is expected that participants will seek to minimise their costs. Therefore if the cost of purchasing energy from the marginal unit in the forward market is greater than exposure to imbalance costs a participant will forgo that opportunity and take the cheaper option of having their imbalance cashed out at SBP. Therefore, in our view, the current methodology is effectively imposing an inappropriate cap on the forward energy price equivalent to the expected level of the average imbalance price.

This market signal could lead to a perverse incentive where, upon days of energy scarcity, market participants would find it economically beneficial not to resolve a short position ahead of the Balancing Mechanism. It is specifically on these days that the incentive to balance should be the strongest as the System Operator's options for resolving imbalance are likely to be the most limited. Therefore enhancing the pricing methodology would provide more appropriate incentives for participants to trade forward and balance ahead of Gate Closure. This would provide a more accurate value of energy in the forward markets and as such allow participants to make better informed trading decisions.

We would like to highlight recently observed market signals and behaviour by way of explanation

Despite extensive media coverage of expected cold weather during the week commencing 21st November 05 the market has been short across the peak demand periods on every week-day. As can be seen from the graph below the System Operator has been accepting offers for energy at prices significantly higher than the imbalance prices generated by the current pricing methodology. This is demonstrated by the marginal cost of resolving NIV (Par 1) which is significantly greater that the imbalance price. The current methodology has effectively induced a capping effect on the energy spot market price. The graph indicates that the forward market price is much more closely correlated with SBP than the marginal cost of generation. As such there is scope to enhance incentives for participants, with expectations of a short position, to purchase the energy from the marginal unit in the forward market.



The argument that this behaviour has been observed due to plant failure does not provide a wholly satisfactory explanation for the market behaviour that has been observed. Participants that have experienced plant failure, if appropriately incentivised, would cover their position in subsequent periods by entering the market to purchase energy. It is not currently financially prudent to cover this position given the relative lesser costs of imbalance exposure.

In response to the Panels reasoning for recommending the rejection of P194

We are concerned that the rationale given by the Panel, for recommending the rejection of P194, fails to take account of the impact analysis carried out by the proposer. The analysis indicates that any significant change to imbalance prices will be predominantly confined to peak demand periods when the system is short. These are precisely the periods that this modification is designed to impact and the P194 methodology will more appropriately incentivise all participants to balance in these periods.

The evidence does not support the supposition that imbalance prices in other periods will be adversely affected. Market Participants will act in an economically rational manner and manage their contractual positions in line with their individual risk appetites. Given this rationale we do not believe that the market would become excessively long or indeed how excessively long is determined. As the market increased in length the System Sell Price would become less attractive and this would be reflected in the management of participant's contractual positions. As such participants would be incentivsed to maintain a more balanced contractual position.

It should be noted that each MWh of imbalance results in a similar cost to the industry through SO activity, irrespective of the size or characteristics of the BSC party creating that imbalance. As such it is appropriate that all participants should be incentivised equally to minimise their imbalance position.

The view has been expressed by Panel members that certain parties may not be able to balance their position more accurately due to lack of available products. However the half-hourly APX market has a minimum volume resolution of 0.5MWh. It is also worth ascertaining

whether these small volume resolution products are not more widely available because small suppliers are not currently appropriately incentivised to actively balance their positions. Under a PAR 100 price methodology balancing incentives would be more appropriate and, as a result, demand for these products would increase. This increased demand would increase their provision and as such general liquidity would be improved.

Panel members have expressed a view that single site generators will be adversely affected by P194 because, in the event that they trip, they will be exposed to imbalance costs and will not receive any recompense by means of RCRC due to a zero metered output level. This is a scenario that is live under the current baseline. The P194 methodology provides improved incentives to maintain reliable plant and hence to balance and as such it is entirely appropriate that all participants are exposed to these imbalance prices. If imbalance prices do not provide appropriate incentives for generators to balance then it is difficult for participants to appropriately value investment in reliability and as such creates more uncertainty through reduced plant reliability in the market.

The Panel has also purported that a PAR 100 pricing methodology may lead single site generators to withhold capacity from the market. In the very limited number of periods in which imbalance prices are likely to increase participants will be able to reflect that risk in their offerings to the market. Under a PAR 100 pricing regime suppliers will be more appropriately incentivised to contract for this volume and in effect single site generators will have more certainty of selling into the market across these limited peak periods than they currently experience.

