# ANNEX 2 - REPRESENTATIONS

**Responses from P135 Urgent Consultation**
Consultation issued 20 August 2003

Representations were received from the following parties:

| No | Company | File Number | No. BSC Parties Represented | No. Non-Parties Represented |
|---|---|---|---|---|
| **1.** | Enfield Energy | P135_URGENT_001 | 1 | 0 |
| **2.** | Edison Mission Energy | P135_URGENT_002 | 1 | 0 |
| **3.** | Corus Group | P135_URGENT_003 | 0 | 1 |
| **4.** | Aquila Networks | P135_URGENT_004 | 1 | 0 |
| **5.** | Powergen | P135_URGENT_005 | 14 | 0 |
| **6.** | ConocoPhillips | P135_URGENT_006 | 2 | 0 |
| **7.** | CECL, IETS, RPCL, SPAL | P135_URGENT_007 | 4 | 0 |
| **8.** | Gaz de France | P135_URGENT_008 | 1 | 0 |
| **9.** | Innogy | P135_URGENT_009 | 9 | 0 |
| **10.** | Scottish Power | P135_URGENT_010 | 6 | 0 |
| **11.** | Barclays Capital | P135_URGENT_011 | 1 | 0 |
| **12.** | AEP Energy Services | P135_URGENT_012 | 2 | 0 |

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|---|---|---|---|---|
| **13.** | energywatch | P135_URGENT_013 | 0 | 1 |
| **14.** | NGT | P135_URGENT_014 | 1 | 0 |
| **15.** | British Gas Trading | P135_URGENT_015 | 1 | 0 |
| **16.** | AEX Drax Power | P135_URGENT_016 | 1 | 0 |
| **17.** | EDF Energy | P135_URGENT_017 | 9 | 0 |
| **18.** | Scottish & Southern | P135_URGENT_018 | 4 | 0 |
| **19.** | BP | P135_URGENT_019 | 2 | 0 |
| **20.** | British Energy | P135_URGENT_020 | 3 | 0 |
| **21.** | British Sugar | P135_URGENT_021 | 0 | 1 |
| **22.** | Entergy-Koch Trading Europe Ltd | P135_URGENT_022 | 1 | 0 |
| **23.** | Teeside Power (late response) | P135_URGENT_023 | 1 | 0 |

**P135_URGENT_001 – Enfield Energy**

Response to Modification Proposal P135 – Marginal System Buy Price During Periods of Demand Reduction

Thank you for the opportunity to respond to this consultation. Enfield Energy Centre Limited does not support the proposed modification, we have attached a completed proforma but would also like to offer the additional comments below.

We believe that if Ofgem approves this modification then it could introduce perverse incentives into the generation sector. At times of system stress it is obviously important that all possible generation capacity is available to NGC in order to maintain system security, should P135 be introduced we feel there is a real possibility that generators (especially single site ones) may be forced to withhold uncertain capacity in order to protect their financial integrity. This will not help system security and will not better facilitate the achievement of the Applicable BSC Objectives.

Under the current pay as bid arrangements introducing P135 will materially alter the balance of risk and reward in both the forward markets and the Balancing Mechanism. EECL agrees that this modification may increase prices for the coming winter though the risks associated with contracting forward (for those participants who intend to deliver energy physically) will also have materially increased. This is unlikely to encourage generators to make plant available and may also stifle short-term liquidity.

We accept that Participants are free to increase their offers within the Balancing Mechanism (in order to cover these risks) but this will also result in an overall increase in system buy prices again increasing risk when imbalance. It seems to us that marginal imbalance prices will only encourage generators to make capacity available to the Balancing Mechanism should they be rewarded with marginal prices in return for their offers.

Of further concern is that the modification does not envisage prompt price reporting. We feel this is paramount to any orderly market and will mean that any signals that may have developed from this modification will be untimely and ineffective (though given demand control is a within gate closure action the signals are only likely to be blunt either introducing short-term panic or complacency).

Participants exposed to high system buy prices could even find they are financially impacted without having time to arrange appropriate funds to cover their credit position.

We have seen no evidence to suggest the current regime is likely to fail and feel that the range of balancing tools that NGC have at their disposal (including services from the demand side) should be adequate to ensure security of supply.

We believe that this modification needs to be investigated in the full context of the market including the impact on credit arrangements, rushing this modification in order to meet this coming winter deadline could have serious implications for all and maybe inequitable for parties who have already entered into contracts for this period. The process so far seems to be reactive and rushed, there appears to have been little discussion about the wider implications of this modification.

Of concern to all must be that in the longer term investors in the industry will only view this as further regulatory interference when the market needs it least of all.

Yours faithfully

Christopher Ford

Enfield Energy Centre Limited

| | |
|---|---|
| **Respondent:** | *Enfield Energy Centre Limited* |
| **No. of BSC Parties Represented** | *1* |
| **BSC Parties Represented** | *Enfield Energy Centre Limited* |
| **No. of Non BSC Parties Represented** | |
| **Non BSC Parties represented** | *Please list all non BSC Parties responding on behalf of (including the respondent company if relevant).* |
| **Role of Respondent** | *Generator* |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 1. | Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives?<br>Please give rationale and state which objective(s) | Yes / No | No - we believe that P135 may perversely incentivise generators at times of system stress |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 2. | Does P135 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure?<br>Please give rationale | Yes / No | |
| 3. | Do you believe there to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | YES / NO | |
| 4. | Are there any further comments on P135 that you wish to make? | Yes / No | Yes - see letter above |

**P135_URGENT_002 – Edison Mission Energy**

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|---|---|
| **Respondent** | *Edison Mission Energy* |
| **No. of BSC Parties Represented** | *One* |
| **BSC Parties Represented** | *First Hydro Company* |
| **No. of Non BSC Parties Represented** | - |
| **Non BSC Parties represented** | - |
| **Role of Respondent** | *Generator* |

Response to P135 and P135 Alternative consultations

**1. Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives?**

Yes

(b) The efficient, economic and co-ordinated operation by the Transmission Company of the Transmission System

P135 will strengthen the signals for Parties to contract in advance of Gate Closure reducing the actions NGC will have to take in the Balancing Mechanism when the system is really tight and demand reduction would otherwise have been likely. This added incentive to contract should also lead to improvements in security of supply, thereby actually reducing the threat of any demand reduction action.

The risk of exposure to potentially high imbalance cashout prices in the event of plant failure should encourage generators to invest in plant improving plant reliability.

P135 will therefore improve the economic, efficient and coordinated operation by the Transmission Company.

(c) Promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity

To the extent that this modification should indirectly result in additional generation capacity being made available, there should be a positive effect on promotion of competition. However, we believe that a more enduring solution to providing appropriate market signals would better assist this objective.

**2. Does P135 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure?**

Please give rationale

No – whilst a number of issues have been raised that could arise if this modification is implemented, these issues could arise now. As a result of a very short system, cashout prices could go very high approaching marginal levels. Generators could trip and be exposed to these high prices, posted credit cover might be insufficient to avoid credit default and the possibility of bankruptcy (a BSC Party entered credit default on Monday 11 August when the SBP was over £240/MWh throughout the day; credit default can therefore occur at current levels).

One response to the above would be to ask why if these issues could arise now, is the modification needed? P135 sharpens the current signals delivering improvements to security of supply more quickly than if the mod is not implemented.

**3. Do you believe there to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)?**

Please see response to Alternative P135 mod

**4. Are there any further comments on P135 that you wish to make?**

Much has been made in the PSMG discussions as to whether P135 will provide appropriate signals to Parties to contract as the signal comes too late to respond. Whilst there is the potential for NGC to initiate Demand Reduction within BM timescales with no prior warning, this will not be beneficial to NGC. NGC have said that they will only initiate Demand Control when all feasible actions have been taken in the Balancing Mechanism. Since the cost of taking potentially very high priced actions will impact NGC's incentive scheme, it is in NGC's interests to give Parties as much prior warning as possible of the threat of Demand Reduction through notification of NISMs and High Risk of Demand Reduction warnings. These early warnings will allow BSC Parties time to balance their positions in the short term markets.

Concerns have also been raised at the PSMG that generators will withhold generation from the forward markets fearing exposure to high cashout prices in the event that plant trips. In withholding generation, generators are foregoing earnings. If generators perceive the risks of cashout exposure are high, they will price in the forward market accordingly. Repeating an earlier comment, high cashout prices could happen without this mod.

Overall we would support this proposed modification as we do think that its implementation would better meet the Applicable Objectives. However, the timing and nature of the modification confirm its status as a short term fix, which is less than ideal for this critical area of the BSC. There is a risk that such changes impact on the credibility of the market as a whole – we urgently need a more robust, long term solution that will reintroduce realistic investment signals for the benefit of all market participants.

**ADDENDUM TO P135 URGENT MODIFICATION CONSULTATION - proforma**

**1. Do you believe either or both of options (a) and (b) to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)?**

Yes, a and b combined but please see our comments on a further alternative described below.

P135 may discourage generators from offering into the BM because of exposure to non delivery at the marginal SBP which might be much higher than their offer price. To avoid this exposure, generators will want to be the marginal generator which will leave them indifferent to non delivery in the event of plant failure. To provide absolute certainty that they are the marginal generator, a generator will want to offer at the highest price that can be submitted. If all generators take this action when there is the threat of demand reduction, the marginal price will be the maximum possible price - £99,999/MWh. If demand reduction is not needed, then any offers that are taken in the BM will be at this price so the average price will also tend towards £99,999/MWh.

If instead all generators are paid the marginal price for offers that are accepted when demand reduction is in operation, these perverse incentives will not exist, and they will not need to increase their offer prices to protect against non delivery. This will result in a more appropriate marginal price and, if demand reduction doesn't occur, an average price not distorted by such behaviour.

This alternative therefore improves the economic operation by the Transmission Company of the Transmission System (objective b) compared to the original P135 modification since it can prevent excessive balancing costs particularly at times when demand reduction is indicated but not required. It also promotes competition in the generation of electricity (objective c) as generators will wish to compete in the BM rather than being compelled to raise their offer prices.

**2. Are there any other options that you believe may form an Alternative Modification?**

Yes

It is not clear why suppliers who suffer demand disconnection should receive the marginal offer price. If demand is disconnected, a supplier may be left long and if so will receive the SSP which under the original P135 modification will be the market price. Concerns have been raised by PSMG members that suppliers may have paid far more than SSP to avoid being short but will only be recompensed at SSP if their customers are subsequently cut off. If suppliers are receiving the market price (which is supposed to reflect the cost of energy in the short term markets) when disconnected, this should approximate to the amount suppliers have paid to avoid going short. To pay for disconnection at the marginal SBP will result in windfall gains.

The alternative should only apply to generators who have had offers accepted during the period of demand reduction and not to demand as well

**3. Are there any further comments on the options comprising a potential alternative to P135 that you wish to make?**

No

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**P135_URGENT_003 – Corus Group**

Corus has considerable reservations about this proposed mod and does not believe it should be made. Whilst the aim of avoiding demand reduction notifications is laudable there is clearly a risk that moving to a marginal SBP could result in perverse incentives, particularly if generators, fearful of the financial exposure if they trip, do not offer into the market at times of potential system stress. Moreover, pushing market participants into carrying their own reserve by going long rather than being managed centrally by NGC will increase costs overall, which would no doubt be passed on to end-users. The use of

marginal pricing will result in increased volatility and risk of very high imbalance charges and is likely to impact more on smaller generators and suppliers. This hardly facilitates competition; on the contrary it will hasten exit and be a barrier to new entry. If P135 is enacted, a dangerous precedent will be set, particularly in respect of a number of further mods relating to marginal pricing that have been proposed. All these are of fundamental significance to the operation of NETA and need to be considered holistically along with P135 and not be rushed. If NGC is genuine about avoiding demand reduction notifications, then it should consider further contracting with mothballed plant or with the demand side, rather than seeking a high risk change to the BSC. I hope you find these comments from a very large consumer of electricity helpful.

Regards, Stephen Macey.

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**P135_URGENT_004 – Aquila Networks**

Aquila Networks PLC would like to return a response of 'No Comment' to P135 Urgent Consultation

Regards,

Deborah Hayward, Distribution Support Office & Deregulation Control Group

Aquila Networks plc

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**P135_URGENT_005 – Powergen**

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| **Respondent:** | Powergen |
| **No. of BSC Parties Represented** | 14 |
| **BSC Parties Represented** | Powergen UK plc, Powergen Retail Limited, Cottam Development Centre Limited, TXU Europe Drakelow Limited, TXU Europe Ironbridge Limited, TXU Europe 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 Limited |
| **Role of Respondent** | Supplier, Generator, Trader, Exemptable Generator |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 1. | Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives? Please give rationale and state which objective(s) | No | P135 is predicated on the belief that there is an insufficient signal from the imbalance prices produced using the weighted average price of acceptances. However, it only proposes using the marginal price in the instance when the market has failed to provide system security and demand reduction is required. At this point the signal has been sent too late.<br><br>Market signals work through an iterative process of people trading and altering their positions on the basis of experience of past prices and market conditions. This will be a one off signal which occurs after the event which it is designed to avoid.<br><br>It could be that P135 is designed to make participants sufficiently scared about the price to which SBP could go, so that they forward contract to ensure that they cannot be exposed to it. However, participants have no idea where the price will end up or even the likelihood that it may occur, which means that the market cannot make the appropriate response.<br><br>We also believe that P135 is likely to have a negative effect in terms of encouraging generation plant to operate at full output at times of systems stress. The risk to a generating station relates to the risk of tripping off the system and this is likely to be increased under these circumstances, when the station is being pushed to its full extent. This is a significant risk under the current pricing rules and it is not possible at present to insure against it. However, knowing that the station could be exposed to the marginal price for tripping will substantially increase the generator's perception of risk which will mean that it is less likely to offer its output to the fullest extent possible, just at the time when the market requires it to.<br><br>The discussion in the group has focussed on prices possibly going as high as £100k per MWh. However, the information on indicative marginal prices provided with the consultation paper |

| Q | Question | Response | Rationale |
|---|---|---|---|
| | | | shows the potential risks and disproportionate nature of the possible prices at lower levels than this. Prices for period 35 on the 10 December 2002 show that a 500MW unit which tripped during that period would have been exposed to an imbalance price of £10k per MWh under P135 and a total cost of around £2.5 million for that half hour. If this generator had been selling at £20/MWh then it would have be paying compensation for non-delivery of a product which was 500 times the price it would have received for delivering it.<br><br>For a baseload station this would represent just over 10 days revenue. For a non baseload plant it is likely to represent more than this. In terms of profit margin lost the effect would have been even more significant. Of course, suppliers would have been exposed to the same prices. However, the financial effect on suppliers would be mitigated to some extent as they would receive some of the significant over recovery proportionate to their share of metered volumes. The generator would have no metered volume and would therefore be exposed to the entire cost. |
| 2. | Does P135 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure?<br>Please give rationale | No | |
| 3. | Do you believe there to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | No | Not one consistent with the principle of P135, that Parties are only hit with a signal once demand reduction has been called and therefore it is too late for them to act. |
| 4. | Are there any further comments on P135 that you wish to make? | No | |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 5. | Do you believe either or both of options (a) and (b) to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | No | They still have the fundamental problem associated with the original proposal. That is, that Parties are only hit with a signal once demand reduction has been called and therefore it is too late for them to act.<br><br>We do not see these as providing a signal to incentivise more forward contracting in the market so that more generation is made available for the winter. |
| 6. | Are there any other options that you believe may form an Alternative Modification? | No | |
| 7. | Are there any further comments on the options comprising a potential alternative to P135 that you wish to make? | No | |

