March 2003

MODIFICATION REPORT

MODIFICATION PROPOSAL P109 – A Hedging Scheme For Changes To TLFs in Section T Of The Code

Prepared by ELEXON on behalf of the Balancing and Settlement Code Panel

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energywatch	energywatch
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c Intellectual Property Rights and Copyright

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1 SUMMARY AND RECOMMENDATIONS

1.1 Recommendation

On the basis of the analysis, consultation and assessment undertaken in respect of this Modification Proposal during the Modification Procedures, and the resultant findings of this report, the Balancing and Settlement Code Panel (the Panel) recommends that:

Proposed Modification P109 should not be made.

In the event that the Authority determines that the Proposed Modification P109 should be made, AGREE an Implementation Date of:

- **1 April 2004 if an Authority decision is received by 14 April 2003; or**
- **1 August 2004 if an Authority decision is received after 14 April 2003 but before 18 August 2003.**

1.2 Background

P109 was submitted on 1 November 2002 by British Energy plc, in accordance with Section F 2.1.1 of the Balancing and Settlement Code ('the Code'). The Modification Proposal seeks to address a perceived lack of efficient signals for long-term investment due to the risk of a change in Transmission Loss Factors (TLFs). P109 seeks to mitigate this risk through a scheme that protects investors against the windfall effects of future changes to TLFs, whilst maintaining economic incentives at the margin, so that investors react more efficiently to current and future incentives within the Code.

The suggested mechanism is that each BM Unit would be allocated two F-factors (one for Delivering and one for Offtaking) and these would be fixed volumes, either based on history (for existing CVA BM Units), published technical data (for new CVA BM units), or on a pro-rata allocation of a larger aggregated volume (SVA BM Units and Interconnector BM Units). These F-factor volumes would be exposed to an Applicable Loss Factor, which would be based on a non-zonal varying amount (for existing BM Units) or on the prevailing Transmission Loss Factor at the time of registration. Only metered amounts relative to the F-factor would be exposed to the current Transmission Loss Factor itself.

Parties would have a one-off opportunity to opt into the F-factor arrangements.

1.3 Rationale for Recommendations

Three key arguments, described in the P109 Assessment Report, were put forward against implementation of Modification Proposal P109. First, P109 would reduce the benefits introduced by P82 through a reduction in the accuracy of the allocation of transmission losses and by diminishing the locational signals of the scheme. Therefore, Applicable BSC Objectives (b) and (c) would not be better facilitated. Second, the purported benefits resulting from the perceived reduction in risk introduced by P109 would be outweighed by increased variability in 'Transmission Loss Multipliers' (TLMs)[1]. Thereby not better facilitating BSC Objective (c). Finally, Applicable BSC Objective (d) would not be better

[1] 'Transmission Loss Multipliers' ('TLMs') are the multiplicative factor applied to metered volumes in Settlement to allocate transmission losses.

facilitated owing to the reduction in efficiency of the settlement arrangements resulting from the cost and complexity of administering P109.

The Panel considered that, although there was a narrow majority of the P109MG who considered that P109 did better facilitate achievement of the Applicable BSC Objectives, the arguments suggesting that this was not the case were the more compelling. Furthermore, one Panel member suggested that the arguments relating to the perceived reduction in the cost of capital afforded by P109 were not robust and that no such reduction had been demonstrated. Therefore, there was no better facilitation of Applicable BSC Objective (c) in that respect. Another Panel member considered that Applicable BSC Objectives would not be better achieved by BSC Parties at large providing a hedge for particular BSC Parties, in respect of zonal losses.

2 INTRODUCTION

This Report has been prepared by ELEXON Ltd., on behalf of the Panel, in accordance with the terms of the Code. The Code is the legal document containing the rules of the balancing mechanism and imbalance settlement process and related governance provisions. ELEXON is the company that performs the role and functions of the BSCCo, as defined in the Code.

This Modification Report is addressed and furnished to the Gas and Electricity Markets Authority ('the Authority') and none of the facts, opinions or statements contained herein may be relied upon by any other person.

An electronic copy of this document can be found on the BSC Website, at www.elexon.co.uk.

3 HISTORY OF PROPOSED MODIFICATION

P109 was submitted on 1 November 2002 by British Energy plc. The Initial Written Assessment (IWA) for P109 was presented to the Panel meeting of 14 November 2002. The Panel determined that P109 required further assessment and submitted P109 to a 3-month Assessment Procedure by the P109 Modification Group (P109MG) and that an Interim Report should be presented to the Panel meeting of the 12 December 2002.

The P109MG met twice to consider the issues that the Panel had agreed should form the basis of the Interim Report. These included some definitional elements of P109, the vires of the Assessment Procedure, governance and the initial assessment against the Applicable BSC Objectives, given the anticipatory nature of P109 and the limitation of the proposed hedging to TLFs.

At its meeting of the 12 December, 2002, the Panel considered the content of the Interim Report, agreed that no further guidance needed to be given to the P109MG and that no provisional thinking was required from the Authority in respect of any matter raised in the Interim Report. The Panel also agreed that the Assessment procedure should continue, in accordance with agreed Terms of Reference.

The P109MG subsequently met four times and issued a consultation on the 13 January 2003. The Assessment Report was considered by the Panel at its meeting of the 14 February 2003. The P109MG was split on the merits of P109 but, by a small majority, recommended that the proposed change should be made. The Panel considered the views of the P109MG and decided that P109 should not be made.

Legal text was not provided with the Assessment Report, but was subsequently completed and reviewed by the P109MG and a report consultation was issued on the 21 February 2003. Responses were received by the due date of 3 March 2003. One further response was received on the 5 March 2003.