Therefore it is our view that, for the reasons outlined in this response, a recommendation to implement the modification would be more appropriate

Do you agree with the Panel's view that the legal text provided in the draft Modification report correctly addresses the defect or issue identified in the Modification Proposal?

Yes

Do you agree with the Panel's provisional recommendation concerning the implementation date for P194?

Yes

Are there further comments on P194 that you wish to make?

National Grid, as the GB System Operator, urges the BSC panel to reconsider its recommendation in relation to P194. We believe the defect identified in this proposal has a direct bearing on Security of Supply.

As we move into a cold winter we believe that there is benefit in further enhancing the incentives for the market to generate sufficient trading activity to resolve the demand requirement of consumers. This has been materially demonstrated by the continual demand shortfall over the peak weekday periods of the previous week. P194 would improve these incentives to balance and provide greater Security of Supply for the system.

P194 REPORT PHASE CONSULTATION QUESTIONS

BSC Parties ("Parties") and other interested parties are invited to respond to this consultation expressing their views or provide 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:	*Jonathan Scott*
Company Name:	Alcan Smelting and Power UK
No. of BSC Parties Represented	0
Parties Represented	N/A
No. of Non BSC Parties Represented	1
Non Parties represented	Alcan Smelting and Power UK
Role of Respondent	*Licence Exempt Generator / Large End User*

Q	Question	Response	Rationale
1.	Do you agree with the Panel's views on P194 and the provisional recommendation to the Authority contained in the draft Modification Report that P194 **should not** be made? Please give rationale.	Yes	Alcan supports the Panel's view and recommendation that P194 should not be made fro three primary reasons: • Alcan believes that P194 would, on average, result in more extreme imbalance prices. This would encourage participants to take longer positions, thus increasing the overall cost of balancing the system (NGET + participant costs), which would lead to a less efficient operation of the transmission system. • The PAR volume is purely arbitrary. It is designed to deliver the desired results, but the justification for its value is derived from historical analysis. Setting a future parameter based on historical market behaviour may be inappropriate. • P194 is not cost-reflective. It neither reflects the marginal costs nor the average cost. As balancing over recovers the cost anyway, increasing the signals would further undermine cost-reflectivity.

© ELEXON Limited 2005

Q	Question	Response	Rationale
2.	Do you agree with the Panel's view that the legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal? Please give rationale.	**No**	Alcan does not believe that P194 should be implemented, therefore we do not believe that the legal text amendments, which attempt to address the defect, are relevant.
3.	Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P194? Please give rationale.	**No**	Alcan believes that the implementation date should be at least twelve months after the Authority decision. We believe that sufficient time is required to factor a material change in the imbalance methodology for contracting purposes.

© ELEXON Limited 2005

Q	Question	Response	Rationale
4.	Are there any further comments on P194 that you wish to make?	**Yes**	Below are some viewpoints from a small independent generator perspective. Alcan believes any arbitrary volume used to calculate imbalance prices would compromise the efficiency of the system. Any proxy for the marginal price is likely to over-recover costs and lead to a higher value of RCRC. Some participants will receive this higher value of RCRC, but embedded generators are prevented from full access to this fund. Small single-site generators, large end-users and small independent suppliers would be the most affected if P194 were implemented, as they generally do not have the option to carry reserve generation to cover for trip risk. Small players do not have the flexibility afforded by a large portfolio, an advantage which is enjoyed by vertically-integrated players. Moreover, these players could face the risk of bankruptcy if exposed to extreme prices, which, under system tightness, would be more likely if P194 were implemented. Furthermore, we do not believe there is sufficient development in risk management products that could provide adequate insurance against such risks for small/single-site generators and small players generally. The liquidity for non standard shapes and volumes is virtually non existent. There is potentially a large credit risk under P194. The credit risk would increase exponentially to cover the likely higher and volatile imbalance prices. Small players already face tight credit lines from the dominant market players. P194 is likely to result in increased credit risk for smaller players, which, potentially, could undermine competition amongst small generators and small suppliers. This P194 would transfer the balancing costs from NGET to market participants, with no consideration on the impact of total system efficiency. Alcan awaits, with interest, the discussions relating this modification, although cannot support its implementation.

© ELEXON Limited 2005

Please send your responses by **17:00 on Monday 28 October 2005** to modification.consultations@elexon.co.uk and please entitle your email 'P194 **Report Phase Consultation**'. Please note that any responses received after the deadline may not receive due consideration by the Panel.