**P135_URGENT_006 – ConocoPhillips**

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| **Respondent:** | *Name: Rekha Patel* |
| **No. of BSC Parties Represented** | *2* |
| **BSC Parties Represented** | *ConocoPhillips UK Limited and Immingham CHP* |
| **No. of Non BSC Parties Represented** | |
| **Non BSC Parties represented** | *Please list all non BSC Parties responding on behalf of (including the respondent company if relevant).* |
| **Role of Respondent** | *Trader and Generator* |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 1. | Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives?<br>Please give rationale and state which objective(s) | No | Rationale provided below. |
| 2. | Does P135 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure?<br>Please give rationale | No | |
| 3. | Do you believe there to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | Yes | Alternative described below. |
| 4. | Are there any further comments on P135 that you wish to make? | Yes | Comments expressed below. |
| 5. | Do you believe either or both of options (a) and (b) to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | YES | ConocoPhillips believe both options a and b to be a potential alternative modification to P135. The alternative proposal that incorporates option a, including the volume associated with demand control in the Energy Imbalance Price calculation, shall derive a more 'correct' marginal SBP than P135, sending a more accurate price signal.<br>Whilst, including option b into the alternative proposal shall incentivise generators to place offers within the balancing mechanism during times of demand control, unlike P135. The alternative proposal leads to better facilitating the applicable BSC Objective (b) the efficient, economic and co-ordinated operation by the transmission company of the transmission system. |
| 6. | Are there any other options that you believe may form an Alternative Modification? | YES | ConocoPhillips believe it is not obvious that a problem exists. However, if a consensus is reached amongst market participates that 'stronger' signals |

| Q | Question | Response | Rationale |
|---|---|---|---|
| | | | are necessary during times of demand control then the following alternative to P135 should be considered; 'Elimination of NIV tagging and CADL during times of Demand Control, to calculate SBP'. We would like this alternative to be discussed within the PSMG:<br><br>During times of demand control, in accordance with OC6.1.2 (c), (d) and (e) of the Grid Code, ConocoPhillips would like to propose an amendment to the Energy Imbalance Price calculation such that the SBP is derived from all accepted untagged offers. However, it is proposed that the Net Imbalance Volume (NIV) tagging process is not undertaken to calculate the SBP during times of demand control, as all actions undertaken by the System Operator (SO) would be deemed to be 'energy' related, i.e. insufficient generation to meet demand. The Continuous Acceptance Duration Limit (CADL) rule shall also be removed during times of demand control as even short duration acceptances shall be associated with 'energy' balancing. De minis tagging and arbitrage tagging would still continue to be applied under a demand control environment.<br><br>This potential alternative to modification proposal P135 addresses the defect that the current methodology imposes on security of supply by ensuring the 'energy' price of SBP sends the appropriate price signals that incentives forward contracting, thus generation meets demand whilst retaining the concept of averaging energy actions over a settlement period. Retaining averaging should ensure that there is less over recovery of balancing mechanism actions cash flow (RCRC) and is less likely to result in penal SBP. Under this alternative methodology, ConocoPhillips believe that SBP would not be understated as a result of higher priced offers not being tagged out through NIV and CADL. |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 7. | Are there any further comments on the options comprising a potential alternative to P135 that you wish to make? | No | |

**ConocoPhillips' consultation response to Urgent Modification P135, 'Marginal SBP during periods of Demand Reduction'.**

Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives? Please give rationale and state which objective(s)?

ConocoPhillips do not support proposed modification P135. We do not believe that the proposal better facilitates the applicable BSC Objective (b) the efficient, economic and co-ordinated operation by the transmission company of the transmission system.

The proposal has the potential of causing BSC Objective (b) to deteriorate from the current baseline. During times of demand control, the proposal shall signal system stress via a marginal SBP, however the incentive to balance is too late for market participates to react through contracting ahead of gate closure. As a consequence of market participates being unable to react to the marginal SBP, a change of behaviour shall arise. Generators will now be incentivised to withhold generation from the balancing mechanism to decrease the probability of an unplanned outage, during times of demand control. The proposal shall further exacerbate demand being greater than generation, thus increasing the operational issues for National Grid and therefore causing a decrease in the efficient, economic and co-ordinated operation by the transmission company of the transmission system.

National Grid believe that the proposed modification P135 addresses the defect of security of supply by using a marginal price to send price signals that incentivise forward contracting to ensure that generation meets demand. However, as a consequence of the marginal imbalance price only being applied to the SBP, market participants will be incentivised to take a 'long' position rather than balance. Ofgem's decision letter on approved modification P78, indicated that parties should be strongly incentivised to forward contract to 'balance' their position ahead of gate closure. The proposal is inefficient through causing each individual party to hold its own reserve. As a consequence of all suppliers being unable to correctly forecast their customers' demand, especially amongst the smaller suppliers, it would be more efficient for the transmission company to purchase reserve for parties, thus better fulfilling BSC Objective (b).

To conclude, the proposal does not provide a timely signal to market participates to react, thus causing no beneficial behavioural change amongst market participates during times of demand control. Ultimately, P135 shall encourage generators to withhold generation at the crucial time of demand control. A

further deterioration of BSC Objective (b) shall also be incurred through all participates purchasing their own reserves, taking a 'long' position rather than attempting to balance.

**Do you believe there to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect and is better at facilitating the Applicable BSC Objective than P135)?**

ConocoPhillips believe it is not obvious that a problem exists. However, if a consensus is reached amongst market participates that 'stronger' signals are necessary during times of demand control then the following alternative to P135 should be considered; 'Elimination of NIV tagging and CADL during times of Demand Control, to calculate SBP'.

During times of demand control, in accordance with OC6.1.2 (c), (d) and (e) of the Grid Code, ConocoPhillips would like to propose an amendment to the Energy Imbalance Price calculation such that the SBP is derived from all accepted untagged offers. However, it is proposed that the Net Imbalance Volume (NIV) tagging process is not undertaken to calculate the SBP during times of demand control, as all actions undertaken by the System Operator (SO) would be deemed to be 'energy' related, i.e. insufficient generation to meet demand. The Continuous Acceptance Duration Limit (CADL) rule shall also be removed during times of demand control as even short duration acceptances shall be associated with 'energy' balancing. De minis tagging and arbitrage tagging would still continue to be applied under a demand control environment.

This potential alternative to modification proposal P135 addresses the defect that the current methodology imposes on security of supply by ensuring the 'energy' price of SBP sends the appropriate price signals that incentives forward contracting, thus generation meets demand whilst retaining the concept of averaging energy actions over a settlement period. Retaining averaging should ensure that there is less over recovery of balancing mechanism actions cash flow (RCRC) and is less likely to result in penal SBP. Under this alternative methodology, ConocoPhillips believe that SBP would not be understated as a result of higher priced offers not being tagged out through NIV and CADL.

**Are there any further comments on P135 that you wish to make?**

ConocoPhillips would like to express its disappointment with regards to Ofgem's decision of granting 'urgent' status to proposal P135. We believe that the recent imbalance cash-out prices, under the P78 environment, have provided 'strong' signals to prevent the supposed 'free-rider problem' highlighted by National Grid. For example, on the 21st July 2003, settlement period 21, the SBP rose to £402. It is not obvious that a problem exists and hence National Grid has numerous tools, i.e. balancing mechanism actions, forward contracts, pre-gate closure BMU transactions and ancillary services already available to resolve a potential problem.

**P135_URGENT_007 - CECL, IETS, RPCL, SPAL**

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|---|---|
| **Respondent:** | *Chris Ridgway* |
| **No. of BSC Parties Represented** | *4* |
| **BSC Parties Represented** | *CECL, IETS, RPCL, SPAL* |
| **No. of Non BSC Parties Represented** | *1* |
| **Non BSC Parties represented** | *InterGen (UK) Ltd* |
| **Role of Respondent** | *Generator* |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 1. | Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives?<br>Please give rationale and state which objective(s) | No | The Proposer believes that P135 will provide more appropriate signals, via imbalance prices, for parties to contract forwards to avoid SBP exposure. This is claimed to better facilitate applicable BSC objective (b).<br><br>Since the system prices are only calculated after the end of a Settlement Period and because a period of demand reduction is expected to be only a few Periods in duration, P135 does not send price signals in sufficient time for the market to respond by forward contracting. The timescales to communicate imbalance prices would be further extended since it is proposed to implement P135 through a manual workaround.<br><br>SBP's in excess of £300/MWh already provide sufficient incentive to Parties not to be intentionally short. P135 imposes an excessively punitive retrospective penalty on Parties who were unable to balance, especially generators who happen to trip during a period of demand reduction. The increased financial |

| Q | Question | Response | Rationale |
|---|---|---|---|
| | | | risk is more likely to lead to portfolio generators hoarding capacity in order to self-balance. This would have the reverse effect of the modification's stated intent.<br><br>For these reasons, we do not believe that P135 better facilitates the achievement of applicable BSC objective (b). |
| 2. | Does P135 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure?<br>Please give rationale | Yes | The issues surrounding credit cover have been highlighted in the Urgent Mod Report (1.3.10) but no further consideration is planned. Given the high risk of a number of Parties going into Credit Default if extremely penal SBP's are applied, and the domino effect this may have on other Parties if contracts are disapplied, we believe this matter should be given greater consideration.<br><br>Consideration should be given to the possibility of interactions between an NGC demand control period and a Transco invoked gas interruption affecting CCGT plant. |
| 3. | Do you believe there to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | YES | If NGT are concerned that insufficient generation capacity is available to meet demand this Winter then should they not consider the introduction of a capacity payment which reflects the supply margin? |
| 4. | Are there any further comments on P135 that you wish to make? | No | |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 5. | Do you believe either or both of options (a) and (b) to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | YES | Although we do not support P135 we believe that both may be considered as potential Alternative Mods.<br><br>Option (a) addresses the high risk to generators offering into the BM during periods of demand reduction and, by encouraging participation in the BM better facilitates applicable BSC objective (b).<br><br>Option (b) simply aims to make the calculation of SBP less wrong. Neither P135 or Option (b) yield a "correct" price so we do not believe this option facilitates applicable BSC objective (b) better than the original mod. |
| 6. | Are there any other options that you believe may form an Alternative Modification? | YES | See response to Q3 on original proforma. |
| 7. | Are there any further comments on the options comprising a potential alternative to P135 that you wish to make? | No | |

**P135_URGENT_008 – Gaz de France**

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|---|---|
| **Respondent:** | *Rob Watson* |
| **No. of BSC Parties Represented** | *1* |
| **BSC Parties Represented** | *Gaz de France Marketing limited* |
| **No. of Non BSC Parties Represented** | *0* |
| **Non BSC Parties represented** | N/a |
| **Role of Respondent** | *Supplier* |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 1. | Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives?<br>Please give rationale and state which objective(s) | No | The current pricing methodology delivered by modification proposal P78 has had significant impact on the prices to which parties out of balance are exposed. This methodology has yet to be tested during a winter peak maximum demand situation however has delivered high prices and additional volume, and therefore one would assume 'the correct pricing signals', during several instances this summer when NGC issued a series of Notice of Insufficient System Margin warnings.<br><br>Ofgem stated in their P78 decision letter of 9th September 2002 that the P78 proposal would 'increase the level of competition by encouraging Parties to trade ahead of Gate Closure', whilst NGC stated that 'it had not experienced any adverse effects on the behaviour of market participants since the changes to BRL and Gate Closure and that the proposed change to Energy Imbalance Prices on 25th February 2003 presented no operational concerns'.<br><br>Proposed modification P135 would introduce significant market risk regarding the increased potential for generation reserve to be withheld by portfolio players from the market to mitigate against potential supply side shortfalls. |
| 2. | Does P135 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure?<br>Please give rationale | Yes | The assessment to date has not provided sufficient comfort with regard to the increased credit cover requirements to provide for extreme prices up to a maximum of £99,999.99. |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 3. | Do you believe there to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | Yes | NGC has the ability to ensure sufficient plant margin provisions via several products available to them pre gate closure, including ensuring inclusion of the pre arranged demand side reductions by Industrial and Commercial consumers. NGC forecast system requirements and are thus best placed and suitably incentivised to ensure adequate levels of system margin are made available. |
| 4. | Are there any further comments on P135 that you wish to make? | Yes | This proposed modification has been submitted at a time when we are received a variety of messages from NGC. On the one hand we have recently heard from the NGC proposer of this modification that there are indications of potential system margin problems this winter whilst recent press releases by the same company state that there are no predicted problems for this winter. Some consistency is required here to ensure that the message to the market is accurate and clear. Either there is a potential problem or there isn't.<br><br>NGC are in the privileged position of being central to the whole process and therefore should take responsibility, as their incentive scheme provisions require, ensuring that all avenues, including those solutions provided by the demand side have been thoroughly investigated.<br><br>In the light of this uncertainty we would not be supportive of a move towards marginal pricing and all the uncertainty such provisions would subsequently introduce. |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 5. | Do you believe either or both of options (a) and (b) to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | NO | We do not support a move to marginal pricing. |
| 6. | Are there any other options that you believe may form an Alternative Modification? | Yes | See previous response |
| 7. | Are there any further comments on the options comprising a potential alternative to P135 that you wish to make? | Yes | See previous response |

**P135_URGENT_009 - Innogy**

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|---|---|
| **Respondent:** | Shona Watt |
| **No. of BSC Parties Represented** | 9 |
| **BSC Parties Represented** | Innogy plc, npower Limited, NP Cogen Trading Limited, Innogy Cogen Limited, npower Direct Limited, npower Northern Limited, npower Yorkshire Limited, Npower Yorkshire Supply Limited, Npower Northern Supply Limited |
| **No. of Non BSC Parties Represented** | N/A |
| **Non BSC Parties represented** | N/A |
| **Role of Respondent** | Supplier/Generator/ Trader / Consolidator / Exemptable Generator |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 1. | Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives?<br>Please give rationale and state which objective(s) | ~~Yes~~ / **No** | We do not believe that the proposed modification better facilitates either:<br>The applicable BSC objective (b) the efficient, economic and co-ordinated operation by the Transmission Company of the Transmission System; or<br>The applicable BSC objective (c) the promotion of effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity.<br>for the following reasons:<br><br>Although we would agree that a marginally determined price would produce a more efficient signal for parties to better manage their risks of imbalance, the remote probability of a demand control event will result in the pricing signal being hugely blunted in influencing the contracting strategies of parties. Rather than producing an efficient outcome it will merely introduce additional cost by causing parties to hold additional reserve unnecessarily for much of the year.<br><br>Furthermore unless the volume delivered through Demand Control is included in the NIV the marginal |

| Q | Question | Response | Rationale |
|---|---|---|---|
| | | | price determined would not reflect correctly the marginal resource cost, thus distorting the management of the associated risk. Distributors have an obligation to advise NGC of the power reduction delivered by a demand control action immediately after the event so the volumes could be readily included.<br><br>If the effect of demand control is not incorporated in a Supplier's imbalance then it could have the consequence of increasing the exposure to System Sell Price, and thus reduce the incentive on Suppliers to take proper account of possible shortages ahead of Gate Closure. |
| 2. | Does P135 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure? Please give rationale | **Yes** / ~~No~~ | Demand control gives NGC an option that is not taken into consideration in their Incentive Scheme, nor does it provide any consideration to those providing the service. Without an appropriate method of valuing Demand control actions, an efficient economic choice between demand control and the procurement of additional reserve cannot be made. |
| 3. | Do you believe there to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | **Yes** / ~~No~~ | P135 is predicated on the idea that imbalance prices driven by unlikely and short term balancing actions taken by the SO will influence electricity market prices. The structural separation in NETA of SO balancing actions from the half hourly energy market makes it unlikely that modifying the calculation of imbalance prices during demand control periods will ever create this linkage. However, we have expressed elsewhere the view that a consideration of P135 should also embrace the volume effect of demand control as well as ascribing a price to the demand side response brought about by a demand control action. |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 4. | Are there any further comments on P135 that you wish to make? | **Yes** / ~~No~~ | Energy prices can only impact on the half-hourly energy market. Demand control, if it were to occur, would be in the context of post Gate closure, within settlement period balancing actions by the SO, and thus effectively be a source of reserve. The development of a liquid and transparent reserve market in which National Grid is obliged to procure adequate reserve would help ensure that Demand Control will only occur when the marginal cost of reserve was greater than the loss of load cost to the customer whose supply was interrupted. |
| 5. | Do you believe either or both of options (a) and (b) to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | – NO<br>- YES | Option (a) :<br>This option seeks to change Bid and Offer cashflows rather than the calculation of Imbalance prices. Consequently it does not address the same defect as the original modification and is not therefore a valid Alternative.<br><br>Option (b):<br>This option recognises that any volume delivered through Demand Control should be accounted for within the calculation of the Net Imbalance Volume (NIV) and thus gives a more accurate calculation of the relevant energy imbalance price. Consequently we believe that this does address the same defect, and is better at addressing the BSC Objectives than P135.<br><br>However, we believe that P135 is flawed for the reasons outlined in our main response and it remains so even with the inclusion of either or both of the above options. |
| 6. | Are there any other options that you believe may form an Alternative Modification? | YES | See answer to Q3 in response to main P135 consultation. |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 7. | Are there any further comments on the options comprising a potential alternative to P135 that you wish to make? | NO | |