4 DESCRIPTION OF PROPOSED MODIFICATION

P109 seeks to address a perceived lack of efficient signals for long-term investment due to the risk of approval of a Modification Proposal seeking to change the allocation of transmission losses. When P109 was submitted on 1 November 2002, the Code set the value of TLFs to zero for all market participants, but it was recognised that the Code could be modified at any time in the future to make TLFs vary by location. Such a Modification would change the value of long-term investments in the production or consumption of electricity. According to the Proposer, the resulting risk would either be too costly to hedge or unhedgeable, and so would reduce the efficiency of investment decisions. P109 seeks to mitigate this risk through a scheme that protects investors against the windfall effects of future changes to TLFs, whilst maintaining economic incentives at the margin, so that investors react more efficiently to current and future incentives within the Code.

The P109MG refined P109 such that the 'trigger' for the proposed risk mitigation scheme would be an Authority determination that the Code be modified such that TLFs changed. On 17 January 2003, the Authority determined that Modification Proposal P82 'Introduction of Zonal Transmission Losses on an Average basis' (P82) should be made. Modification P82 will introduce zonal differentiation of transmission losses on 1 April 2004. Acknowledging that the Code baseline had changed, the P109MG defined the 17 January decision as the 'trigger' for the hedging scheme proposed by P109.

The Code currently allocates 45% of total transmission losses to BM units located within 'Delivering' Trading Units and 55% to BM Units located within 'Offtaking' BM Units, in both cases on a uniform basis determined for each half-hour.

P109 would maintain this rule for each existing CVA-registered BM Units, but only for a fixed volume known as the 'F-Factor'. There would be two F-Factors per BM Unit – one for 'Delivering' and one for 'Offtaking'. For each existing CVA-registered BM Units, the associated F-Factor volumes would be defined by formulae relating to the past level of its output and consumption respectively, and would remain constant for the lifetime of the hedging scheme (i.e. 15 years from the trigger). Differences between actual output and these F-Factor volumes (whether positive or negative) would incur a TLF based on the new rules for allocating transmission losses (i.e. those contained in Approved Modification P82). Applying the new TLFs to marginal changes in output and consumption would preserve any desirable incentives provided by the new rules. However, applying the TLFs in existence prior to the trigger to fixed (i.e. F-Factor) volumes would provide a means of hedging against the windfall effects of such a change. CVA-registered BM units would have a one-off option to invoke this F-Factor or not (i.e., to set their F-Factor to zero), depending upon whether they wished to take advantage of the scheme or not.

'New' CVA-registered BM Units, those registered on or after 1 December 2001[2], would be able to opt for F-factors based on average plant characteristics (also on a one-off basis). For these F-Factors, they would tie in the zonal TLF prevailing at the time of their registration. This aspect would offer some protection against instability in incentives – e.g. the prospect of TLFs worsening if a second generator connected at the same place.

[2] Any BM Unit registered on or after this period would not have been present for the duration of the baseline period agreed by the P109MG, and therefore would lack the required data set from which to calculate F-Factors on a historical basis..

For SVA-registered BM Units, the scheme would offer similar hedging, subject to the following conditions:

(1) Suppliers within a GSP Group would share a single F-Factor volume defined for the GSP Group as a whole;

(2) consequently, there would be no provision for such Suppliers to opt in or out of the scheme; and

(3) the F-Factor volume would decline gradually to zero over 15 years, to prevent any sudden change in costs to customers.

Interconnector BM Units would be offered hedging similar to that provided for SVA-registered BM Units, subject to the following conditions:

(1) Interconnector BM Units would share a single F-Factor volume defined for the Interconnector as a whole,

(2) the Interconnector Administrator (IA) would make a one-off decision, on behalf of all Interconnector Users, to hedge or not; and

(3) the F-factor volume would constant for the lifetime of the hedging scheme (i.e. 15 years from the trigger).

The table below summarises the different treatment by BM Unit type:

	CVA 'Existing'	CVA 'New'	SVA	Interconnector
Basis for F-Factor Values (F-Factors are the volume to be hedged against varying TLFs)	Sample period from 1/12/01 to 31/11/02[3]	Published statistics for new technology and migrating BM Units, as per CALF Methodology Statement	Pro-rata amount of GSP Group load, based on sample period from 1/12/01 to 31/11/02	Pro-rata amount of Interconnector load, based on sample period from 1/12/01 to 31/11/02
Applicable Loss Factors (ALFs are the Loss Factors to be applied to the F-Factor Volumes)	Dynamically calculated to remove zonal variation.	Prevailing TLF at the time of registration.	Dynamically calculated to remove zonal variation.	Dynamically calculated to remove zonal variation.
Option to Hedge (Allows hedging to be switched on, or off)	Yes (Lead Party)	Yes (Lead Party)	No	Yes (IA)
Duration of Hedge (Time over which the hedge applies)	15 years from month of trigger date	Remainder of 15 years from month of trigger date	15 years from month of trigger date, with a linear rundown	15 years from month of trigger date

[3] Existing in this case means registered prior to the 1 December 2001.