Any queries on the content of the consultation pro-forma should be addressed to Tom Bowcutt on 020 7380 4309, email address thomas.bowcutt@elexon.co.uk.

© ELEXON Limited 2005

P194 REPORT PHASE CONSULTATION QUESTIONS

BSC Parties ("Parties") and other interested parties are invited to respond to this consultation expressing their views or provide 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:	*Martin Mate*
Company Name:	British Energy
No. of BSC Parties Represented	5
Parties Represented	*British Energy Power & Energy Trading Ltd, British Energy Generation Ltd, British Energy Direct Ltd, Eggborough Power Ltd, British Energy Generation (UK) Ltd*
No. of Non BSC Parties Represented	-
Non Parties represented	-
Role of Respondent	*Supplier/Generator/Trader/Consolidator/Exemptable Generator/Party Agent*

Q	Question	Response	Rationale

© ELEXON Limited 2005

Q	Question	Response	Rationale
1.	Do you agree with the Panel's views on P194 and the provisional recommendation to the Authority contained in the draft Modification Report that P194 **should not** be made? Please give rationale.	No	We believe P194 would increase the incentive on parties to manage their own imbalances rather than to rely on the System Operator. 1. BSC Objective (b) relating to system operation should be better met by reducing the work of and cost to the System Operator. In particular, incentives to balance at times of system 'stress' (extremes of shortfall or spill) would be increased, and the electricity system should be inherently more balanced, with parties procuring reserve/options to suit their individual requirements. 2. BSC Objective (c) relating to competition should be better met by further focusing the costs of balancing on parties themselves. Rather than sharing costs under an average imbalance price, with potential cross-subsidies between parties, different balancing performance and risk profiles can be better reflected, with long term benefits to competition. Retention of some degree of averaging reduces the extent to which anomalous actions/prices can influence energy imbalance prices. Our 'further comments' below indicate some of the ways in which anomalous prices can occur. Hopefully increased incentives for parties to manage their positions would promote liquidity in energy and reserve/option/hedging/insurance products, and promote improved transparency and forecasting.
2.	Do you agree with the Panel's view that the legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal?	Yes	The legal text appears to reflect the intention of the modification, although we have not tested the logic of Annex T-1 in all situations. Proposed new section T4.4.4C appears correct as explanation but is it strictly necessary given that details are specified in Annex T-1? Annex X-2 definition of PAR should include 'Reference' not 'reference'.
3.	Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P194?	Yes	Timescales appear sensible given time and cost constraints of software development, and give parties opportunity to prepare for change. They would need to be revisited if supply problems were anticipated in the meantime.

© ELEXON Limited 2005

Q	Question	Response	Rationale
4.	Are there any further comments on P194 that you wish to make?	Yes	• We note that the existing and proposed imbalance pricing mechanisms allow imbalance prices to be influenced by actions taken in extreme circumstances where, in a rational market, demand response to price would be expected. In this situation the price charged to parties in imbalance may exceed the price at which, in an ideal market, customers would forego or take supply, in the case of very high or very low prices respectively. The proposed method may increase the significance of this effect. We believe it would be sensible to limit imbalance prices to values representing a level at which significant customer response would be expected in an ideal market. • We note that the existing and proposed tagging mechanisms allow imbalance prices to be influenced, in some situations, by actions taken for reasons other than pure national energy balancing, for example transmission constraints. The proposed method may increase the significance of this effect. • We note that the rules in BSC Section T and Annex T-1 for establishing which actions should be included in imbalance price are complicated by the differing treatment of accepted Bids and Offers compared to all other balancing actions taken by the System Operator. The BSAD aggregation of 'other' balancing actions allows imbalance prices to be influenced by (a) SO judgement on which actions should be priced, and (b) the detail of the tagging process. The proposed method may increase the significance of this affect. We believe inclusion of all actions taken by the SO in the objective tagging and imbalance price calculation would promote transparency of balancing actions and price determination, and remove subjectivity. If the principle of P194 were to be accepted, other modification proposals in these areas might be expected.

Please send your responses by **17:00 on Monday 28 October 2005** to modification.consultations@elexon.co.uk and please entitle your email 'P194 **Report Phase Consultation**'. Please note that any responses received after the deadline may not receive due consideration by the Panel.

© ELEXON Limited 2005

Any queries on the content of the consultation pro-forma should be addressed to Tom Bowcutt on 020 7380 4309, email address thomas.bowcutt@elexon.co.uk.

© ELEXON Limited 2005