**P135_URGENT_010 – Scottish Power**

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|---|---|
| **Respondent:** | *Name* Man Kwong Liu (SAIC Ltd) |
| **No. of BSC Parties Represented** | 6 |
| **BSC Parties Represented** | *Please list all BSC Parties responding on behalf of (including the respondent company if relevant).*<br>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** | |
| **Non BSC Parties represented** | *Please list all non BSC Parties responding on behalf of (including the respondent company if relevant).* |
| **Role of Respondent** | Supplier / Generator / Trader / Consolidator / Exemptable Generator / Party Agent |

| **Q** | **Question** | **Response** | **Rationale** |
|---|---|---|---|
| 1. | Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives?<br>Please give rationale and state which objective(s) | ~~Yes~~ / No | While we agree with the principle of sending clearer price signals to the market which would better facilitate the BSC objective (b) *"the efficient, economic and co-ordinated operation by the Transmission Company of the Transmission System",* we believe that this is unlikely to happen with this modification in its present form. P135 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 at all due to the potentially damaging imbalance charges associated with unexpected plant failure.<br>Acceptance of the modification in its present form would greatly increase the risk of generators going out of business and also significantly increase the cost to participants in managing the risk exposure. P135 in its present form therefore would not better facilitate the BSC Obj (c) – "*promote competition…".*<br>It would also seem pertinent to take an appropriate length of time in order to fully understand the implications of the proposed changes. |
| 2. | Does P135 raise any issues that you | YES / ~~NO~~ | The current modification requires further research and development especially in the areas |

| Q | Question | Response | Rationale |
|---|---|---|---|
| | believe have not been identified so far and that should be progressed as part of the Assessment Procedure?<br>Please give rationale | | of security of supply and incentivising participants to balance at Gate Closure. In particular, treatment of post Gate Closure plant loss needs to be addressed as imbalance settlement does not take place at Gate Closure, but some time later. Unless this is recognised and considered appropriately, generators would not be encouraged to provide any potential spare capacity to meet peak demand. |
| 3. | Do you believe there to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | YES / ~~NO~~ | We believe an alternative, which would encourage generators to offer any potential spare capacity is required. Specifically, treatment of post Gate Closure plant loss needs to be addressed, as currently participants are prohibited from adjusting their position to maintain the balance, which they had achieved at Gate Closure. In this situation, either the shortfall should be treated as system balancing and removed from the price calculation or the generator should be able to self-balance after Gate Closure. |
| 4. | Are there any further comments on P135 that you wish to make? | Yes / ~~No~~ | As stated above, the modification aims to send clearer price signals to the market in order to provide sufficient incentive to contract in the forwards market but the risks associated with marginal imbalance charges could negate this effect.<br>In our previous responses on pricing Mods (P34/36, P74/78), we indicated concern that pricing modification proposals did not undergo a more thorough analysis because of their expeditious treatment. We also identified valid reasons why further analysis requires to be undertaken. We believe now that our argument for a more thorough consideration of the issues relating to imbalance pricing has been given more credence in the numbers of alternatives and mod proposals (P136/137/138) raised. We believe (as it was our view then) that the Pricing Standing Modification Group could have assessed all the relevant issues first and present a holistic solution to the problems identified. In our view, this would provide a more efficient and cost-effective method of dealing with market participants' concerns than the current piecemeal approach, which leads to greater uncertainty in the market. |
| 5. | Do you believe either or both of options | YES / ~~NO~~ | We do believe that both options (a) and (b) are potential alternatives to P135 in that they |

| Q | Question | Response | Rationale |
|---|---|---|---|
| | (a) and (b) to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | | further extend the proposed solution to the identified defect, but our fundamental objections, as detailed in our response to P135 Proposed Modification Urgent Report Consultation, remain the same.<br>Even with these amendments, P135 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 at all due to the potentially damaging imbalance charges associated with unexpected plant failure.<br>Acceptance of either of these proposed alternatives or the original 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. |
| 6. | Are there any other options that you believe may form an Alternative Modification? | YES / ~~NO~~ | We believe an alternative, which would encourage generators to offer any potential spare capacity is required. Specifically, treatment of post Gate Closure plant loss needs to be addressed, as currently participants are prohibited from adjusting their position to maintain the balance, which they had achieved at Gate Closure. In this situation, either the shortfall should be treated as system balancing and removed from the price calculation or the generator should be able to self-balance after Gate Closure. |
| 7. | Are there any further comments on the options comprising a potential alternative to P135 that you wish to make? | Yes / ~~No~~ | We have previously indicated concern that pricing modification proposals did not undergo a more thorough analysis because of their expeditious treatment.<br>We again reiterate that concern and would encourage the Pricing Standing Modification Group to assess all the relevant issues first and present a holistic solution to the problems identified. In our view, this would provide a more efficient and cost-effective method of dealing with market participants' concerns than the current piecemeal approach, which leads to greater uncertainty in the market. |

**P135_URGENT_011 – Barclays Capital**

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| **Respondent:** | Barclays Capital |
| **No. of BSC Parties Represented** | 1 |
| **BSC Parties Represented** | Barclays Capital |
| **No. of Non BSC Parties Represented** | None |
| **Non BSC Parties represented** | None |
| **Role of Respondent** | Trader |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 1. | Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives?<br>Please give rationale and state which objective(s) | YES | Marginal cash-out pricing sends the correct economic signal of the opportunity cost of balancing the system. The correct balancing incentive is sent to market participants when they face the opportunity cost of procuring energy to meet their imbalance at the margin. The current averaging rule dilutes this incentive, since – at the margin – additional imbalances are only charged at the (average) price which will be below the cost of procuring the additional imbalance energy. The result is an inefficient incentive to balance. This effect is particularly pronounced at times of generation shortage, when the cost of procuring additional balancing energy can significantly exceed the average cost. By introducing marginal pricing at times of demand control, P135 will improve the incentives to balance at these times. Under P135 this improved incentive effect is limited to those periods in which demand control occurs (or is believed likely to occur). However, even a partially applied improvement in balancing incentives still represents an improved incentive overall. This will improve competition in the generation and supply of electricity, by ensuring |

| Q | Question | Response | Rationale |
|---|---|---|---|
| | | | that pricing at times of expected generation shortage – and consequently forward market prices associated with those periods – better reflect the underlying fundamentals of supply and demand. |
| 2. | Does P135 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure?<br>Please give rationale | NO | |
| 3. | Do you believe there to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | YES | There is a potential anomaly with P135 in those circumstances where the bid stack exceeds the offer stack. In our view this anomaly is unlikely to occur. Nevertheless, including a proxy for the volume associated with demand control in the offer stack would ensure that the system cannot "flip" to being long once demand control has been invoked and improve the robustness of P135. Given the unlikely nature of the anomaly, however, this should only be considered a valid alternative if it does not jeopardise the implementation of P135 in time for this Winter. |
| 4. | Are there any further comments on P135 that you wish to make? | YES | While P135 covers a (hopefully) unlikely contingency and may therefore have a limited effect, qualitatively P135 provides a more efficient incentive to balance in those periods to which it applies. In our view, this renders many of the counterarguments to P135 outlined in the Draft Modification Report invalid and, in particular:<br><br>any impact on credit is consequential and should not drive the decision on whether or not to accept P135;<br>even a diluted, partial signal will provide stronger incentives than the current baseline to ensure that participants are not short when generation |

| Q | Question | Response | Rationale |
|---|---|---|---|
| | | | is scarce and demand control becomes likely. Even if it were true that the signal is weak and may come too late to effect major changes to plant availability, these are arguments for the broadening of marginal pricing rather than arguments against the adoption of P135.<br>the likelihood of prices being set by "sleeper" offers has been overstated given that dynamic parameters can be used to prevent offers being accepted;<br>while trip risk will increase, this should be reflected in generator's offers in the balancing mechanism rather than there being a binary decision between running or not running a unit. When demand control is imminent or likely this may mean that BM offers and cash-out prices rise to very high levels. However, this can be seen as an efficient market response to generation scarcity.<br><br>Arguments suggesting that it is inappropriate to incentivise supplier "length" at times of shortage (and that the incentive should be to "balance" rather than to be long or short) are also completely misleading. SBP cash-out penalties only apply to those suppliers who – in actuality – do not buy enough power to meet their customers requirements, ie, if they are short not long. Arguments surrounding the incentive to "balance" therefore swing on an implied notion of what is an appropriate forecast of one's customers requirements, eg, that suppliers should only be required to meet the average expectation of their customers' demand. In truth, suppliers should aim to buy sufficient to meet their customers' actual demand. Given uncertainty on the actual level of demand, suppliers therefore face a trade off between the cost of procuring more energy in advance and the expected cash-out penalty (ie, the expected level of cash-out multiplied by |

| Q | Question | Response | Rationale |
|---|---|---|---|
| | | | the probability of imbalance). When generation is scarce and any imbalance is likely to be very expensive, it becomes economically efficient for suppliers to buy more electricity to reduce the probability of being short. Similarly, when there is a surplus of generation, suppliers have a weakened incentive to avoid being short. In summary, the incentive to "balance" can only be relative to the size and likelihood of the cash-out penalty and there is no verifiable sense in which an absolute incentive to "balance" can apply. |
| 5. | Do you believe either or both of options (a) and (b) to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | YES | Alternative (b) would remove the potential anomaly whereby the bid stack exceeds the offer stack at times of demand control. In our view this anomaly is unlikely to occur. Nevertheless, including a proxy for the volume associated with demand control in the offer stack would ensure that the system cannot "flip" to being long once demand control has been invoked and improve the robustness of P135. Given the unlikely nature of the anomaly, however, this should only be considered a valid alternative if it does not jeopardise the implementation of P135 in time for this Winter.<br><br>Alternative option (b) is not a potential alternative to P135 because it would not better facilitate the applicable BSC objectives. Paying all offer acceptances the marginal price would render the participant making the offer neutral to the delivery on the offer. While this would reduce trip risk, it also raises the possibility of spurious offers being submitted on the off-chance that a participant ends up spilling into cash-out. For example, a supplier may submit a very high priced offer to turn down demand with no intention of delivering a physical response to back up that offer. If the offer is accepted, they would be neutral to non-delivery (ie, if they do not turn down demand). However, if their customers' demand turns out to be |

| Q | Question | Response | Rationale |
|---|---|---|---|
| | | | below their contractual purchases, they would be deemed to have delivered on the offer at the high (marginal) price. This could result in spurious offers to NGC which would jeopardise the efficient balancing of the transmission system. It would also lead to offers which bear no relationship to the underlying costs, distorting the marginal price which would undermine competition in the generation and supply of electricity by sending price signals which do not reflect the underlying marginal costs. |
| 6. | Are there any other options that you believe may form an Alternative Modification? | NO | |
| 7. | Are there any further comments on the options comprising a potential alternative to P135 that you wish to make? | NO | |

**P135_URGENT_012 – AEP Energy Services**

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|---|---|
| **Respondent:** | Ruediger Schils |
| **No. of BSC Parties Represented** | 2 |
| **BSC Parties Represented** | AEP Energy Services Ltd / AEP UK Generation Ltd |
| **No. of Non BSC Parties Represented** | 0 |
| **Non BSC Parties represented** | |
| **Role of Respondent** | Generator/ Trader |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 1. | Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives?<br>Please give rationale and state which objective(s) | **No** | AEP do not believe that the proposed modification better facilitates the achievement of any of the relevant objectives. If implemented, the proposed modification would make fundamental changes to the way that imbalance prices are calculated in the event of a market shortage.<br><br>Evidence from operation of the market to date suggests that the current imbalance price arrangements provide very strong incentives for suppliers to contract to meet their forecast demand even during periods of severe weather and very high demand when shortages may occur. The market has consistently been long pre-gate closure since the new arrangements were put in place. Last winter, during the day of peak demand, suppliers were fully contracted.<br><br>Based on the consistent evidence that suppliers respond to these incentives and contract to meet peak demand the main effect of any change to imbalance prices will be on generators. If suppliers are fully contracted, generators face exposure to imbalance prices in the event of a forced outage. The proposal should therefore be assessed in the light of its impact on generator behaviour and incentives.<br><br>The modification proposal would have a significant impact on the forced outage risks faced by generators during periods where supply margins are tight. Specifically, the modification proposal would significantly increase the price risk faced by generators when assessing their forced outage risk this winter.<br><br>Given the proposed timetable for implementation, there is limited (if any) scope for generators to take any actions in the market to mitigate these additional risks. There is no market available to insure forced outage risks and it would not be possible to develop such a market given the limited remaining time ahead of this winter when it is proposed that the modification is implemented. |

| Q | Question | Response | Rationale |
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| | | | As suppliers are hedged, all generators will have forward sold a significant portion of their planned output this winter. Generators will therefore be unable to command any additional premium to offset the additional forced outage risks they face.<br><br>If the modification were implemented, generators would be faced with significant additional financial risk from outages without any additional financial reward. As a consequence it is more likely than under the current rules that generators withdraw capacity from the market. Under the current pricing arrangements, a generator facing a high probability of outage (e.g. as a result of a known fault going into the day) on a peak day would seek to manage this risk by buying in any hedges associated with its output and then offering its generation in the balancing mechanism. If the proposed modification were made, a generator facing the same situation would either offer at significantly higher prices (based on the generator's assessment of the likely marginal offer price) or not offer at all.<br><br>This is because the generator would face the risk of being exposed to a system buy price based on the marginal offer accepted (in the event of a shortage) if the generator has an offer accepted and then subsequently trips and is unable to deliver.<br><br>Based on market experience to date (and existing sleeper offers) generators would be likely to assess the marginal offer price as £99999/MWh and to cluster their offers around this price. As a result, the modification could lead to the withdrawal of generation during periods of peak demand when margins are tight or to significantly higher balancing prices and costs. The modification proposal would not, therefore, better facilitate the achievement of the relevant objective of the efficient and economic operation<br>of the transmission system. |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 2. | Does P135 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure?<br>Please give rationale | Yes | The modification group has considered whether the proposal would incentivise Parties to further balance ahead of Gate Closure. Before considering this issue, AEP believe that Elexon should analyse whether there is any need for the existing incentives to be strengthened. AEP believe that the existing incentives provide sufficient incentive to balance.<br><br>Elexon should also consider the issue of how generators would be likely to price offers if the proposal is implemented and the effect of any change in generators' behaviour on balancing costs.<br><br>Elexon should consider the potential impact of the modification on the reallocation of cash flows under the mechanism. If offers are paid as bid but imbalances are cashed out at the marginal price it is likely in the event of a shortage that there would be a significant positive cash surplus from imbalance. Elexon need to analyse the potential for this to occur and the potential impact of reallocating this surplus on competition.<br><br>Finally, Elexon should consider whether it is feasible for the market to develop risk management and insurance products given the proposed timetable for implementation.<br><br>AEP would also emphasise the following issues that have been identified:<br><br>the potential significant impact on credit cover requirements for all market participants raising costs to the industry and customers. This should be quantified.<br>the proposal would **not**, on the balance of probabilities, improve security of supply. Given the timetable, generators cannot mitigate the additional risks and so would be more likely to withhold capacity to manage the increased risk of forced outage. |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 3. | Do you believe there to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | **Yes** | AEP does not believe that a modification should be made ahead of this winter for the reasons outlined above.<br><br>If, however, a modification is made then AEP believes that alternative proposal (a) is preferable to P135 for the reasons outlined in our response to the P135 Addendum consultation. |
| 4. | Are there any further comments on P135 that you wish to make? | **Yes** | AEP is surprised that NGC has raised a proposal that would make such a significant change to the market so close to winter. NGC's concerns were first raised earlier in the year. Had NGC raised a proposal earlier in the year it would have given the industry and customers time to identify whether there is a problem and to develop a robust solution. It would also have allowed the market and companies to plan for any change and for new markets/products to be developed ahead of this winter.<br><br>If NGC believes that there is an issue this winter then AEP believe that it would be more efficient for NGC to procure additional reserve (from generation and the demand side) than to force through a poorly designed rule change at short notice. AEP notes that recent press reports suggest that NGC has been looking to sign reserve contracts with large demand-side participants. AEP believes that this approach would be more cost effective and would provide a more certain outcome than the proposed rule change. |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 5. | Do you believe either or both of options (a) and (b) to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | No | AEP does not believe that a modification should be made ahead of this winter for the reasons outlined above. For the reasons outlined in our response to P135 AEP does not believe that any modification would better facilitate the achievement of the relevant objectives.<br><br>If, however, a modification is made then AEP believes that alternative proposal (a) is preferable to P135 |
| 6. | Are there any other options that you believe may form an Alternative Modification? | No | |
| 7. | Are there any further comments on the options comprising a potential alternative to P135 that you wish to make? | Yes | The alternative proposal (a) would mitigate some of the additional risk that generators would face if a rule change is made this winter.<br><br>Under the alternative proposal (a) generators would not be forced to withhold capacity or to offer in the balancing mechanism at very high prices based on expectations of the marginal offer.<br><br>As generators would be paid as bid, a generator who faces a significant risk of a trip could offer at marginal cost. Under the proposal, the generator would not face the risk of exposure to the difference between its offer price and the marginal price in the event of a subsequent trip.<br><br>As option (b) does not address this fundamental asymmetry, AEP believes that option (a) is preferable to option (b). |