5 RATIONALE FOR PANEL RECOMMENDATIONS

In the first instance, the Panel considered further the vires issues associated with the proposal and acknowledged legal advice provided by ELEXON as to the interpretation of relevant sections of the Code in judging whether a submitted proposal should be taken forward. Two distinct criteria were described:

- A proposal must imply a change to the prevailing Code (F2.1.2 (f) refers), in order to be a Modification Proposal, as defined. If the proposal implies a change to some future version of the Code (i.e. the prevailing Code, plus one or more Approved Modifications) then it is a contingent proposal and is not a Modification Proposal, according to the Code definition. In this latter case, such a proposal can not be considered under section F of the Code.
- If a proposal is considered to be a Modification Proposal then, under F2.1.2, it must address an issue or defect with the prevailing Code (F2.1.2(c) refers). If, however, the Modification Proposal describes an issue or defect that may manifest itself at some future point, as a result of one or more subsequent Code Modifications, but is not an issue or defect with the prevailing Code then the Modification Proposal is anticipatory and the Modifications Secretary (or the Panel) may refuse the Modification Proposal, since no issue or defect currently exists.

It was also stated that, if a proposal is a Modification Proposal and has not been refused, even if it is subsequently determined that it could have been (for example, if it were recognised that no current issue or defect existed), then the Modification Proposal must be processed to its completion, as required by F2.1.7.

The Panel noted that P109 would have an impact on the achievement of the following Applicable BSC Objectives:

- Applicable BSC Objective (b): 'The efficient, economic and co-ordinated operation by the Transmission Company of the Transmission System.'
- Applicable BSC Objective (c): 'Promoting effective competition in the generation and supply of electricity and (so far as is consistent therewith) promoting such competition in the sale and purchase of electricity.'
- Applicable BSC Objective (d): 'Promoting efficiency in the implementation and administration of the balancing and settlement arrangements.'

The principal argument in support of P109, was as follows (see P109MG Assessment Report). Achievement of Applicable Objectives (b) and (c) would be better facilitated through the provision of a more stable investment environment, coupled with the retention of the benefits provided by the locational signals resulting from P82. Limiting exposure of existing investment to variable transmission losses and providing protection against potential future changes in the allocation of transmission losses would increase the efficiency of long-term investment in generation and supply. As a consequence, investment in the Transmission System would be more efficient. In addition, the reduced risk faced by industry as a result of this more stable environment would decrease the cost of capital, reducing barriers to entry. Moreover, the benefits of this reduction in risk would outweigh the implementation costs of P109 – therefore, achievement of Applicable BSC Objective (d) would not be compromised.

The principal arguments against implementation of P109, were threefold (see P109MG Assessment Report). First, P109 would reduce the benefits introduced by P82 through a reduction in the accuracy of the allocation of transmission losses and by diminishing the locational signals of the scheme. Therefore, Applicable BSC Objectives (b) and (c) would be undermined. Second, the purported benefits resulting from the perceived reduction in risk introduced by P109 would be outweighed by increased variability in

'Transmission Loss Multipliers' (TLMs)[4]. Thereby undermining Applicable BSC Objective (c). Finally, Applicable BSC Objective D would be undermined owing to the reduction in efficiency of the settlement arrangements resulting from the cost and complexity of administering P109.

The Panel considered that, although there was a narrow majority of the P109MG who considered that P109 did better facilitate achievement of the Applicable BSC Objectives, the arguments suggesting that this was not the case were the more compelling. Furthermore, it was suggested by one Panel member that the arguments relating to the perceived reduction in the cost of capital afforded by the proposal were not robust and that no such reduction had been demonstrated. Therefore, there was no better facilitation of Applicable BSC Objective C, in that respect. Another Panel member considered that Applicable BSC Objectives would not be better achieved by BSC Parties at large providing a hedge for particular BSC Parties, in respect of zonal losses.

6 LEGAL TEXT TO GIVE EFFECT TO THE PROPOSED MODIFICATION

6.1 Conformed Version

Redlined versions of the legal text are contained in Annex 2. In summary, the changes to legal text are as follows:

- Clause K 3.2.3 will be amended to require submission of the 'Hedging Flag' as part of BM Unit registration, as necessary.
- Clause R 7.4.3 will be amended to oblige Interconnector Administrators to submit relevant 'Allocated Capacity data.
- Clause T 2.3.1 will be amended to reflect changes to the 'TLMO' calculation.
- Clause T 2.4 will be added, describing the 'Applicable Loss Factor' calculation.
- Clause T 2.5 will be added, describing the 'F-factor' calculation.
- Clause T 2.6 will be added, describing the obligations relating to the 'Hedging Flag'.
- Clause T 4.5.1 will be amended to reflect changes to the 'Credited Energy' calculation
- Annex T-3 will be added to describe the 'Hedging Load' derivation.
- Annex X-2 will be amended to include definitions of; Allocated Capacity, Allocated Hedging Volume, Applicable Loss Factor, F-factor, Hedging Flag, Hedging Load, Hedging Volume and Unhedged Credited Energy Volume.

7 ASSESSMENT

In addition to the issues considered initially, as described in the Interim Report, the Assessment Report considered the following issues:

- Impact of the Authority determination in respect of Modification Proposal P82 (Introduction of Zonal Transmission Losses On An Average Basis);
- Different treatment of BM Unit types;
- Different treatment of 'new' and 'existing' CVA BM Units;

[4] 'Transmission Loss Multipliers' ('TLMs') are the multiplicative factor applied to metered volumes in Settlement to allocate transmission losses.

- Use of a CALF-type methodology in calculating the volume to be hedged for new CVA BM Units;
- The sample period for the calculation of the volumes to be hedged;
- Mechanistic rather than discretionary setting of the volumes to be hedged;
- Impact on the cost of capital;
- Credited energy calculations;
- Tradability of the volumes to be hedged; and
- Overall impact (against Applicable BSC Objectives), in the light of the above.

The detailed arguments associated with these issues are contained in the Assessment Report.

