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BSC Modification proposals P211 and P217

In this letter we set out our rationale for delaying a decision on BSC modification proposal P211 (P211) until October 2008, to allow it to be considered alongside modification proposal P217 (P217).

P211 was raised by EdF Energy in April 2007, whilst P217 was raised by RWE npower in October 2007. Both proposals aim to modify the calculation of the main electricity imbalance price in an attempt to address the same defect – namely the influence of 'system' actions in the calculation of the cash-out price in some periods. The proposals are mutually incompatible so that they could not be in place at the same time.

Ofgem received the Final Modification Report (FMR) for P211 in October 2007. Meanwhile P217 is still in Assessment Phase and we are not due to receive the FMR until July 2008. With respect to implementation timing the 211 FMR stated that:

"*The Panel agreed the following recommended implementation approach for P211: An Implementation Date of 06 November 2008 if an Authority decision is received on or before 29 February 2008; or 25 June 2009 if the Authority decision is received after 29 February 2008 but on or before 16 October 2008*."

The different timings of P211 and P217 create a difficult dilemma for Ofgem on whether to make its decision on P211 in February, to allow implementation for winter 2008/9 if it was accepted, or to postpone the decision until the FMR for P217 is received so that a decision on the two modifications could be made in parallel.

In December we published an impact assessment (IA) on P211. Alongside the IA, we published an open letter to Elexon, in which we highlighted the dilemma we faced and invited views from the industry on when we should make the decision on P211. We received 5 responses to that letter, of which 4 favoured delaying the decision and 1 favoured a February decision. Many responses to the IA on P211 (and P212) also offered views on this question. Of 20 responses, 11 preferred postponing, 6 favoured a February decision and 3 did not comment.

Hence after considering responses to the IA and the open letter, Ofgem has decided to postpone making a decision on P211. We will publish our decision on the proposal before the second deadline of 16th October 2008 to allow implementation by June 2009 if it is accepted. We understand the arguments of those favouring an early decision on P211, but believe that being able to consider both proposals in parallel will result in implementation of the most appropriate set of cash-out arrangements.

The decision to postpone the P211 decision is taken after due consideration of the specific costs, risks and circumstances surrounding the modifications in question. It is in no way intended to set a precedent for the process of any future modifications. Rather it is, on balance, the best option in these circumstances.

We recognise that by delaying the decision on P211 we are postponing addressing what we believe is a proven defect with the current arrangements, namely "system pollution" in cash-out prices, by at least seven months. This is likely to have a number of negative consequences in the short term as our IA clearly set out, including our analysis of the impact of this defect on certain market participants. But we have to balance this against the importance in the longer term of setting appropriate signals through cash-out for parties to forward contract, to invest to maintain and improve plant reliability, and for suppliers to improve their demand forecasting. On balance, we think that modifications P211 and P217 should be considered in conjunction to evaluate which, if either, better facilitates the applicable objectives of the BSC. The alternative of accepting P211 in February 2008, whilst P217 is still in Assessment Phase, would lead to uncertainty and would lead to wasted implementation costs[1] if P217 was subsequently implemented.

A further consideration is the baseline that we adopt to assess whether P211 would produce prices that better reflect the underlying costs of energy balancing and hence better facilitate the achievement of the applicable objectives b and c of the BSC. In our Impact Assessment, we presented two alternative Proxy Energy Price series, PEP (Base) which classified reserve creation actions as "system" related and PEP (Alt) which classified reserve creation as "energy" related. Depending on which PEP series is used, P211 would produce prices more or less reflective of energy balancing costs than the current arrangements. In the IA, we set out our current view (a view also expressed by previous standing modification groups), that reserve creation should not be included in cash-out prices, but rather shared by all parties through Balancing Services Use of System (BSUoS) Charges. The basis for this view is not that we refute that reserve is predominantly required to manage uncertainty in the energy balance, but rather the current arrangements based on imbalances in discrete half-hourly settlement periods do not allow accurate targeting of these costs[2].

In contrast a number of respondents to the IA believe strongly that reserve creation costs are targeted accurately under the current arrangements and these costs should remain in cash-out. We note that this issue is being further debated in the P217 Assessment Phase and Standing Issue 30 meetings, and consider that analysis currently being undertaken may usefully inform the future decision on P211.

We expect to receive a FMR for P217 in July. We plan to make a decision on both P211 and P217 after that date and before 16th October.

We are very disappointed to find ourselves in this position. The issue of system pollution and the system/energy reserve debate are not new and we have highlighted these issues through our various cash-out review initiatives and in a number of previous modification decision letters. It is very disappointing that P217 was not raised much earlier as this would have allowed a quicker resolution to a potentially significant defect in the existing rules that our IA has shown could impact disproportionately on renewable generators and small generators and suppliers. We think that this provides evidence of a failure in the existing industry governance process. We will obviously consider the implications of this series of events in our review of industry governance.

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[1] Estimated at around £725,000 in the IA.
[2] We believe this is analogous to using the Continuous Acceptance Duration Limited (CADL) taqging rule to remove sub-15 minutes intra-half hour and frequency response actions from cash-out prices.

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In addition, we urge the industry to prioritise progressing the assessment of P217 so that resolution of the identified defects can be implemented as early as possible.

Yours faithfully,

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