**P135_URGENT_013 – energywatch**

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|---|---|
| **Respondent:** | Lesley Davies |
| **Non BSC Parties represented** | energywatch |
| **Role of Respondent** | Gas and electricity consumer watchdog |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 1. | Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives?<br>Please give rationale and state which objective(s) | No | energywatch does not consider that P135 would better facilitate the relevant BSC objectives (b) and (c).<br><br>*(b) The efficient, economic and co-ordinated operation by the Transmission Company of the Transmission System*<br>energywatch is not persuaded that P135 is the appropriate mechanism to address potential generation shortages this coming winter. energywatch recognises that there are other mechanisms open to NGC to ensure that generation meets demand over the peak including negotiation of interruptible demand contracts or balancing contracts with generation.<br>energywatch is concerned that P135 may create perverse incentives. For example generators may withhold generation from the market at times of system stress to guard against the risk of trip.<br><br>*(c) The promotion of effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity*<br>A number of industrial and commercial consumers have expressed concern to energywatch about P135 (and the subsequent modifications seeking to introduce marginal pricing) and the cost implications it could have for customers as a consequence of increased commercial risk of imbalance. The modification is likely to have greater impact on independent parties who are not vertically integrated and could potentially hasten their exit from the market. The increased commercial risk raises barriers to new entry. |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 2. | Does P135 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure? Please give rationale | No | |
| 3. | Do you believe there to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | No | However, please see previous comments on alternative mechanisms open to NGC to ensure there is sufficient generation to meet demand. |
| 4. | Are there any further comments on P135 that you wish to make? | Yes | Security of supply is of prime importance to consumers and to energywatch. We recognise that forecast supply margins for this winter are tighter than last winter and that NGC has raised concerns at the modification group about potential shortfalls this winter. However, we also note that NGC has recently said publicly that they forecast there to be enough generation to meet demand at all times during the winter and that there are no problems with power supplies this coming winter. It is essential that a consistent message is presented to the market and consumers. |
| 5. | Do you believe either or both of options (a) and (b) to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | No | |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 6. | Are there any other options that you believe may form an Alternative Modification? | No | |
| 7. | Are there any further comments on the options comprising a potential alternative to P135 that you wish to make? | No | |

**P135_URGENT_014 – NGT**

| | |
|---|---|
| **Respondent:** | *National Grid Transco* |
| **No. of BSC Parties Represented** | *1* |
| **BSC Parties Represented** | *National Grid* |
| **No. of Non BSC Parties Represented** | *0* |
| **Non BSC Parties represented** | |
| **Role of Respondent** | *BSC Party* |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 1. | Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives?<br>Please give rationale and | Yes | Marginal imbalance prices provide an undiluted signal to the market as to the underlying cost of supplying the last increment of energy required to balance generation and demand. It is particularly important that imbalance prices provide appropriate signals in times of energy shortage, as weakened signals could threaten security of supply. By providing more appropriate price signals to the forward markets, Market Participants will be incentivised to contract forward in order to mitigate the risk of not being able to balance at Gate Closure. This will reduce the likelihood that Demand Control measures will be required |

| Q | Question | Response | Rationale |
|---|---|---|---|
| | state which objective(s) | | this winter and will help to ensure security of supply. In this respect the modification proposal will better facilitate the applicable BSC objective (b) the efficient, economic and co-ordinated operation by the Transmission Company of the Transmission System. |
| 2. | Does P135 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure?<br>Please give rationale | No | The consultation document covers all the issues that should be considered in assessing this Modification Proposal. |
| 3. | Do you believe there to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | No | P135 was raised to address a defect in the calculation of imbalance prices and **not** to address other perceived defects caused by involuntary Demand Control. The scope of P135 was deliberately restricted to apply **only** in specific circumstances, (i.e. Demand Control) in order that a solution could be implemented in time for this winter. NGT has raised Modification Proposal P136 which proposes an enduring solution to the same defect as P135, but applying in all Settlement Periods. |
| 4. | Are there any further comments on P135 that you wish to make? | Yes | See below |

As Proposer of P135, NGT welcomes the opportunity to respond to this consultation and provide some rationale as to why this Modification Proposal was raised, as well as responding to some of the specific issues raised during the assessment of P135.

**1. Rationale behind P135**

The current averaging methodology employed in the calculation of the 'Main' Energy imbalance price understates the underlying marginal cost of balancing energy. It is our view that this understatement sends inappropriate signals to the forward markets. In times of energy shortage this threatens security of supply as understated imbalance prices do not provide the appropriate incentives for Participants to contract forward sufficiently to ensure a balanced position during these times. P135 has been raised in order to address this defect, but due to concerns regarding security of supply this winter, the scope of the proposed solution was limited to periods when Demand Control was activated due to there being insufficient generation available to meet demand. By limiting the scope of the solution to these times, although only addressing a subset of circumstances, we believe P135 will provide incentives for participants to contract forward during times when Demand Control is more likely to occur (e.g. periods of peak demand) thus making those occurrences less likely. In the longer term, P136 has been raised to address the same defect by proposing an unlimited enduring solution. Clearly, although P136 provides a fuller solution to the defect, it cannot be implemented in time to assist in ensuring security of supply this winter and therefore we firmly believe that P135 is appropriate.

**2. Specific Issues Raised During Assessment**

The material in the consultation document contains our views on the issues raised during the assessment of P135. However, there are some key points which we believe require further clarification

**2.1 Non-Treatment of unsupplied volume**

The current BSC baseline does not provide for the treatment of 'unsupplied' energy, or reduced energy consumption, due to involuntary demand reduction of any sort. P135 is not aimed at addressing this issue, and we note that this is part of the perceived defect which P138 has been raised to address. By not compensating for this energy in the calculation of market length, in order to determine which imbalance price is the 'main' price, there is the theoretical potential for SSP to be the 'main' price (i.e. by not accounting for demand reduction this makes the market "look" long when it isn't). However, we believe that in most credible circumstances, leading up to the requirement for Demand Control the majority of balancing actions would be in the buy direction and as such SBP would be the 'main' price. Even during a Demand Control event, (which may last for more than one Settlement Period) it does not follow that only Bids will be accepted to reduce generation to meet a reduced demand level, as:

- Offers will continue to be accepted to maintain generation at the level achieved prior to Demand Control;

- Demand Control may not cause demand to drop below the level seen prior to Demand Control as there is 'unsupplied' Demand (i.e. the portion that could not be met) to account for.

Hence we believe that during Demand Control, SBP would be the main price – i.e. the market would remain short.

A second issue stemming from the non-treatment of reduced energy consumption (resulting from any form of demand reduction) relates to the effect of Demand Control on the imbalance position of suppliers. A supplier in a GSP Group where Demand Control was instructed will have their metered consumption reduced which will change their imbalance position. If a supplier was short, they will become "less short". If a supplier is long, they will become "longer". This defect is present in the current BSC baseline and P135 is not aimed at addressing it. We note that P138 has been raised which will do this. Given that Demand Control is only likely to be instigated in one or two GSP groups (groups will not be known to suppliers ahead of time) and this altered imbalance position only affects a small subset of supplier volumes, this does not pervert the incentive on suppliers to avoid Demand Control.

### 2.2 Other Forms of Demand Control

There is another form of involuntary demand reduction, other than 'Demand Control' as defined in the Grid Code and used in P135. In the event of prolonged energy shortage an Electricity Supply Emergency can be called by the Secretary of State and demand reduction through rota disconnection can be invoked via the Electricity Supply Emergency Code (ESEC). During these extreme situations, which are only likely to be caused by a significant shortage of fuel or some other national emergency, contingency arrangements currently apply for the calculation of imbalance prices and for the avoidance of doubt P135 will not apply. P135 does apply to situations when Demand Control is used to maintain control and integrity of the transmission system due to the inability to meet a relatively small and short-lived demand peak. We believe that Market Participants should contract to cover such peak demands under normal circumstances (i.e. not ESEC) and that P135 enhances the incentives on Participants to do this, hence making Demand Control less likely to be required.

### 2.3 The Marginal Price

The maximum Offer price that can be submitted into the Balancing Mechanism is £99,999/MWh. Parties may be using this level of Offer price to indicate that this Offer is not really available. There are other parameters that a party can, and should, use to indicate that they do not wish to have an Offer accepted (MEL for generators, NTO for Demand Side) which make the Offer infeasible. Thus only 'real' Offers which are feasible will be accepted in the Balancing Mechanism prior to invoking Demand Control, suggesting that the marginal price will not automatically be £99,999/MWh. The pricing strategy adopted by a BM participant is their commercial decision and P135 does not change this.

**3. Summary of views**

An averaging methodology for the calculation of the 'main' energy imbalance prices understates the underlying marginal cost of providing balancing energy. This sends diluted price signals to the forwards markets and does not provide appropriate incentives for Participants to contract sufficiently to meet the demand requirements of their customers. During times of energy shortage this threatens security of supply.

NGT believes that P135 will incentivise Participants to ensure they are sufficiently contracted to meet the demand requirements of their customers, and avoid Demand Control being necessary. This will help to ensure security of supply this winter.

P135 aims to address the described defect in the calculation of imbalance prices and does not address a perceived defect relating to the non-treatment of unsupplied and reduced demand volume (as a result of Demand Control) within the BSC. However we do believe that this perceived defect does not have a significant effect on the incentives promoted by P135.

P135 does not apply in extreme situations of prolonged energy shortage when government intervention occurs. Contingency arrangements apply in these circumstances.

Only feasible Offers will be accepted in the Balancing Mechanism prior to Demand Control. The market will determine the marginal price of providing balancing energy. It will not automatically be £99,999/MWh.

| | | | |
|---|---|---|---|
| 5. | Do you believe either or both of options (a) and (b) to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | NO | This option changes the payment mechanism for Offers in the Balancing Mechanism rather than the energy imbalance price. This could incentivise generators to withhold plant until the balancing mechanism in an attempt to receive greater payment for accepted Offers, reducing the incentive to contract forward. It also has the potential to remove incentives on generators to deliver Offers accepted in the Balancing Mechanism, as they would be neutral to non-delivery. We believe that this option addresses a different perceived defect from P135 and therefore cannot form part of a valid Alternative Modification.<br>Determining the volume reduced by Demand Control could be problematic. In accordance with Grid Code OC6, LDSO's notify NGC of "an estimation of Demand reduction or restoration achieved". Unless a Grid Code change is made to require LDSO's to estimate energy volume reduced in each |

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|---|---|---|---|
| | | | half hour, a process will need to be developed to estimate the reduced energy volume in each half hour, with very limited information from the LDSO on which to base this estimate. The Treatment of unsupplied and reduced demand volume (as a result of Demand Control) is not catered for in the BSC and P135 was not raised to consider this perceived defect. We note that P138 has been raised with the intention of considering this perceived issue.<br><br>P135 is a Modification Proposal concerned with the imbalance price calculation methodology in section T of the BSC. We believe it would be wholly inappropriate for any Alternative to be considered which does not address the same defect as P135. In summary, it is our view that neither options a) or b) should form part of an Alternative Modification to P135 as they are both aimed at addressing different defects. |
| 6. | Are there any other options that you believe may form an Alternative Modification? | NO | |
| 7. | Are there any further comments on the options comprising a potential alternative to P135 that you wish to make? | NO | |

**P135_URGENT_015 – British Gas Trading**

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|---|---|
| **Respondent:** | Mark Manley |
| **No. of BSC Parties Represented** | |
| **BSC Parties Represented** | British Gas Trading (BGT) |
| **No. of Non BSC Parties Represented** | |
| **Non BSC Parties represented** | |
| **Role of Respondent** | |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 1. | Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives? Please give rationale and state which objective(s) | No | BGT do not support the modification and do not believe it will better facilitate the Applicable BSC Objectives.<br><br>Firstly, there has been a strong indication from members of the modification group, and it is a view that BGT concur with, that marginal pricing will lead to excessive length in the market. Furthermore this will not achieve the proposer's intention of increasing the amount of generation available to the System Operator (SO). All Parties holding their own capacity can be seen as being inefficient, as inappropriate levels of reserve will be held by all Parties. Therefore the modification will not better facilitate the efficient, economic and co-ordinated operation by the licensee of the licensee's transmission system.<br><br>Secondly, BGT note the concerns and agree with the views of many of the modification group that modification proposal P135 will have the opposite effect to that of the stated intention of the proposer. The effect of marginal pricing and the fear of a plant tripping and being exposed to the marginal price will encourage generators to withhold plant. Generators will part load plant and not make plant available in the BM to allow them to self-insure. This will have the effect of |

| Q | Question | Response | Rationale |
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| | | | reducing the amount of available plant for the SO in times of system stress. Furthermore generators will be less likely to push their plant to maximum output for fear of tripping and exposing the whole plant to a marginal imbalance price. Therefore the modification will not better promote competition in the generation and supply of electricity. |
| 2. | Does P135 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure?<br>Please give rationale | Yes | BGT is concerned about the timing of this proposal and the potential impact it may have. Raising an urgent modification in an area as sensitive as pricing could have far-reaching effects on BSC Parties. Furthermore as the modification does not address the specifics of how the volume is treated once a period of demand control has occurred this does not provide a complete solution. Whilst BGT note the proposer's desire to have the proposal in place for winter 2003, BGT does not agree that a partial solution will help to address the defect. |
| 3. | Do you believe there to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | No | |
| 4. | Are there any further comments on P135 that you wish to make? | Yes | The proposer states that the current average pricing methodology provides insufficient incentives for parties to contract in the forward markets to mitigate the risk of not being able to achieve a balanced position in all scenarios. Firstly, there is no evidence that this the case. Also BGT believe the existing cash out regime is working and point to the high cash out prices seen over the summer. BGT believe the existing level of cash out prices provides sufficient incentives for Parties to forward contract. Also since the implementation of P78 the average length of the market during the peak weekday hours (7am till 7pm) has been approximately 1.5GW long. This figure would suggest BSC Parties are already over contracting to satisfy their demand requirements.<br><br>Secondly, BGT do not believe that a marginal price will send appropriate signals to the market to |

| Q | Question | Response | Rationale |
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| | | | build new stations or to re-introduce mothballed plant. Generating plant was being mothballed prior to P78 implementation when the cash out regime was producing much more volatile and spiky prices. Balancing Mechanism prices did not prevent plant being mothballed then and BGT do not believe it will encourage new build or encourage the re-introduction of mothballed plant now.<br><br>BGT are supportive of the concept of suppliers forward contracting to satisfy their own demand requirements. The implication from the proposer suggests that suppliers are not forward contract sufficiently and leaving the SO to balance their position. BGT are unsure if this is in fact representative of the intended actions of suppliers or if it is a by-product of the inaccuracies of demand forecasting. Demand Forecasting is an estimate of expected usage and therefore by nature will contain errors. If the Demand Forecast has an error of 4 to 5 percent that is acknowledged as being a good forecast. If the latter is the case it seems inequitable to penalise a Party so heavily because of their demand forecast which will always contain errors. Equally if conditions do change after gate closure there is nothing a BSC Party can do to mitigate those changes for a maximum of three settlement periods.<br><br>BGT note within the report the discussion about the development of new products to cover party's exposure to extreme system buy prices. BGT do not believe that such products can be developed for actions that occur after gate closure. This will mean that parties will be helpless to react to changing circumstances and will merely be hit with a significant imbalance charge.<br><br>Within the proposer's rationale for raising P135 they state the current methodology can significantly understate the cost of the marginal balancing action, which is correct. However moving to a marginal regime will lead to substantial over recovery of BM actions. BGT are unsure why an over recovery of those actions is more appropriate than an under recovery, especially given the arbitrary nature of charging all BSC Parties at the cost of the marginal action. |