The Panel, in its consideration of the Assessment noted the above issues and noted the outcome of an impact assessment, also detailed in the P109 Assessment Report. Furthermore, the Panel noted that the BSC Agent impacts were the result of a High Level Impact Assessment and that, as a consequence, there were limitations on the confidence in the results. However, the HLIA did provide sufficient information on which to base a decision. The Panel also acknowledged that there had been no impact assessment in respect of the data provision requirement on Interconnector Administrators[5], since these requirements had been a late refinement suggested by the P109MG.

A refined High Level Impact Assessment has now been undertaken. This refined HLIA has yielded refinements to the BSC Central Agent costs (development costs of approximately £1.3m and ongoing costs of approximately £185k per annum). Furthermore, both Interconnector Administrators have stated that the proposal would have an impact on them; the Interconnector Administrator for the Scottish Interconnector has suggested costs of some £26k and the Interconnector Administrator for the French Interconnector has advised that any required developments should not take more than nine months and that the agreement of the Interconncetor Users would be required for the required data items to be made available to settlement.

Finally, the Panel noted that the P109MG had suggested two potential implementation dates (01 April 2004 and 01 Auguest 2004), depending on the timing of any Authority determination. The Panel noted the implication that, if implementation were to occur on the later date, there would be an interim period during which all BM Unit volumes would be exposed to live zonal losses. The Panel were also given an assurance that the choice of Implementation Date could be accommodated by the algebraic expressions set down in the requirements.

The P109 Assessment Report did not contain legal text. The Panel consulted with the Authority in order to determine whether the Modification Report should contain such text. The Authority confirmed that legal text was required, and this was included in the draft Modification Report.

8 SUMMARY OF REPRESENTATIONS

A total of 13 responses (42 Parties) to the consultation on the draft Modification Report were received. The majority, 8 responses (26 Parties) agreed with the Panel's provisional recommendation in the draft Modification Report that Proposed Modification P109 should not be made. 1 respondent (1 Party) provided a "No Comment" response. 1 response (2 Parties) was received two days after the closing date.

[5] In parallel with the draft Modification Report consultation, the Interconnector Administrators were asked to provide a High Level Impact Assessment, BSC Agents were asked to update their High Level Impact Assessment in order that any issues can be fully considered by the Panel at their meeting on 13 March 2003.

There were no new arguments. However a number of further points were raised and these are summarised below.

A summary of the responses to the P109 draft Modification Report consultation is included below:

Respondent	Agree with Panel Recommendation	Agree with Legal Text	Agree with Implementation Date	Number of Parties
Enfield Energy Centre	✓	N/C	✓	1
EdF Trading and EdF (Generation)	✓	N/C	N/C	2
SEEBOARD	✓	✓	X	1
Innogy	✓	N/C	✓	9
Teeside Power	x	✓	N/C	1
LE Group	✓	✓	✓	9
Scottish and Southern Energy	x	✓	✓	4
British Gas Trading	✓	✓	N/C	1
National Grid	✓	N/C	N/C	1
British Energy	x	✓	✓	3
Aquila Networks	N/C	N/C	N/C	1
Scottish Power	x	x	✓	7
Edison Mission Energy	✓	unsure	✓	2

N/C = No Comment

8.1 Comments In Support of The Panel Recommendation

A number of those respondents that supported the Panel's recommendation suggested that P109 would be inconsistent with P82, or would dilute the effect of P82. Other remarks from these respondents considered that P109 was complex and thereby undermined the better facilitation of Applicable BSC Objective (d) and could deter new entrants. A further set of remarks suggested that P109 would lead to inaccurate targeting of costs and would delay efficiency benefits arising from P82. Hence Applicable BSC Objectives (b) and (c) would not be better facilitated.

One respondent (1 Party) who supported the Panel's recommendation suggested that the BSC was not the appropriate vehicle for this proposal. The respondent went on to suggest that P109 protected the interests of a small number of Parties, to the detriment of other Parties and that the proposal discriminated between current and new investment (described as 'grandfathering'). This respondent also questioned whether it had been appropriate to have considered P109 at all, since when it was originally raised, Modification Proposal P82 had not been determined upon and the respondent suggested that this made P109 contingent. One respondent (2 Parties) who also supported the Panel recommendation suggested that it was inappropriate for the Interconnector Administrator to be making a commercial decision that would impact on Interconnector Users and that, at the very least, the BSC should require the Interconnector Administrator to consult with Interconnector Users, or for the decision to be deterministic.

8.2 Comments Against The Panel Recommendation

A number of responses disagreed with the Panel recommendation suggested that P109 would improve efficiency by reducing risk across the industry, whilst retaining the benefits of zonal losses. One respondent (4 Parties) suggested that windfall losses and gains which would arise from the implementation of Approved Modification P82 would be reduced by this proposal. One respondent (4 Parties) also noted that there was no consensus amongst economists as to what constituted a cross subsidy but that the concept was generally associated with reduced efficiency. The respondent went on to suggest that the proposal did not reduce efficiency, but enhances it. It should be noted that in raising this point, the respondent noted that a Party had provided related analysis to the Modification Group tasked with considering Modification P82 and other related proposals (the Transmission loss Factor Modification Group; TLFMG). However, all such analysis would have been regarded as being provided by a TLFMG member, independent of any Party.

One respondent (1 Party) asserted that the Panel had failed to recognise the fact that the proposal would reduce the risk profile for all participants, resulting in lower financing costs. One respondent (4 Parties) suggested that a detailed cost-benefit analysis would identify the enhanced efficiency arising from the reduced cost of capital. The respondent further suggests that such a cost benefit analysis should conform to the 'best practice' guidance contained in the Better Regulation Task Force (BRTF) Report on Economic Regulators (Economic Regulators, Better Regulation Task Force, July 2001). The Cabinet Office Code of Practice is also referenced and the respondent notes that the Authority's view has tended to focus on central system costs and the respondent looked forward to the Authority undertaking a thorough and detailed regulatory impact assessment of the proposal. Finally, one respondent (7 Parties) considered that P109 would offset the deleterious effects of P82 and noted that since the Authority appeared to support the concept that a transfer of wealth from one group of Parties to another would better facilitate Applicable BSC Objectives, then a hedge should do likewise.

8.3 Comments on Legal Text

One respondent (7 Parties) identified an amendment in respect of the proposed change to section R of the BSC relating to the requirement for the Interconnector Administrators to submit summated Production and Consumption 'Allocated Capacities' for each Interconnector, respectively. The drafting has been amended to take account of this.

A number of minor refinements to the drafting have been incorporated on the advice of the BSCCo legal advisors.

BSCCo believe that these do not alter the intent of P109 and therefore no further consultation is required.

One respondent (2 Parties) was uncertain as to whether the legal drafting reflected the intent of P109, given the inherent complexity of what was proposed.

8.4 Implementation Date

One respondent (1 Party) disagreed with the suggested Implementation Date on the grounds that they did not support the proposal.

ANNEX 1 – REPRESENTATIONS

Responses from P109 Draft Report Consultation

Consultation issued 21 February 2003

Representations were received from the following parties:

No	Company	File Number	No. BSC Parties	No. Non-Parties
1.	Enfield Energy Centre	P109_DR_001	1	
2.	EdF Trading and EdF (Generation)	P109_DR_002	2	
3.	SEEBOARD	P109_DR_003	1	
4.	Innogy	P109_DR_004	9	
5.	Teeside Power	P109_DR_005	1	
6.	LE Group	P109_DR_006	9	
7.	Scottish and Southern Energy	P109_DR_007	4	
8.	British Gas Trading	P109_DR_008	1	
9.	National Grid	P109_DR_009	1	
10.	British Energy	P109_DR_010	3	
11.	Aquila Networks	P109_DR_011	1	
12.	Scottish Power	P109_DR_012	7	
13.	Edisson Mission Energy	P109_DR_013	2	

P109_DR_001 – Enfield Energy

Respondent:	*Enfield Energy Centre Limited*

No. of BSC Parties Represented	1
BSC Parties Represented	*Enfield Energy Centre Limited*
No. of Non BSC Parties Represented	0
Non BSC Parties represented	Not Applicable
Role of Respondent	*Generator*

Q	Question	Response	Rationale
1	Do you agree with the Panel's views on P109 and the provisional recommendation to the Authority contained in the draft Modification Report? Please give rationale.	Yes / ~~No~~	EECL also fails to see how this modification better facilitates any of the BSC objectives. EECL believes that the purpose of this modification is not to better facilitate the Applicable BSC Objective but to further compromise the benefits locational losses will bring. Furthermore, EECL believes that the complexity of this arrangement is inconsistent with Applicable BSC Objective (d)
2	Do you agree that the legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal? Please give rationale.	Yes / No	
3	Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P109? Please give rationale.	Yes / No	Yes
4	Are there any further comments on P109 that you wish to make?	Yes / No	

P109_DR_002 – Edf Trading Ltd & EdF (Generation)

Respondent:	*Name* EDF Trading Ltd
No. of BSC Parties Represented	Two
BSC Parties Represented	EDF Trading Ltd and EDF (Generation)
No. of Non BSC Parties Represented	None
Non BSC Parties represented	*N/A*
Role of Respondent	Trader and Generator

Q	Question	Response	Rationale
1	Do you agree with the Panel's views on P109 and the provisional recommendation to the Authority contained in the draft Modification Report? Please give rationale.	Yes	The impact of P109 would be to effectively dilute P82 for all parties for some years to come, even though they may have opted out of the Hedging Scheme proposed. Furthermore we are uncomfortable with the concept that the Interconnector Administrator can make a fundamental decision on behalf of the Interconnector Users that will a strong commercial effect on those Users. At the very least should have been a firm recommendation that the IA should actively consult the Users before making any such decision or that a deterministic approach should taken with the decision being decided upon based on the average net flow during 2002.
2	Do you agree that the legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal? Please give rationale.	Yes / No	No comment
3	Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P109? Please give rationale.	Yes / No	No comment
4	Are there any further comments on P109 that you wish to make?	Yes / No	No

P109_DR_003 – SEEBOARD

Respondent:	Dave Morton
No. of BSC Parties Represented	1
BSC Parties Represented	SEEBOARD Energy Limited
No. of Non BSC Parties Represented	0
Non BSC Parties represented	
Role of Respondent	Supplier

Q	**Question**	**Response** Error! Bookmark not defined.	**Rationale**
1	Do you agree with the Panel's views on P109 and the provisional recommendation to the Authority contained in the draft Modification Report? Please give rationale.	Yes	
2	Do you agree that the legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal? Please give rationale.	Yes	
3	Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P109? Please give rationale.	No	As we do not consider that this proposal better facilitates BSC objectives we cannot support any implementation date detailed within draft modification report.
4	Are there any further comments on P109 that you wish to make?	No	

P109_DR_004 – Innogy

Respondent:	*Name: Bill Reed*

No. of BSC Parties Represented	9
BSC Parties Represented	*Please list all BSC Parties responding on behalf of (including the respondent company if relevant).* Innogy plc, Innogy Cogen Limited, Innogy Cogen Trading Limited, Npower Limited, Npower Direct Limited, Npower Northern Limited, Npower Northern Supply Limited, Npower Yorkshire Limited, Npower Yorkshire Supply 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	*(Supplier/Generator/ Trader / Consolidator / Exemptable Generator / BSC Agent / Party Agent / other – please state)* *Supplier/Generator/ Trader / Consolidator / Exemptable Generator*