| Q | Question | Response | Rationale |
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| | | | Since NETA Go-Live all the pricing modification proposals that have been raised and approved have attempted to reduce the volatility in cash out prices and reduce the spread between the System Buy and Sell Price. However P135, P136 and 137 will reverse this trend and introduce significant volatility. BGT do not understand what has lead to this significant U-turn.<br><br>The intent of this modification proposal appears to be transference of the risk and costs of balancing the system from NGC to BSC Parties. The 10 December 2002 has been quoted by the proposer as being the closest the market has come to a period of demand control. If marginal pricing had been implemented then BSC Parties would have been faced with a cash out price of £9,999 MWh in one settlement period. This offer was accepted as a consequence of NGC under forecasting the demand by 400MW and turning a plant off at 14.30 which then did not have the dynamics to be available when it was required later in the afternoon.<br><br>Using the 10 December as an example, an 800MW plant tripped (as happened) based on the cash out price above the trip would have left the BSC Party with an imbalance cost of approximately £4 million for one settlement period. BGT do not believe that risk to be manageable for any BSC Party, BGT also believe that exposure to marginal prices could be ruinous.<br><br>BGT note within the proposed solution for P135 the potential for incorrect reporting of energy indebtedness. In view of the potential magnitude of imbalance prices under a marginal regime it is essential that the Indebtedness calculation includes the correct imbalance costs. The implication from the report is that the calculation may be based on the average weighted price as opposed to the marginal price. This could significantly understate a Party's indebtedness liabilities and result in an incorrect picture being presented to the market.<br><br>BGT note that BSCCo is exploring the possibility of being able to provide real time pricing. BGT |

| Q | Question | Response | Rationale |
|---|---|---|---|
| | | | believe it is equally important that BSC Parties have access and visibility of correct real time price reporting. It is essential for all BSC Parties that this information is made available as quickly as possible so Parties are aware of their outstanding liabilities.<br><br>BGT note the references within modification proposal P137 which states there is an artificial cap on imbalance prices due to the way option fees and BSAD are calculated. BGT believe it would be much more appropriate to be addressing these issues rather than fundamentally changing the underlying pricing mechanism. BGT believe resolution of this issue with increased transparency of NGC actions would provide both a materiality and information signal to the industry. The combination of which would allow BSC Parties to be able to respond rather than just imposing substantial and arbitrary imbalance prices. |
| 5. | Do you believe either or both of options (a) and (b) to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | No | Whilst BGT recognise that paying generators the marginal price to generate may incentivise them to be available and offer into the BM, it will not necessarily incentivise forward contracting to ensure generation meets demand. This alternative does not provide protection for the bi-laterally contracted load. BGT do not believe this alternative will provide any further incentive to forward contract.<br><br>BGT believe this proposal may have the opposite effect in that generators could choose to withhold generation and offer it into the BM rather than forward contracting. This would mean NGC would be undertaking significantly more balancing actions as suppliers maybe unable to forward contract sufficiently for their demand.<br><br>BGT does not support marginal pricing for imbalance cash out and equally does not support a move to being paid at the marginal price as opposed to pay as bid. Any move away from pay as bid introduces the possibility of gaming.<br><br>BGT note the concerns referred to in the addendum to the urgent report about the ability to |

| Q | Question | Response | Rationale |
|---|---|---|---|
| | | | create potential for false offers. This is a concern because under a marginal regime a 'false' offer could set the imbalance price. This could mean that a non-delivered acceptance sets the imbalance price. |
| 6. | Are there any other options that you believe may form an Alternative Modification? | No | |
| 7. | Are there any further comments on the options comprising a potential alternative to P135 that you wish to make? | No | |

**P135_URGENT_016 – Drax Power**

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|---|---|
| Respondent: | Ian Foy |
| No. of BSC Parties Represented | 1 |
| BSC Parties Represented | AES Drax Power Ltd |
| No. of Non BSC Parties Represented | 0 |
| Non BSC Parties represented | |
| Role of Respondent | Generator |

| Q | Question | Response | Rationale |
|---|---|---|---|
| 1. | Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives?<br>Please give rationale and state which objective(s) | No | See below |
| 2. | Does P135 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure?<br>Please give rationale | Yes | See below |
| 3. | Do you believe there to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | NO | The defect does not exist unless it is a requirement of the BSC that all demand has to be satisfied regardless of cost. |
| 4. | Are there any further comments on P135 that you wish to make? | No | |

**Summary**

P135 does not better facilitate the relevant economic objectives. It produces arbitrary costs and cash flows and attempts to interfere with the normal operations of the traded market, changing the risk profile for contracts already in place. The consequences of the mod cannot be accurately forecast in terms of security of supply or market participant reaction. It claims to be a mechanism to encourage additional capacity but in reality produces an unstable market environment that actively discourages investment.

The alternative should be rejected for the same reasons.

**Rationale**

To attempt to rush forward a mod such as this is market damaging. As can be seen from the Panel's report it is impossible to forecast what market participants will do at times of system distress.

The mod should be rejected for a number of fundamental reasons.

1. One function of the BSC cash out process is to allocate costs incurred by the SO to those who created them.

Extract from MOD P78 Decision Document –section: Ofgem's view

"Conversely, participants on whose behalf the SO has to procure the flexible delivery of electricity at short notice should pay the full cost of power delivered over short timescales."

The full cost of power delivered must be derived from the weighted average of accepted offers not the marginal offer, as this would artificially inflate the costs.

From the same document also from section Ofgem's view:

Ofgem considered an alternative modification that utilised the first non-arbitraged BOA in a stack to create a cash out price.

"However, it is possible that the first BOA could be a Bid or Offer which has been submitted in relation to a Balancing Services contract for System Balancing purposes. For these reasons, Ofgem considers that this approach could result in arbitrary reverse prices, particularly since they will be calculated from a single BOA."

The same risk of arbitrary pricing would be evident under MOD 135

2. There is no defect; if we believe the traded market is working then all participants can clearly see the value of winter capacity, if that price is too low to encourage additional capacity then participants are willing to accept the possibility of demand reductions. It is a fundamental aspect of commodity markets that shorts may exist, to artificially remove those shorts is to interfere with, and bring in to disrepute, normal market signals.

3. Cash out was never designed to be the driver of the forward curve.

4. It is arrogance for any party or individual to claim that the market price is wrong, what should the winter 03 prices be and what SBP does it relate to?

5. It comes too late. The groups at greatest risk from this mod are the generators. Total and immediate unit losses are a fact of life. Units cannot be built with 100% reliability and they certainly cannot be made so in the space of three months. It is probable that most generators already have a significant proportion of their output contracted for the winter. It is almost certain that the margin locked in is not sufficient to mitigate these extreme penalties. The balance of risk and reward for market participation should not be changed arbitrarily or at short notice.

6. Mechanisms that impose extreme penalties on generators for industry accepted and unavoidable break down rates is a disincentive to market participation.

**Issues not already raised or fully explored**

The proposer has assumed that there is insufficient generation capacity; it is equally valid to start from the assumption that there is too much demand. In fact from an environmental view point the correct solution is to reduce demand. Do we need to carry out an environmental impact study before we try to resurrect old and inefficient generating plant?

For the sake of argument let us consider the winter situation presented to us by NGC. NGC are claiming an insufficient level of reserve not a capacity shortage. There is in all probability adequate capacity (before breakdowns) for all suppliers to enter into contracts to meet their anticipated demand. It does not make economic sense for a supplier to buy more power than he requires (do we wish to encourage parties to run to imbalance? this would be contrary to the decisions on many previous mods). This mod therefore does not seek to correct the 'defect' via the supply side directly. On the generation side there is a choice, sell your power and hope you do not breakdown at the wrong time; sell part of your capacity and hold your own reserve; or do not sell at all during risk periods. The decision reached may be different for different classes of generator.

*Single unit generator*

The output has to be sold forward or he goes out of business. If his unit breaks down during a demand reduction period there is no way to mitigate the loss because he cannot trade in gate closed periods. Post the immediate loss periods, assuming power was available in the market, who would sell power to a company which had just been hit with a multi-million pound life threatening imbalance charge?

*Generator with unpredictable output*

Spill only, do not contract, the P78 mod has ensured that at times of system stress there is a reasonable chance of being rewarded for not contracting.

*Generator with multiple units*

Sell only a portion of available output holding reserve to cover largest credible capacity loss. If within gate closure risk mitigation is necessary run all units spilling power across the portfolio equal to that of a single unit loss. Again P78 should prove beneficial.

If the effect of these generator decisions is to create a shortage of capacity for the forward markets, price rises and consequently plant is returned to service. The generators risk, though reduced, still remains because the modification remains in place and there is no guarantee that demand reductions will not occur

*Reserve contracts*

This mod would impact upon the operation of firm standing or back up reserve contracts. If we consider what happened following the loss of Sizewell on 26th May, 35% of OCGTs failed to generate when called for. These units run only occasionally and reliability is not as high as conventional large capacity plant. During demand reduction periods these units will be despatched to run but inevitably there is a high risk of failure and the costs incurred will outweigh the benefits from the contract. The only logical protection is to renegotiate the contract or make the units unavailable.

**NGC issues**

If there is transmission line failure leading to a generator being unable to generate and consequential demand control, would the generator be charged for imbalance? would all parties share the cost through BSuoS? or would NGC pick up the costs?

Where is MOD P80?

Will NGC with in their privileged position of not incurring imbalance charges, be allowed to buy power ahead of gate closure, potentially locking in capacity which other market participants may desperately need and at the same time producing artificial SSP and SBP.

**Post event/settlement effects**

If a generator loses a unit and incurs multi-million pound imbalance charges then is unable to meet his credit requirements, will he be expelled from the BSC just when the system needs him most? Most probably not, he will be allowed to continue to operate as best he can and when he cannot meet the costs incurred all other participants will pick up the tab.

With extreme System Buy and Sell prices cash flows from imbalance, Residual Cash and BSuoS will be unpredictable. Virtually every physical participant has some imbalance and this mod will cause some players to go very long, if SSP defaults to SBP windfall payments will flow. BSuoS, which under apparently

normal conditions has exceeded £7/MWh, will be extreme. The combination of Residual Cash and BSuoS payments may mean a party who contracted in good faith and remained in balance runs at a loss

Extreme SBP and SSP will set extreme reference prices for frequency response energy payments, response providers may be discouraged from offering their services or attempt to make windfall gains.

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**P135_URGENT_017 – EDF Energy**

BSC Mod 135 : Consultation

EDF Energy is pleased to have the opportunity to comment on this consultation.

We do not believe that BSC Modification 135 better meets any of the BSC Objectives.

We are concerned that P135 does not appear likely to achieve the outcome desired by its proposer, in terms of giving predictable long-term incentives that could aid security of supply. On the contrary, it would appear likely, if adopted, to occasionally expose some players in the short-term, in a way that could not be anticipated, to a very great deal of risk which could not be easily managed.

We see merit in stability of the NETA arrangements, especially the imbalance cashout pricing mechanism which plays such an important role in ensuring efficient competition in the electricity market. This is not to say that we would discount the possibility that changes in this area might better meet the applicable BSC objectives, but rather that we feel that this could be much better assessed after the effects and any defects in the operation of P78 during the coming winter have been observed. If the rules are changed too readily, even a beneficial change might have limited effect as investors would not give much weight to its effects, being uncertain as to its stability / endurance.

Having said that we cannot see how P135 better meets any of the BSC objectives and have the following comments to make :

- If P135 were adopted, we note that there might be undesirable effects on market participants, especially smaller players, in terms of the potentially prohibitive costs of arranging credit cover. This could significantly reduce competition.
- If P135 were adopted we further note that there would be a case for reviewing whether or not ex-post contract notification ("ex-post trading") should be permitted given that there would otherwise be very large, perhaps unmanageable risks.

To mitigate some of the undesirable effects of P135, we have three specific proposals for an alternative modification proposal 135 that would, in the first two instances ( (1) and (2) ) alleviate its drawbacks, and in the third, (3), comprise an alternative that would actually better meet BSC objective b.

**Our Three Alternative Modifications**

(1) **Reduce the harmful effects on suppliers** - this amendment to P135 would be such that the marginal system buy prices set by P135 would be capped at some level that might be comparable to the concept of "Value of Lost Load". This would have the particular advantage of rendering the marginal system buy price far less susceptible to "gaming".

(2) **Reduce the harmful effects on generators** - P135 would potentially expose generators to very significant risks of not meeting contracted volumes and being cashed out at very high System Buy Prices (SBPs). This would disincentivise generators to agree contracts with suppliers for full output and hence reduce system security. This undesired effect could be ameliorated if the P135 marginal SBP, capped as per (1) above, only applied to suppliers, with generators remaining exposed to the average System Buy Price as currently defined. We are aware that this could be considered discriminatory, but believe that this would reduce the risks on generators (including renewables) and improve security of supply.

(3) **Reversion to Pre-P78 SBP At Times of NISM or Demand Contro**l

We believe that another, more radical, form of P135 would be more likely to better facilitate BSC objective (b) than either Alternatives 1 or 2 above. This third option would, whenever demand control was used or whenever a NISM was called (even if later rescinded), apply the system buy price as it would have been calculated prior to 11 March 2003 (ie, the pre-P78 SBP, regardless of whether the system were long or short in that period) in place of the marginal SBP that is currently proposed in P135. The replacement SBP would give a stronger, but not a gameable or unduly risky, signal at such times and so would better ensure appropriate incentives to balance, rather than merely ameliorating harmful effects. Such a modest change at this stage, prior to assessing the operation of P78 through the winter, would be inherently less risky than either P135 or Alternatives 1/2 above, and is very likely to be beneficial.

**Paul Mott**
EDF Energy

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

**P135_URGENT_018 – Scottish and Southern**

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

***Please note our response to any of the following questions should not be construed to lend support whatsoever to this Modification.***

In relation to the four questions listed in the Modification Report consultation, contained within your note of 20th August 2003, concerning Modification Proposal P135, we have the following comments to make:-

**Q1 Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives? Please give rationale and state which objective(s)**

No. We do not believe that P135 will better facilitate the achievement of the Applicable BSC Objectives.

Our rationale is based on three areas of reasoning:-

**(a) the fact that P135 is based on a narrow 'definition' of demand reduction; i.e. "Demand Control" as detailed in OC6.1.2 (c, d and e) of the Grid Code**

Looking at these matters in more detail we note the comments, made by the Proposer with regard to the percentage reduction performed by NGT, that:-

> *NGT would not reduce 40% of a single DNO's demand before moving on to the next, so I suggest that we stick with stage 1 (5%) with scenarios for estimating unsupplied demand.*

We believe there is a credible reason as to why NGT would reduce 40% of a single DNO's demand and not any other DNO's demand. You may recall that threat to effect the electrical isolation of the London area from the rest of the GB transmission system.

If such an event were to happen then, given the lack of sufficient generation in the London DNO area to meet high demand (as is common with DNO areas in southern Britain), plus the lack of transmission capability to import more power into the area then immediate (and sustained) demand reduction (via "Demand Control") of 40% (and quite possibly more) could be required. At the same time little or no effect (in terms of "Demand Control" etc.,) might be seen in other DNO areas (although it is accepted, with this scenario, that there could be significant short term frequency and other system control issues outwith the London area).

Secondly, looking at demand reduction in general, the Proposer indicated that:-

> *In my view, the question that needs to be answered is whether the "mechanics" of P135 actually work - i.e. do people who are short pay SBP in times of demand reduction?*
>
> *In my view the simple answer is:*
>
> *"Yes" if you are a generator*
>
> *"Yes" if you are a supplier whose customers are not affected by demand reduction (unaffected areas are likely to be 11 out of 12 DNO's) "Maybe" if you are a supplier whose customers are affected by demand reduction. (1 out of 12 DNO's). If you were "a little bit" short, you could be sent long by DR. If you were "a lot" short you could be made "less short".*

The Proposer goes onto note that:-

> "As you [Elexon, on behalf of PSMG] are trying to simulate a scenario of demand reduction, by effectively adjusting metered off-take volumes, it is important that the effect of demand control is represented as accurately as possible".