Q	Question	Response	Rationale
1	Do you agree with the Panel's views on P109 and the provisional recommendation to the Authority contained in the draft Modification Report? Please give rationale.	Yes	We support the Panel's recommendation. We do not believe that the modification proposal better facilitates the relevant BSC objectives. In particular P109 will not better facilitate Objective C of the BSC relating to "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". The electricity market has been aware of the potential need to introduce a zonal transmission losses scheme for a considerable time period (since the Pool scheme was proposed in 1995). Implementation of P109 would inaccurately target the costs of losses to those parties that do not create them for longer than is necessary. In addition, it would delay the efficiency benefits of any zonal scheme from reaching the appropriate market participants, perpetuate the existing cross subsidy, increase the cost of losses and encourage further inefficient investment. Furthermore, P109 does not better achieve Objective D of the BSC. It would be administratively complex and potentially expensive to implement.
2	Do you agree that the legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal? Please give rationale.	Yes / No	We note that the complex algebra and the associated procedures for implementation illustrate the difficulties in implementing this modification proposal.
3	Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P109? Please give rationale.	Yes	This modification should be implemented in the same timescales as P82.
4	Are there any further comments on P109 that you wish to make?	No	

P109_DR_005 – Teeside Power

Respondent:	*Name*

No. of BSC Parties Represented	One
BSC Parties Represented	*Teesside Power Limited*
No. of Non BSC Parties Represented	None
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 agree with the Panel's views on P109 and the provisional recommendation to the Authority contained in the draft Modification Report? Please give rationale.	No	P109 will improve the efficiency of the BSC trading arrangements. The arguments are adequately set out in the P109 documentation prepared by the Modification Group. It is generally accepted that a P109 would achieve reduced risk profile for all market participants which chose to be included in the scheme. The risk profile for those participants which chose not to be included would remain unchanged. hence the risk profile overall for market participants will reduce: this will inevitably result in lower financing costs for the industry. Whilst the work on quantifying the level of reduction in financing costs had not been completed, it requires only a small reduction to offset any costs of implementation. The Panel failed to recognise this fact in reaching its decision.
2	Do you agree that the legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal? Please give rationale.	Yes	
3	Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P109? Please give rationale.	Yes / No	Not applicable.
4	Are there any further comments on P109 that you wish to make?	Yes / No	

P109_DR_006 – LE Group

Respondent:	*Rupert Judson on behalf of LE Group*
No. of BSC Parties Represented	9
BSC Parties Represented	LE Group plc, London Electricity plc, Jade Power Generation Ltd, Sutton Bridge Power Ltd, West Burton Power, London Power Networks plc, EPN Distribution Ltd, Seeboard Power Networks plc, Seeboard Energy Ltd.
No. of Non BSC Parties Represented	None that we consider applicable
Non BSC Parties represented	*N/A*
Role of Respondent	Supplier / Generator / Party Agent / Distribution Business

Q	Question	Response	Rationale
1	Do you agree with the Panel's views on P109 and the provisional recommendation to the Authority contained in the draft Modification Report? Please give rationale.	**Yes**	We believe that the changes proposed by P109 would distort the allocation of the costs of transmission losses and the locational signals provided by P82. This would effectively undo the benefits delivered by P82 and would therefore be detrimental to the achievement of BSC objective (b), the efficient operation of the transmission system; and, objective (c), promoting effective competition in generation and supply. We are also concerned about the complexity of the proposed modification which we believe would be detrimental to the achievement of BSC Objective (d), the efficient administration of the balancing and settlement arrangements. We also believe that this complexity would deter new entrants to the market and is consequently detrimental to the promotion of competition (BSC Objective (c)).
2	Do you agree that the legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal? Please give rationale.	**Yes**	
3	Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P109? Please give rationale.	**Yes**	Notwithstanding our comments above, we believe that the recommended implementation date is both achievable and consistent with the implementation of modification P82.
4	Are there any further comments on P109 that you wish to make?	**No**	

P109_DR_007 – Scottish and Southern

Dear Sirs,

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

In relation to the four questions listed in the Consultation Paper, contained within your note of 21st February 2003 concerning Modification Proposals P109, we have the following comments to make:-

Q1 Do you agree with the Panel's views on P109 and the provisional recommendation to the Authority contained in the draft Modification Report?
Please give rationale.

No. We do not agree with the Panel's view. We believe that P109 will better facilitate the achievement of the Applicable BSC Objectives (c): Promoting effective competition in the generation and supply of electricity and (so far as is consistent therewith) promoting such competition in the sale and purchase of electricity.

We note the comments made by the TLFMG that since competition is a tool that produces efficient outcomes, in practice they must mean the same thing. It therefore follows that an outcome that does not promote efficiency cannot promote competition. In addition, risk imposes a cost on industry participants and reducing risk reduces costs and enhances efficiency.

Furthermore, we note the slide presentations made at the September 24th zonal losses meeting which referred to there being "Winners" and "Losers" in terms of Generation and Demand. Any future change in the value of TLFs suggest in P82, we believe would:-

a) create large windfall gains and losses for existing generators and consumers; and
b) introduce a risk arising from future changes in TLFs for both existing participants and new entrants.

We believe that Modification Proposal P109 allows the retention of any potential benefit from changing incentives while significantly reducing windfall gains and losses among existing participants and the risk of future changes in the TLF for existing and new participants. It therefore follows that P109 will reduce the overall level of risk in the industry resulting in enhanced efficiency in the sale and purchase of electricity.

Furthermore, in our view Modification Proposal P109 would reduce the cost of capital in the industry by reducing the level of perceived risk which we believe a detailed cost-benefit analysis would identify. Such a detailed cost-benefit analysis should, in our view, conform to the 'best practice' guidance contained in the Better Regulation Task Force (BRTF) report on Economic Regulators ("Economic Regulators, Better Regulation Task Force, July 2001").

In line with the Recommendation 2 of the BRTF the Authority "should be required to produce assessments of costs and benefits for proposals with a significant impact on business activity". The Cabinet Office Code of Practice also makes clear that a consultation "should so far as possible include an assessment of the impact of the proposals on groups likely to be particularly affected" (page 10, Para 2).

We note, in this respect, that the Authority's view of what constitutes a cost-benefit analysis could be considered to be more akin to a 'cost of systems'; i.e. central system costs etc.; study. Where the Authority has considered costs at all (see for example the Authority's evidence to the House of Commons Trade and Industry committee), it has tended to refer only to the Authority or central system costs, not implementation costs across market participants; nor has it appeared to take account of the Authority's wider objectives in respect of the environment and other matters. In the light of the Government's recent Energy White Paper, and the associated comments concerning the Authority and regulatory impact assessments, we look forward to the Authority using the opportunity, in considering this P109 Modification, to undertake a thorough and detailed regulatory impact assessment.

For the avoidance of doubt, we believe that the cost of implementation of P109 (that is the 'system' costs and the overall non system related costs) to market participants will be low.

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

Yes.

Q3 Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P109? Please give rationale.

If the Modification Proposal P109 is approved, we agree with the proposed BSC Panel recommendation on the timing for the Implementation Date, as outlined in Section 1.1 of the Modification Report.

Q4 Are there any further comments on P109 that you wish to make?

We understand that there is a belief that Modification Proposal P109 may entail cross-subsidies, a view that we disagree with.

Consultation documents issued by Elexon regarding P109 have indicated that: "a member of the TLFMG has suggested that Applicable Objective (c) would not be better achieved because P109 would result in a ?cross-subsidy', however, there was no agreement as to what constitutes a ?cross-subsidy? or whether or not P109 would result in one."

In our view there is no consensus, in economic literature, on the precise definition of a "cross-subsidy". However, it is clear that cross-subsidies are generally associated with reduced efficiency (i.e. a reduction in overall welfare). As we have argued in the answer to Q1 above, P109 enhances efficiency and we have seen no evidence in the Consultation Document, to the contrary. From this we deduce that P109 does not give rise, by any reasonable definition, to a "cross-subsidy" situation.

It is our understanding that one Party, in their submission to the TLFMG, claims to show evidence of cross-subsidies. However, it is important to note that this submission does not provide evidence on any reasonable definition of a cross-subsidy or on how the P109 scheme will harm the efficiency of the industry. The spreadsheet included in that submission merely shows that the payments made to some players are recovered from all; since the same could be said of house insurance and other legitimate risk-sharing schemes, this observation cannot possibly constitute a definition of a "cross-subsidy"

The main contention of the submission, which was accompanied by worked examples of the scheme, was that:-

a) "TLMs depend upon F factor hedging decision of all participants"; and that
b) "in order to hedge effectively, [participants] need to know the [hedging] decisions of others".

The first statement (a) is true but does not describe a cross-subsidy. The fact that the loss allocation of a participant depends on the decisions of other participants is true in any scheme where allocated losses and actual losses must be equal. In particular the metered quantity of a participant affects the metered quantities of other participants through the TLMO factor in the TLMs.

With respect to the second statement, (b) the Party seems to be implying that participants would need to know the value of TLMO (in order to predict their TLM) before deciding whether or not hedging would be worthwhile. This interpretation is incorrect, since the value of hedging depends entirely on the difference between future TLFs (which any investor would need to assess anyway) and the ALF applicable to the participant (which is known). TLMO affects all participants equally and so feeds through into market prices. Hence, although the size of TLMO depends on hedging decisions of all participants, the optimal hedging decision of an individual does not depend on TLMO.

Furthermore, the Party seems to incorrectly understand how an optimal hedging decision would be taken and erroneously concludes from this that P109 "would be unworkable". The Party states that

> In effect a generator that is 100% hedged could be worse off in a F factor scheme than if he had remained with an unhedged factor. For example parties in zone 7 are worse off by £469.85 with a 100% hedge for the winter peak compared with being worse off by £292.86 with an unhedged volume. This perhaps illustrates that P109 could be unworkable in practice.

The first part of this statement is not very meaningful and applies to any form of insurance; it is equivalent to saying that someone could have car insurance and not have an accident.

The statement along with the example seem to imply that knowing one's future TLF and the ALF is not enough to know whether to hedge or not. This is incorrect. In the example cited zone 7 BMUs have an ALF of approximately -0.009 and a future TLF of approximately -0.006. Given that TLF<ALF the optimal hedging decision for zone 7 BMUs would therefore be not to hedge. Accordingly if a BMU in zone 7 makes the erroneous decision to hedge it will

get a larger quantity of losses allocated to it than if it doesn't hedge. In conclusion the example used in the Party's submission does not in any way suggest that P109 "could be
unworkable in practice".