We could not agree more - it is important that the effect of "Demand Control" is represented as accurately as possible and in order to do that we need to consider do people who are short pay SBP in times of demand reduction?

It seems to us that there are basically eight ways that demand will be reduced when there is an imbalance between generation and demand (which is at the core of the defect that P135 is seeking to address).

For the avoidance of doubt this assumes that NGT, market participants etc., have tried everything to maximise generation output / taken Fuel Security Code action etc., through 'normal' means and that an imbalance remains requiring a reduction in demand.

Of these eight types of demand reduction we believe two may be covered by P135 (one certain, the other questionable).

1. Demand reduction initiated by NGC for operational reasons (covered by Grid Code OC6.1.2 (c), (d) and (e)) which is clearly defined in the Grid Code as "Demand Control" and the PSMG agreed makes it part of P135.

We believe that "Demand Control" is action that NGC will take in order to meet an immediate generation / demand imbalance; i.e. within the next few minutes; (perhaps in only a certain part of the country due, for example, to the 'disconnection' of the transmission links between the Midlands and southern Britain, or the links feeding into London) or an imbalance that is expected by them to happen in the very near term; i.e. circa less than 24 hours notice.

If more 'notice' (that is its pretty obvious to the Government, NGT, the Authority, market participants etc., that there is going to be an imbalance tomorrow - or some other time in the future - because there is a nuclear type fault, loss of St Fergus, Drax has gone under, etc., etc.,) then we think that one, or more, of the other options, for demand reduction, identified below may be used, such as those under the Electricity Supply Emergency Code (ESEC) as this avoids disconnection of protected customers (that is who meet the criteria for 'protection' status set out in the ESEC).

Protected customers are defined in the ESEC and include "vital" users such as:-

> licensed generators, including nuclear stations so as to ensure the safety requirements of their nuclear licences continue to be met, electricity transmitters & distributors, gas reception terminals, gas storage installations, gas compressor stations, control sites which provide facilities for the control of the gas supply systems & emergency procedures, oil refineries & vital oil pipeline pumping stations, essential water & sewage installations, telecommunications & broadcasting services, [significant] hospitals, major airports & associated control facilities and railway operations.

According to OC6.1.5, "no such protection [from loss of supply] can be given [to these ESEC protected customers] in relation to "Demand Control" [carried out by DNOs] under the Grid Code."

In other words if NGT invokes OC6 "Demand Control" actions it could result in cutting off supplies to power stations, nuclear sites, gas reception terminals, gas storage installations, gas compressor stations, gas supply control sites, oil refineries, oil pipeline pumping stations, significant hospitals, airports, air traffic control sites, railways etc., with all the resulting safety implications, as well as the implications for wider energy supplies if electricity is not provided to power stations, nuclear site, gas terminals, gas compression stations, gas supply control sites, oil refineries etc.

This implies that OC6 "Demand Control" may not be a suitable demand reduction 'tool', given a certain degree of foresight (of, for example, 24 hours together with an expected reduction requirement in excess of the 5-10% voltage reduction - such as might occur with the loss of, say, a major gas terminal).

2. Demand reduction initiated by DNO's for operational reasons (defined in the Grid Code), which we believe technical made it part of P135 (as initially proposed).

However, the Proposer has stated that they believe this not to be the case and this is reflected in the Modification Report. We would tend to agree with this view (of excluding these DNO actions from "Demand Control" as far as P135 is concerned).

If they were included then it raises the question as to why any customer disconnection initiated by a DNO constitutes a "Demand Control" event (as defined in the Grid Code, all be it that DNOs only need to notify NGC in accordance with OC6.4) and thus results in penal marginal cash-out prices? We suspect there may be a number of these 'events' daily!

3. Normal demand reduction as customers naturally reduce consumption over time, say, for example after the tea-time peak (not covered by Grid Code OC6, not part of P135). We put this in here for completeness, and fully accept that this is not 'actionable' as a demand reduction 'tool'.

4. Demand reduction achieved by using radio tele-switching to disconnect load (not covered by Grid Code OC6, not part of P135).

For example, Suppliers, faced with an imminent generation / demand imbalance situation (with the associated risk vis penal marginal cash-out prices) might wish to reduce their customers demand requirements by seeking to move the timing of or reducing the 'charging' time etc., for their 'Economy7' type heating load.

5. Demand reduction achieved by halting all exports across Interconnectors with other systems (not covered by Grid Code OC6, not part of P135).

6. Demand reduction as customers respond to Government appeals to reduce consumption of electricity (not covered by Grid Code OC6, not part of P135). It is our understanding that anecdotal evidence from previous usage of public appeals (in 1977) suggest that there maybe a 15-20% reduction in electricity demand via this approach

7. Demand reduction as customers implement Government instructions (issued under Energy Act 1976 powers) restricting/limiting to certain times etc., their usage of electricity, such as:-

(a) street lighting, advertising hordings;

(b) heating premises, including factories, offices, showrooms, shops, banks, post offices, petrol stations, restaurants, bars, warehouses, studios, public halls, places of education, places of recreation, entertainment or sport;

(c) lighting offices, shops, catering establishments, warehouses, libraries, places of education, places of recreation, entertainment or sport and the public parts of hotels;

(d) to a percentage of their weekly usage;

(e) prohibiting the use of electricity on any industrial or commercial premises (except shops) or for building or engineering operations (linked back to the DNOs' load shedding arrangements);

(f) prohibiting the use of electricity on any premises, except domestic premises, industrial premises or any other premises specified; and

(g) prohibiting the use of electricity on any industrial premises.

Contravention, by the customer, of these Government orders would be an offence punishable by imprisonment and/or a fine. This 'type' of demand reduction is not covered by Grid Code OC6 and is not, therefore, part of P135.

8. Demand reduction due to rota disconnection instructed by the Secretary of State (by virtue of the powers in the ESEC and Energy Act 1976) to DNOs to shed load.

NGT, Elexon and others made it very clear during PSMG meetings, as does the Modification Report consultation, that only those forms of demand reduction listed in the Grid Code (i.e. "Demand Control") are covered by P135 and that these six other methods of demand reduction; 2, 4, 5, 6, 7 and 8 (or any others people can come up with); are NOT "Demand Control" so are not covered by Grid Code OC6 and thus not part of P135.

So what you might say!

Returning to the Proposer's question above ("whether the 'mechanics' of P135 actually work - i.e. do people who are short pay SBP in times of demand reduction?") we believe the answer is not a 'simple' Yes.

If, as a Supplier or Generator, you think there will be an imbalance between generation and demand, you then need to consider which of the above seven actions will be taken to achieve a reduction in demand.

If you think the need to take demand reduction action will be quick (that is with very little warning, say, of a few minutes or hours) or for a small percentage figure (i.e. a circa 5-10% reduction, achievable by DNOs using just OC6 voltage reduction); which is 1 above; then you would wish to obtain cover; i.e. do what NGC wants with P135 and over contract to avoid penal marginal cash-out prices. You would answer 'Yes' to the Proposer's question.

However, if you think one or more of the other six methods for reducing demand may be used (perhaps, for example, because there is sufficient time to invoke them, the demand reduction level required is 'significant', there is a desire to maintain supplies to protected customers etc., etc.,); which is 2, 4, 5, 6, 7 and 8 above; then there is no need to obtain cover as the P135 penal marginal cash-out will not apply. You would answer 'No' to the Proposer's question.

This, for example, might be the case if as a Supplier whose customer base is predominately made up of those types of customer listed in 7 above, and you felt that Government action, as outlined in 7, could be taken in preference to NGC "Demand Control".

The implication of this is that the forward curve will only move to reflect the risk of NGT invoked Grid Code "Demand Control" demand reduction occurring; i.e. OC 6.1.2 (c, d and e); resulting in penal marginal cash-out prices. The realization by the market that this type of demand reduction (and some might argue the other types as well) may be invoked is likely to be very near to real time (minutes, hours, maybe days before an expected demand reduction event) rather than a month or more ahead that would be needed for generators to make plant available in the market.

Is such a short term price signal enough to ensure extra generation is made available this winter (the defect identified in P135 and its need for 'urgency')? We think not.

Another thought - what about TEC? If the P135 approach gives only a short term signal; i.e. impacts on the day/week ahead forward curve rather than the forward curve for the season/month ahead; how can generation (from those stations in a positive area) respond as it takes time to apply for, and receive, NGC approval to increase station output above their existing TEC (prior to an 'emergency' situation* occurring) .

*For example, pre OC6 "Demand Control" or ESEC rota disconnection actually being invoked.

**(b) that it provides a perverse incentive on generators to withhold plant during times when there is a risk of "Demand Control"**

If P135 goes ahead it will have the perverse effect of taking generation off (not bringing more on) as Parties will be concerned that they risk being exposed to huge cash-out payments if their plant trips / is forced off (say due to actions by Transco interrupting gas, transmission faults due to lightening/storms etc.,). Faced with this increased financial cash-out risk then a greater amount of plant will be held in reserve against trips by Generators and Suppliers. This will have the effect of 'withdrawing' plant available to NGT to provide reserve/standby and other associated ancillary services.

This would obviously be the complete opposite effect of what the Proposer is seeking to achieve with this P135 Modification Proposal.

In addition, this proposed approach is "punitive", rather than fair. If a plant trips and NGT have to buy in to cover for it, why should the generator have to pay the price for the top 1MW that NGT bought in - rather than the average? Surely if NGT is having to buy in, they are in, in effect, just being a proxy for the generator who cannot take market actions within Gate Closure (unlike NGT).

This gives rise to the question "does this give NGT the right incentives"? We note that NGT is in a unique position. It alone knows, real time, what all Generators and Suppliers are producing and consuming, not only via transparent market data such as FPNs, BOA's etc., but the less transparent arrangements such as those surrounding PGBTs and real time actual system demand. In addition NGT is also privy to what is happening on the gas network (as the Gas Network Transmission Operator). This places NGT in a position to balance the market, for which NGT receives recompense via its incentive

arrangements, which all Parties pay for. Some may consider that with P135 the Proposer may be driven to trying to maximize their incentive payments by reducing the amount of balancing action they have to take.

Whilst NGT is in this unique position (with its 'supreme' market knowledge) other Parties lack this complete market overview. Generators and Suppliers will be forced, by P135, to cover the risks associated with real time balancing, whilst being 'blind' to the overall market situation. This will inevitably lead to Generators and Suppliers collectively obtaining excessive cover, brought most probably from the more expensive providers than NGT could obtain (given their market insight) which must therefore be less efficient and as a result fail to facilitate the better achievement of the Applicable BSC Objectives

Furthermore, it is not clear how locational offers would be handled under P135. We note that in early August that we had been offering in plant significantly cheaper than Litttlebrook. However, Litttlebrook was BOA'ed on ahead of us. As the effect of these higher (Litttlebrook) prices are getting averaged out the impact on the market is relatively small. If P135 were to proceed we require that the Legal Text clearly states that marginal prices will ONLY apply where there is an actual imbalance between generation and demand; i.e. where NGT has taken ALL available generation/demand reduction available across the market (irrespective of their location) and that NOTHING is held (by the Transmission Company) in 'reserve' or is 'constrained' (by NGT). If NGT fails to purchase even a single kW of energy that would have avoided "Demand Control" (and "Demand Control is invoked) then marginal cash-out prices should not apply.

**(c) that it does not attend to the issue or defect that the Modification Proposal seeks to address**

In providing incentives to make capacity available for use in times of system stress NGT should be targeting the products it wants at those that can provide them. If there are concerns about system reserve then more reserve should be contracted by NGT. Putting an extremely penal cash-out regime in place is not, we believe, likely to provide much more of an incentive to provide reserve. This is because those that don't have it still can't provide it and those that have it will still be paid as bid and hence the plants concerned will still receive the same revenue (if they require more they can offer at a higher price).

What will happen with this proposal is that very much more money will be recovered than NGT spent (as a small bid of 1kW would set the entire cash-out price) resulting in an extremely large over recovery of costs and large RCRC, giving large profit swings for all.

Whilst in theory this may provide the desired effect of forcing players to contract for more reserve themselves, the question is "is this the most efficient way of running the market"? We think not. Surely it is better for NGT to contract for it. All that will happen is that Suppliers will seek to pass the extra reserve costs through to customers along with a hefty risk premium for the cash-out risk/cost. This will push up supplier prices generally, but will be more risky. Parties will be exposed to penal cash-out prices.

For example, a medium sized power station, using the NGT figures for what the actual and potential December 10th 2002 where/could be, would be facing an exposure to plant trips (in one half hour period) of either circa £100k (average) or in excess of £3M+ (marginal). This is totally out of all proportion, particularly when that Generators is 'paid as bid' but faces the risk of having to pay the marginal price if his plant fails.

If one looks at recent prices for peaking plant they have been in the order of £400/MWh. However, operators of such plants face a prisoners' dilemma. If they are called they get paid £400/MWh, but if their plant fails they could be required to pay out at £99,999/MWh. They will not be sure until after the event what was actually called by NGT (and at what price). This is a wholly disproportionate risk and is likely to lead to (a) such plant factoring in a 'risk premium' to cover this possibility (which gets passed on in higher prices to customers) and/or (b) the plant being withdrawn from the market at times of high risk.

A further effect of the prisoners' dilemma could be that generators seek to hold back a certain level of volume in order to themselves set and receive the marginal price. Again, the holding back of volume is likely to lead to a forced generation/demand imbalance situation.

We note that power stations are built and financed over a long timeframe, circa 15 to 40 years . At times of potential generation/demand imbalance, we would expect NGT, the Government and the Authority to be beseeching Generators to maximize their output. However, striving to achieve this extra few MW could result in a plant failure, which given the penal marginal cash-out prices associated with P135, could be catastrophic for the Generator. A 1GW plant built to operate for 25 years could be put out of business, after only an hour or so's failure, for helping the system by providing a few extra MW.

This is a wholly unacceptable risk for a Generator to face and will drive Generators and Suppliers to adopt a 'defensive' approach, of withholding capacity at times of potential system imbalance. What is needed is for Generators and Suppliers to be encouraged to take an 'offensive' approach, of seeking to maximize all available generation output and demand reduction that they can. Opening Generators and Suppliers, who take this 'offensive' approach, to extreme penal marginal cash-out costs will drive them to taking a 'defensive' stance, which is directly opposite to what the Proposer is seeking to achieve.

We believe this proposal will lead to less flexibility being made available to NGT as the risk of providing it becomes prohibitive and plant owners of peaking plant that is unreliable will either have to offer at a much higher price (which they can already do at less risk) or close them.

If the Proposer is looking to provide a longer term signal to incentivise more reserve to be carried, Modification Proposal P135 won't do it as the forward curve does not trade at that resolution so it would not be obvious this signal has been included.

A further point is that even if price margins look tight P135 only applies during narrowly defined periods of "Demand Control", which are unlikely to be forecasted by either Generators or Suppliers and hence generally won't be included in forward prices (as "operational risks" tend not to be).

Even if one were to assume that the forecast cash-outs were so extreme that each market participant contracted length into their position to cover exposure and in doing so drove prices to a level where plant is retrieved from mothball, then indeed a surplus may be created. However, this does not strike us as being an efficient or robust way to create reserve. It would be a equally fair assumption that the subsequent lull in cash-outs would cause a rebound effect on those mothballed plant. An approach to this issue based on a 'Boom and Bust' or 'Stop/Start' mentality is unlikely, in our view, to achieve the long term solving of the defect identified in P135.

The premise of P135 is that it will send a stronger signal to the market to contract forward. However, we do not see forward prices trading to a level that would force oil sets onto the system voluntarily ahead of gate closure. Therefore we do not see how P135 will address the Proposer's view that the main issue/defect (based on submitted plant availability and forecast system demand) that the system margin is tight (short) over the winter. In this respect also note the Proposer's confusion over how tight the system margin is (see Appendix 1).

Therefore in principle we do not believe that Modification Proposal P135 is an effective way of providing a signal for the market to provide sufficient reserve for all scenarios and therefore it does not better facilitate the achievement of the Applicable BSC Objectives.

**Q2 Does P135 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure? Please give rationale**

**We believe that a major issue, should P135 be approved, will be its impact on the credit arrangements. It will dramatically raise the likelihood of Parties going out of business. It will introduce significantly increased pricing risk and volatility into Winter 03 energy imbalance equations. Therefore, given that P135 was not available for comment at the time of the original CAP consultation, we would reverse our original view that CAP should be revised downwards (should P135 be introduced into the BSC).**

**Under this scenario (of P135 being approved) we believe as a minimum that the current £25/MWh + VAT should remain in force throughout Winter 03. This will allow time to gauge the impact of marginal pricing upon collateral requirements (we note that the precedent of "wait and see" has been set by the current CAP consultation as this has only been undertaken following the implementation of modification P78).**

**Furthermore, we would contend that an increase in CAP to a value higher than £25/MWh + VAT might well be warranted (perhaps to £30/MWh + VAT) in order to afford the market reasonable protection against Party default in a more volatile environment. A further analysis and consultation should then be undertaken following Winter 03 to determine the whether CAP can be reduced in the light of operational experience under P135 modified pricing rules.**

**Q3 Do you believe there to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)?**

Yes. The existing BSC addresses the defect and better facilitates the BSC Objectives than P135.

**Q4 Are there any further comments on P135 that you wish to make?**

We are concerned as to why the Proposer did not raise this matter via a 'normal' Modification earlier in the year to allow BSC Parties and other market participants adequate time to consider the matter in much more detail, rather than waiting till the height of the summer holiday season before springing it on BSC Parties.

A further matter concerns the role of NGT demand forecasting and its use in determining Suppliers 'deemed' demand (and thus associated balance/imbalance position). We note that real-time demand forecasting; i.e. within gate-closure; is primarily done by System Operators, rather than Suppliers, let alone DNOs. As such when "Demand Control" is invoked, DNOs are asked to shed X% of their load at that moment in time. They do this, for 'small' volumes of circa 4-6%, by voltage control and larger amounts by enforced load disconnection at sub-station level based on the demand (at the sub-station) at the time. However, over the course of the overall "Demand Control Period" the actual demand will have altered. This could mean that a Supplier, whilst out of balance in the first few minutes of the period, may come into balance (as per their notified position) as the period progresses and may end the period long. It is by no means clear that this will be accounted for when that Supplier's position is recorded for Settlement purposes.

We note the comments made at the recent PSMG meeting regarding the overall impact that Modification Proposals associated with cash-out prices will have. One impact would be to require BSC Parties to undertake better demand forecasting. Given that the expertise for performing real time demand forecasting rests with Transmission System Operators, the Legal Text for P135 should be amended to require NGT to provide real time actual GSP demand data; i.e. the overall demand occurring second by second in each GSP Grouping. This will assist BSC Parties to perform better demand forecasting.

Finally, as noted in Appendix 2, we believe that the approach that should be followed, in seeking to address the defect identified in P135, should be based on the principle that it "will not cause unnecessary hardship on market participants or windfalls for other participants". We believe that the existing BSC meets this principle and that P135 does not.

Garth Graham

Scottish and Southern Energy plc

**Appendix 1**

The press reports over the August Bank Holiday are indeed a welcomed development from the Proposer of P135, confirming that the defect of P135, vis the need for 'urgency' to address a defect for this coming winter, no longer applies.

In the light of these comments from the Proposer, why did P135 come out so late that it required to be treated with 'urgency' * ? If "this message [about "the issue...that there is not enough generation forecast to meet our OPMR requirement"] has been communicated for many months" (as the Proposer has stated) then why has it not been communicated to the BSC Panel/BSC Parties etc., via a 'normal' Modification?

Also on the matter of the "bigger safety net" (which is assumed to refer to NGT's OPMR requirement):-

I. who determines the level of it?;

II. how often is the level of the OPMR requirement changed by NGT?;

III. what is the process that NGT follows for changing the OPMR requirement level?;

IV. what is the process followed by NGT for informing the market of changes NGT makes to the OPMR requirement level?; and

V. if the revision (of the level) is ad-hoc, what is the process for informing the market that it is under review (for a possible increase/decrease)?

**urgency* which has restricted the ability of BSC Parties, the BSC Panel and market participants to fully consider this matter via the 'normal' BSC Modification assessment process.

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National Grid Sees No Danger of U.K. Winter Power Blackouts 2003-08-24 04:57 (New York)

Aug. 24 (Bloomberg) -- **National Grid Transco Plc**, owner and operator of the U.K.'s power transmission network, **said there is no danger of blackouts this winter in the U.K. as it has enough power plants to meet demand**.

The London-based company has asked business customers to limit electricity use to help stave off blackouts, the Sunday Times reported, citing National Grid.

``We are offering contracts to use less -- these are nothing new and not specific to this year,'' said National Grid spokeswoman Ann Gibson. ``**We're forecasting there is enough generation to meet demand at all times during winter**.''

Wholesale energy prices have fallen 40 percent in three years because of new government policies, and that has led producers such as International Power Plc and E.ON AG's Powergen

Plc to close plants, reducing supply.

Rio Tinto Plc, the world's third-largest mining company and Alcan Inc., the No. 2 aluminum maker, are among companies Grid approached to sign agreements saying their power can be reduced

at a few hours' notice, the Sunday Times said.

The measures aim to counter concerns of U.K. blackouts this winter as the U.K. faces a possible shortfall in power generation, the Sunday Times said, adding National Grid could offer as much as 56,000 pounds ($88,194) to companies that sign up to help compensate them for lost production.

Businesses would get some cash when they enter the agreement and more if they are called on to deliver on the contract and reduce consumption said Gibson, who declined to comment on the amount being offered to companies.

``**We've got contracts on the generating side to boost production if we need to and we've got contracts on the demand side as well to reduce demand if we need to,'' she said. ``This is nothing new.**''

-0- (BN ) Aug/24/2003 8:57 GMT

National Grid denies power ration plans to avert blackouts

by Nigel Cope

**National Grid Transco yesterday denied there is any risk of US-style power blackouts in Britain this winter**, although it admitted it had written to some of its largest industrial customers to offer inducements for lower usage contracts.

**National Grid said there was no suggestion of power being rationed** and that such measures were quite common.

The Grid has contacted major manufacturing plants and other heavy power users to offer inducements for accepting so-called "interruptable" contracts where the Grid can reduce supply at 24 hours' notice. Key customers include companies such as the mining group Rio Tinto and aluminium manufacturer Alcan.

A spokeswoman for the company said: "These contracts are nothing new. We used them last year and the year before. They simply offer an interruptable kind of contract, which enables us to free up capacity. We have alternatives on the supply side but this gives us more flexibility on the demand side."

**The Grid insisted there would be no problems with power supplies this coming winter. "We're forecasting there is enough generation to meet demand at all times during winter. We have just been looking for a bigger safety net."**

Companies likely to take advantage of the offer are those that do not require continuous heat or power in their plants. The contracts can be worth as much as £56,000 an hour to those who sign up.

The electricity market suffered over-capacity a few years ago but this came to an end when the Government introduced the New Electricity Trading Arrangements. This meant that generators had to trade power in a market system with the result that the price soon fell by 40 per cent.

This has caused major problems for generating companies. TXU, the American-owned power company, collapsed last year. The nuclear generator, British Energy, has also faced serious financial problems.

Companies start their annual negotiations to renew their power contracts from October onwards. It is thought that many firms are expecting renewal prices up to 30 per cent higher than last year.

Experts have expressed concern that these increases will add significant pressure on Britain's already beleaguered manufacturing sector.

[The Independent 25/8/03]

END

**Appendix 2**

Reports concerning the situation in the north-eastern United States and Canada in mid August provide interesting examples for us to consider.

One report, amongst many, is shown below. We note, in particular, the comments of the New York Independent System Operator, when referring to their approach to settlement (cash-out) during this period that:-

*"We will choose an approach that will not cause unnecessary hardship on market participants or windfalls for other participants"*

We believe the principle of this approach should be adopted here for cash-out settlement.

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New York Grid May Lower High Prices From Blackout (Update1) 2003-08-19 10:10 (New York)

New York Grid May Lower High Prices From Blackout (Update1)

(Adds review process starting in first paragraph.)

Aug. 19 (Bloomberg) -- The New York Independent System Operator said it may lower high prices that occurred during the power blackout last week as part of its monitoring and settlement process.

``We will be using temporary emergency procedures,'' authorized by the Federal Energy Regulatory Commission, ``to revise prices and payments as a result of an emergency condition,'' said spokesman Kenneth Klapp in an interview following a grid operator meeting this morning.

Real-time spot prices in New York City reached $1,053 a megawatt-hour on Friday. The price was $55.90 a megawatt-hour at 8:35 a.m. today, compared with $58.34 yesterday and $1.041.88 at the same time on Friday. Prices averaged $123.81, the highest since a heat wave in late June, on the day before the blackout.

The review will cover 4 p.m. Thursday through 12 p.m. Sunday, Klapp said. ``**We will choose an approach that will not cause unnecessary hardship on market participants or windfalls for other participants.**''

The grid is seeking input through tomorrow and a draft of the settlement rules will be released on Monday. Final rules for August billings will be issued at the end of the month, he said.

Reviews have been conducted in the past and will examine bid prices along with market demand, Klapp said. Prices will ``most likely'' be revised down ``but we can't say that for sure until after the review.''

The New York Times earlier reported the grid operator would review the price surges.

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**P135_URGENT_019 - BP**

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| **Respondent:** | *Name* |
| **No. of BSC Parties Represented** | *2* |
| **BSC Parties Represented** | **BP Gas Marketing Ltd, Great Yarmouth Power Ltd** |
| **No. of Non BSC Parties Represented** | *0* |
| **Non BSC Parties represented** | - |
| **Role of Respondent** | *(Generator/ Trader)* |

| Q | Question | Response | Rationale |
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| 1. | Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives?<br>Please give rationale and state which objective(s) | **No** | Please see comments below |
| 2. | Does P135 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure?<br>Please give rationale | **Yes** | Please see comments below |
| 3. | Do you believe there to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | **YES** | Please see comments below |
| 4. | Are there any further comments on P135 that you wish to make? | **Yes** | Please see comments below |

Supportive comments referred to above

**Q1**

We believe that P135 does not provide appropriate incentives to parties

The incentive, if it exists at all, because of the enhanced asymmetry of pricing is to go further long, not to balance;

The unmanageable and potentially crippling price risk arising from a generator tripping will discourage generators from offering their last few MW into the BM, thereby exacerbating the generation shortfall;

Because of the timing of demand control, i.e. beyond gate closure, any signal will come too late for parties to react by contracting ahead of gate closure;

Because of the frequency of demand control, i.e. anticipated to be rare even by NGC, any signal is unlikely to influence the forward price curves and hence returning plant for service during winter peak. Suppliers are most likely to discount the potential for extreme prices by the low probability of occurrence.

We believe that P135 does not improve security of supply

Marginal SBP at times of demand control will incentivise portfolio generators to withhold generation in case of trip, which will make demand control more likely – IPPs may be forced to withdraw from the market when there is a risk of demand control, which will also increase the probability of trip

It will place generators in a dilemma of whether or not to bring on withheld plant (in contravention of the Grid Code), hence possibly increasing operational issues for NGC;

Depending on the details of the situation, this modification could actually lead to scenarios where the opposite of the intended pricing signal is achieved

We are unable to identify any additional incentive that P135 would place on the marginal participant with 300MW of generation (who may well be short 200MW) running at £99k in the balancing market as they can profit. NGT will always need reserve capacity in addition to the net energy balance. Under the proposed change 4.4.5(a1) a steady state short and trigger of demand reduction of up to around 200MW can be gamed as in the above case, with SBP price still at only £380/MWh. Where is the additional price signal when 200MW has been lost?

P135, by creating a disproportionate risk for IPPs that cannot withhold some generation in order to cover for trip contingency will significantly reduce competition as such parties will be forced to sell out to portfolios. Independent suppliers will also be forced out of the market because of the cost of buying reserve at times when large parts of the generating market will not want to be selling on a firm basis because of the risk of trip.

**Q2**

The avoidance of quantifying a marginal price in 1.3.1 had avoided the cost impact for the largest credible contingency on the system. Consider a Teesside trip when the system is at the margin and the loss of 1800MW then requires 1750MW of demand reduction with SBP at £99,999. Teesside would loose approximately £175m per hour. Taking a generation price of around £350/kW (based on recent asset sales) then in only 3.5 hours the asset would have a negative value, excluding any existing debt? With debt included they may be forced into administration the following day and then held off the system. The following day the system then starts off with 1.8GW offline due to credit default and a number of other participants are then left short due to the unit going into administration. Those that can't contract up in the following scramble are then exposed to the next demand reduction period and may then go into administration as well.

**Q3**

We suggest the consideration of the withdrawal of the capability of NGT to forward trade energy at times of system length. Supporting SSP artificially high is just as damaging, why not let SSP go negative to say -£1,000 when the system is set to be 4 or 5GW long?

**Q4**

We believe that it is important to raise the following points.

P135 simply does not achieve its objective. NGC are providing the signal and then dis-incentivising one from providing the necessary support.

P135 will therefore not do what is intended for this winter because suppliers are fully contracted but that is insufficient to cover for any generation failure – therefore this simply creates risk and uncertainty and will kill competition

P135 places the burden of risk onto the IPPs but will not incentivise more generation onto the bars. Appropriate incentives need to be on all parties and this includes NGT, which should be incentivised to forward contract if it believes there is a pending risk to the system. This incentive will only occur if any demand reduction energy is treated as a deemed offer (at marginal price seems reasonable because all other imbalance shortfalls would be at marginal price and so it must be the correct pricing signal to NGT's incentive!).

Suppliers will not be encouraged to buy more generation as they already contract to the top of their predicted demand at peak (it is probably worth mentioning that they don't always contract for their full demand during the shoulder months but it is at peak that demand curtailment events will occur).

The only party that can effectively contract for the required volume of security generation is NGT. There is in principle, no difference between this security reserve and standing reserve.

It is only with longer-term contract that covers fixed cost that mothballed plant will be brought back – it won't be held available on the 1-year-in-20 chance of it actually being required for a settlement period.

The choice by NGC of the gsp group best calculated to relieve the demand surplus, may lead to discriminatory disconnection of particular suppliers;

Disagreement with P135 does not mean that the current arrangements are satisfactory.

We need enhanced transparency of action by NGC within clear limits as to what the 'residual balancer' can and cannot do.

In addition we submit the following comments

If the marginal generation is to set the price at the time of demand reduction then the system needs a price cap to prevent a sequential collapse of companies forced into administration?

If system buy price is marginal at times of demand reduction should system sell not be set to system buy?

Why should an accepted offer that was not delivered be allowed to set SBP? Why not always offer an extra 1MW at £100k that your unit probably can't deliver. Will this also extend the apparent system length / capability?

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| 5. | Do you believe either or both of options (a) and (b) to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | YES | See notes below |
| 6. | Are there any other options that you believe may form an Alternative Modification? | YES / NO | See notes below |
| 7. | Are there any further comments on the options comprising a potential alternative to P135 that you wish to make? | Yes | See notes below |

Notes referenced in the above.

We believe that:

Appropriate incentives need to be placed on all parties and including NGT. NGT should be incentivised to forward contract if it believes there is a pending risk to the system. This incentive will only occur if any demand reduction energy is treated as a deemed offer (at marginal price seems reasonable because all other imbalance shortfalls would be at marginal price and so it must provide the correct pricing signal to NGT's incentive). We believe that this analysis would be feasible to be undertaken on a spreadsheet basis because demand reduction will surely only ever affect one or two settlement periods in a winter. We note that suppliers already contract forward to cover maximum expected demand but not to cover generator trip

In order to send more appropriate pricing signals to NGT, we believe that it would be more appropriate if the energy estimated as subject to demand reduction be treated ex post as deemed offers for inclusion in BSAD at marginal price

We support this alternative proposal as a possible method of protecting against the unmanageable risk faced by generators allowing them to offer reasonable endeavours energy to NGT in the extreme situation. It is however not a perfect solution.

The element of marginal price for all acceptances should be included as this is the best way of incentivising generators to offer the energy that will ultimately keep the lights on because it will cover them for trip risk. Spurious offers (as described in the consultation addendum) are we believe not likely to be a problem because failure to deliver will not benefit the generator as it won't get paid and that a spurious demand-side offer only offers the supplier benefit to the extent that it has over-forecast its own demand (rather than simply over-contracted its own demand).

The trip risk may be so great that generators will cancel contracts and not run where there is a risk of demand reduction being called.

**P135_URGENT_020 – British Energy**

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| **Respondent:** | *Martin Mate* |
| **No. of BSC Parties Represented** | *3* |
| **BSC Parties Represented** | *British Energy Power & Energy Trading Ltd, British Energy Generation Ltd, Eggborough Power Ltd* |
| **No. of Non BSC Parties Represented** | |
| **Non BSC Parties represented** | |
| **Role of Respondent** | *Supplier/Generator/Trader/Consolidator/Exemptable Generator/Party Agent* |

| Q | Question | Response | Rationale |
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| 1. | Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives?<br>Please give rationale and state which objective(s) | No | Increasing the largely unmanageable price risk associated with imbalance will act against BSC Objective (c) (competition) by creating arbitrary losers, particularly amongst non-portfolio parties, and may act against BSC Objective (b) (system operation) by reducing the amount of capacity made available to the System Operator for balancing over short timescales, as generators unable to manage the extreme risk may withdraw capacity at times of system stress. |
| 2. | Does P135 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure?<br>Please give rationale | Yes | The limit on extremes of System Buy and Sell prices are currently £99,999 £/MWh, for practical purposes. While this magnitude of offer price may be reasonable for very infrequently run plant to obtain a return on investment, it is not rational to expose those parties which may, possibly for reasons largely beyond their control, be in imbalance at the moment when this plant is run, to the price of that plant. In most markets, either buyers and sellers would respond immediately to such prices by reducing demand or increasing capacity, or insurance products would develop to cover such risks. However, the special features of the current electricity market (limited demand response, no storage/no delivery delay, long lead times for delivery, limited transparency, NGC controlling despatch in real time) have so far prevented significant demand response or insurance products becoming available, and we do not believe this modification will encourage such |

| Q | Question | Response | Rationale |
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| | | | products, and certainly not for this winter. We believe that until a liquid market in insurance products develops or demand response improves, imbalance prices should be capped to a level representing the maximum price most consumers would be willing to pay were the means available for them to respond to prices. Previous analysis has indicated a level of the order of 2000-3000 £/MWh. |
| 3. | Do you believe there to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | YES | We believe that the potential shortage of capacity which NGC allude to in their proposal is likely to remain a threat until some method of rewarding capacity is created. Extreme imbalance prices at time of system stress were anticipated before NETA, and yet a market for "insurance" products (eg. spare capacity or options to buy or sell balancing energy at an individual party level) has failed to materialise, and we are not convinced that P135 will create one, and certainly not for this winter. We consider that Ofgem should, through NGC initially for this winter, procure sufficient capacity to provide the level of security which the market is apparently currently failing to provide, and at the same time begin a process of consultation on how capacity should be procured in the long term. NGC should not be permitted at this stage to enter into capacity contracts beyond March 2004, otherwise opportunities for a more efficient long term market solution for the future may be prevented. |
| 4. | Are there any further comments on P135 that you wish to make? | YES | We consider that frequent changes to fundamental market rules are harmful to the development of efficient and liquid markets and should be exercised with caution and careful consideration of the effect on long term investment signals. |
| 5. | Do you believe either or both of options (a) and (b) to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | NO/YES | NO on balance - Payment of a marginal price to all offers would reduce the risk to generators/providers associated with failure to deliver during demand reduction, and thus the probability of generators/providers withholding generation at such times. It would also increase the potential for self-hedging by players with multiple BM Units, and for insurance/hedging products to be offered. However, limited transparency and limited competition at the margin increases the probability that marginal prices will be unreasonable and represent windfall gains for some providers.<br>YES - Including estimated demand control volume in NIV calculation would reflect the equivalence |

| Q | Question | Response | Rationale |
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| | | | of this action to a normal balancing action such as offer acceptance. It would also reduce the possibility of offers and BSAD energy buy volumes being inappropriately tagged out, and the apparent system imbalance direction changing inappropriately. |
| 6. | Are there any other options that you believe may form an Alternative Modification? | YES | See suggestions in response to associated main P135 consultation –<br>a limit on imbalance prices reflecting an assumed price of theoretical demand response, and a short term administered approach to short term capacity concerns combined with effort to develop a long term market solution to capacity and security provision. |
| 7. | Are there any further comments on the options comprising a potential alternative to P135 that you wish to make? | NO | |

**P135_URGENT_021 – British Sugar**

British Sugar Response to BSC Modification Proposal P135 1/9/2003

**Company Background**

British Sugar handles the energy affairs of the Associated British Foods Group. The company owns and operates six CHP plants and is a member of the Combined Heat and Power Association. British Sugar is not a Party to the code.

**Requirement for P135**

Whilst we recognise the real problems relating to security of supply which currently exist under NETA, it seems to us that P135 is not a sound way to address these concerns and may actually make existing problems worse.

**Security of Supply**

We do not think that P135 will actually help improve security of supply. All it serves to do is to increase the (already extreme) price risk within a time horizon that is too late for any management actions (whether contract or physical) to be taken.

Additionally, demand control is such a rare event that the higher imbalance prices resulting from P135 will feed through to the market prices in such a weak way that no more plant will be made available, let alone be constructed.

**Incentive to balance**

P135 does not incentivise Parties to balance. Increased price spread incentivises Parties to go long and not to balance.

The imbalance system inherently favours large portfolio players at the expense of small independent players and therefore attempting to use imbalance pricing in this way to deliver security of supply is not only ineffective but makes an existing market distortion worse.

**Summary**

P135 should not be made. The recognition that security of supply is currently threatened under NETA does not mean that P135 is justified. The progressive reduction in imbalance price spread had been welcomed by many, including Government, as a sign that NETA governance was working and could address market problems.

Tweaks to imbalance pricing will not deliver security of supply; more fundamental changes are required.

Ian Calvert

British Sugar

**P135_URGENT_022 - Entergy-Koch Trading Europe Ltd**

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| **Respondent:** | *Entergy-Koch Trading Europe Ltd* |
| **No. of BSC Parties Represented** | *1* |
| **BSC Parties Represented** | *Entergy-Koch Trading Europe Ltd* |
| **No. of Non BSC Parties Represented** | |
| **Non BSC Parties represented** | |
| **Role of Respondent** | *(Trader)* |

| Q | Question | Response | Rationale |
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| 1 | Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives?<br>Please give rationale and state which objective(s) | No | We consider that this modification conflicts with the achievement of the applicable BSC objectives. There are several key problems with this modification:<br><br>The proposal introduces significant risks at a time when the market could be failing. If the defect is that the pricing mechanism fails to produce the correct pricing signals in the prompt and long term market, then this should be the case at all times, and not just when the system operation is heading toward 'command and control' characterised though only limited types of demand control. There is no evidence that the limited circumstances outlined in the proposal represent a special case requiring a significant change to the existing pricing mechanism.<br><br>The proposal also fails in that it increases uncertainty in the operation of the market. The solution is piecemeal and although it is being sold as a solution for this winter, once in place it will require further modifications to fill in the gaps. Promoting policy changes in this manner is inefficient and is likely to introduce more distortions. This approach is damaging to confidence in the UK market and provides a poor example of liberalisation to other markets. |

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| | | | This modification shifts the job of acquiring system reserve away from NGT and on to generators and suppliers without any compensation or without any consideration of adjusting NGT's risk based incentive payments. Without adjusting NGT's incentives there is an increased risk of additional market distortions when the incentives become misaligned with the interests of system users.<br><br>The proposal has not considered the issues on the how to deal with system reserve. There are two key issues in this respect.<br><br>NGT have characterised system reserve as the amount of headroom it thinks is necessary for its operational purposes without any analysis or market feedback on whether this is an appropriate and prudent amount. Reserve market participants consider it necessary to mitigate the additional risk from this proposal is likely to be a different amount, so it is unclear whether NGT's position will be better or worse or whether there will be over-contracting in the market or indeed whether NGT will be squeezed out of the market in respect of other contracted services.<br><br>Secondly, if this modification is focussed on getting price signals to encourage the provision of the reserve required by NGT, then there needs to be a discussion on who should procure this reserve. NGT has numerous tools at its disposal to procure reserve. The concern to the market is the way in which these tools are used, and particularly the lack of transparency. NGT have not demonstrated that it is unable to procure this level of reserve for the winter (although we cannot determine whether they have or haven't procured services for this winter), yet the proposal presumes that this task should be shifted to market participants through the imposition of a fear premium to encourage forward contracting or self-insurance. This in itself could be counterproductive. NGT have failed to provide a strong case for moving away from the current arrangements to deal with rare and unexpected events.<br><br>There is also a risk that the market will be unable to manage provision of the reserve as efficiently as NGT who have the best ability to forecast system supply and demand. The proposal is likely to introduce a 'bankruptcy risk' for some market participants. Suppliers may decide to over insure |

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| | | | through over-contracting and generators by holding back generation to cover potential shorts. If this were the case, then there must be a significant risk that less capacity will be available to the market, resulting in a worsening problem for NGT's reserve requirements.<br><br>The timing of this modification is poor in that a significant amount of winter contracting has already been undertaken and therefore changes to BSC pricing rules will have a limited effect on encouraging additional capacity for this winter. Further, the modification does not taken into consideration that the market is already responding to the expectation of a tighter supply margins this winter.<br><br>The proposal also fails to consider market participants ability to react given the timing of demand control. Further we are not sure why one type of demand control is any more relevant than any other 'emergency type' of action. This problem has been discussed, but there was no satisfactory response to indicate that the triggers outlined in the proposal represent a special case.<br><br>There seems a strong level of doubt on whether the proposal is functionally robust. Discussions in pricing groups have highlighted the potential for the system sell price to become the main energy imbalance price and hence having a relatively ineffective 'marginal SBP'. We consider that it would be irresponsible to change the existing arrangements when there is doubt surrounding the mechanics of this proposal. |
| 2 | Does P135 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure?<br>Please give rationale | Yes | Because the proposal was granted urgent status there has been insufficient time to explore very important issues relating to unintended consequences of increasing risks in the market. These consequences include the potential to encourage reduced capacity, the broader risk of discouraging new build and the detrimental effect on the traded market that will only lead to increased costs for consumers. EKT believes if P78 (which is yet to operate through a winter period) is seen to be flawed then a more rigorous assessment of pricing needs to be carried out rather than a piecemeal approach. |
| 3 | Do you believe there to be a potential Alternative | No | We do not consider that there is a defect in the current arrangements. The risk of tighter winter margins is already being priced into the forward markets and at least one generating party is seeking |

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| | Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | | to bring capacity back to the market. With P78 not having operated through a winter period it seems premature to consider yet further changes to the imbalance price calculation. |
| 4 | Are there any further comments on P135 that you wish to make? | Yes | The signals coming from NGT are mixed with respect to the conditions this winter. These mixed messages will have a detrimental effect on the traded market and encourage a view that the regulation and operation of the England and Wales electricity system is sub-optimal and requires constant tinkering to deal with normal operational issues. In terms of the broader market effects it is always worth remembering that regulatory decisions can add risks as well as mitigate them.<br><br>There was an extensive level of discussion and consultation with respect to the implementation of P78, and yet this mechanism has not yet been allowed to run through winter. Key policy changes ought to have proper reasoned consideration rather than jumping from one approach to another. Inconsistent and ad-hoc policymaking will discourage new entrants to the detriment of end customers.<br><br>We consider that this modification will promote consolidation amongst generators, as it will be more difficult for independent power producers to manage the additional risks. Further consolidation is unlikely to promote greater competition and the benefits that accrue to customers. |

**P135_URGENT_023 – Teeside Power (LATE RESPONSE)**

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| **Respondent:** | *Name Philip Lawless; Teesside Power Limited* |
| **No. of BSC Parties Represented** | *1* |
| **BSC Parties Represented** | *Please list all BSC Parties responding on behalf of (including the respondent company if relevant). Teesside Power Limited (TPL)* |
| **No. of Non BSC Parties Represented** | *N/A* |
| **Non BSC Parties represented** | *Please list all non BSC Parties responding on behalf of (including the respondent company if relevant). N/A* |
| **Role of Respondent** | *(~~Supplier~~/Generator/ ~~Trader / Consolidator / Exemptable Generator / BSC Agent / Party Agent / other – please state~~)* |

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| 1. | Do you believe Proposed Modification P135 better facilitates the achievement of the Applicable BSC Objectives?<br>Please give rationale and state which objective(s) | ~~Yes~~ / No | P135 appears to be an attempt to address current inadequacy of market price signals to ensure security of supply. This is essentially a market structure issue around competition for the production and sale of electricity rather than the efficient and economic operation of the transmission system by NGC. While clear signals for price will help operation, this is not the fundamental market issue P135 seeks to address. We would therefore see any proposal as addressing issues around objective ( C) rather than objective (b) as suggested by NGC. This fundamental issue is highlighted by the fact that annual contracts are trading at about £20/MWh (according to current Heren/Argus reports). We appreciate that NGC have now flagged concerns that this appears insufficient to maintain sufficient marginal generation capacity. We also believe a marginal pricing signal is a move in the right direction. However, the market issues raised are numerous, complex and interrelated and require considerable further analysis if an unsuitable or unstable solution is to be avoided. |

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| | | | P135 fails to address these market pricing issues and provides potential for perverse incentives on generators. Teesside Power would clearly look closely at its plant risks during any potential demand control period and could potentially retain some capacity to manage its risk from technical problems during a demand control period. This situation would compound the problems for NGC since NGC would want TPL to make such plant available. P135 may mean that TPL could be taking an unacceptable risk in making all plant available..<br><br>TPL, due to its configuration has significant peaking capacity. Again this capacity could be retained during likely demand control periods to provide self insurance for contracted capacity. This again compounds the issues NGC is seeking to address.<br><br>Finally, in withholding capacity from the contract market offers made to the Balancing Mechanism are likely to include a very substantial risk premium. This will be to cover the risk of being called and removing the self insurance. This creates a vicious circle which would drive the likely marginal prices higher and reinforce the generators behaviour. |

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| | | | Finally, in retaining capacity from the contract market offers made to the Balancing Mechanism are likely to include a very substantial risk premium. This will be to cover the risk of being called and removing the self insurance. This creates a vicious circle which would drive the likely marginal prices higher and reinforce the generators behaviour. |
| 2. | Does P135 raise any issues that you believe have not been identified so far and that should be progressed as part of the Assessment Procedure?<br>Please give rationale | Yes ~~/ No~~ | As already indicated, P135 does raise issues over the adequacy of current market price signals to address the issue of insufficient reserve capacity to provide security of supply. Based on the analysis so far provided we remain unconvinced that P135 has identified the correct mechanism for incentivising pre gate closure behaviour. The proposal which deals with post gate closure events may drive a greater degree of physical risk mitigation at each balancing mechanism unit. |
| 3. | Do you believe there to be a potential Alternative Modification to P135 (i.e. one that addresses the same defect, and is better at facilitating the Applicable BSC Objectives than P135)? | YES ~~/ NO~~ | Any alternative structure should clearly seek to preserve as much capacity as possible in the system. TPL has not had sufficient time to examine these alternative proposals, such as P136, 137 etc., to form a judgement on these matters. However, we would intend to respond shortly. Again, we would see a role for a marginal pricing mechanism but this should be on the back of analysis of the broader market analysis which is required for a comprehensive solution to this complex problem. |

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| 4. | Are there any further comments on P135 that you wish to make? | Yes ~~/ No~~ | It is not clear from this proposal how liability would be shared for imbalance costs incurred by generators who suffer from low frequency trips during this period of demand control. Indeed, embedded generators will suffer further from the impact of demand control. This may be particularly serious for renewable and CHP generators.<br><br>P135 could also adversely affect the promotion of competition in generation. It is currently well documented that a number of generation companies are in financial distress due to low market prices (a bizarre situation given NGC's concern over generation shortages). P135 could expose these companies to a serious additional financial risk that may compound their behaviours addressed in 1 above. In addition, while any movement in forward prices from these short term costs is welcomed it is possible that IPP generators will not be so well placed to take advantage of this when compared to vertically integrated players. Hence, further damage could be caused to competition from a dramatic and sudden step change in prices. |