Regards

Garth Graham
Scottish and Southern Energy

P109_DR_008 – British Gas Trading

Re: Modification Proposal 109: A Hedging Scheme for Changes to TLF in Section T of the Code
Thank you for the opportunity of responding to the draft modification report for Modification Proposal 109. British Gas Trading (BGT) do not support this proposal. We do not believe it will better facilitate the applicable BSC Objectives.

BGT do not support this proposal because:
- We do not believe the BSC is an appropriate document to provide hedging for the risks of individual parties. Furthermore this will be protecting the interests of a limited number of parties to the detriment of others.
- The proposal will unduly discriminate between new entrants and current market participants by 'grandfathers' rights of existing parties.
- The scheme proposed is very complex and will unnecessarily increase the administrative burden on BSCCo.
- Introduction of the hedging scheme will clearly distort any locational signals that will be provided by the average zonal losses scheme due for implementation by virtue of Modification Proposal 82. We would therefore see this as being inconsistent with Ofgem's thinking with regards to transmission losses as detailed in the Authority's decision letter for P82.
- The validity of the modification proposal being considered at all is questionable as it was raised before P82 was approved, thus making P109 contingent.

Yours faithfully

Danielle Lane

P109_DR_009 – NGC

Respondent:	*National Grid*
No. of BSC Parties Represented	1
BSC Parties Represented	*National Grid*
No. of Non BSC Parties Represented	N/A
Non BSC Parties represented	*N/A*
Role of Respondent	*BSC Party*

Q	Question	Response	Rationale
	Do you agree with the Panel's views on P109 and the provisional recommendation to the Authority contained in the draft Modification Report? Please give rationale.	Yes	We agree that P109 does not better facilitate the Applicable BSC Objectives. There are a number of benefits provided to participants with the introduction of P109. However, these benefits are unlikely to outweigh the complexity and costs involved in implementing and administering such a scheme, and will tend to undermine the benefits of P82.
	Do you agree that the legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal? Please give rationale.	Yes	The proposed legal text reflects the complexity of implementing P109. However, we agree that the legal text supplied addresses the proposed defect outlined in the Modification Proposal.
	Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P109? Please give rationale.	Yes / No	We do not believe that P109 should be implemented. If P109 is implemented, the proposed Implementation Date would be achievable.
	Are there any further comments on P109 that you wish to make?	No	

P109_DR_010 – British Energy

Respondent:	J R Capener
No. of BSC Parties Represented	3
BSC Parties Represented	British Energy Generation Ltd, British Energy Power & Energy Trading Ltd, Eggborough Power Ltd
No. of Non BSC Parties Represented	
Non BSC Parties represented	
Role of Respondent	(Supplier/Generator/ Trader)

Q	Question	Response	Rationale
	Do you agree with the Panel's views on P109 and the provisional recommendation to the Authority contained in the draft Modification Report? Please give rationale.	**No**	British Energy continues to believe that the introduction of a hedging mechanism as set out in P109, which seeks to address a deficiency in the baseline BSC. The BSC is presently devoid of efficient signals for long-term investment due to the risk of a change in Transmission Loss Factors (TLFs). The modification seeks to mitigate this risk through a scheme that protects investors against the windfall effects of future changes to TLFs, whilst maintaining economic incentives at the margin, so that investors react more efficiently to current and future incentives within the Code. P109 will better facilitate achievement of Applicable Objectives (b) and (c) through the provision of a more stable investment environment, coupled with the retention of the benefits provided by the locational signals resulting from P82. Limiting exposure of existing investment to variable transmission losses and providing protection against potential future changes in the allocation of transmission losses would increase the efficiency of long-term investment in generation and supply. As a consequence, investment in the Transmission System would be more efficient. In addition, the reduced risk faced by industry as a result of this more stable environment will decrease the cost of capital, reducing barriers to entry. Moreover, the benefits of this reduction in risk will outweigh the implementation costs of P109 – therefore, achievement of Applicable BSC Objective (d) is not be compromised.
	Do you agree that the legal text provided in the draft Modification Report	**Yes**	

Q	Question	Response	Rationale
	correctly addresses the defect or issue identified in the Modification Proposal? Please give rationale.		
	Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P109? Please give rationale.	**Yes**	
	Are there any further comments on P109 that you wish to make?	**No**	

P109_DR_011 – Aquila Networks

Please find that Aquila Networks response to P109: A Hedging Scheme for Changes to TLF in Section T of the Code, is 'No Comment.'

Regards,

Jason Guest

On Behalf of Rachael Gardener

Jason J Guest
Distribution Support Office
Aquila Networks plc

P109_DR_012 – Scottish Power

Respondent:	Name John W Russell (SAIC Ltd)
No. of BSC Parties Represented	*7*
BSC Parties Represented	Please list all BSC Parties responding on behalf of (including the respondent company if relevant). Scottish Power UK plc; ScottishPower Energy Trading Ltd.; Scottish Power Generation plc; ScottishPower Energy Retail Ltd.; SP Transmission plc; 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 / BSC Agent / Party Agent / other – please state) Supplier / Generator / Trader / Consolidator / Exemptable Generator / Party Agent / Interconnector Administrator

Q	Question	Response	Rationale
	Do you agree with the Panel's views on P109 and the provisional recommendation to the Authority contained in the draft Modification Report? Please give rationale.	**No**	*ScottishPower is disappointed to note the Panel's decision to reject Modification Proposal P109.* *We believe that the deleterious effects on overall efficiency caused by the introduction of locational loss factors, so lightly dismissed by Ofgem in their decision letter on Modification Proposal P82, could, to some extent, be offset by the implementation of P109.* *P109 is specifically designed to retain the exposure of the marginal production of energy to locational loss factors so that any short term efficiency benefits which may be achieved through their use would be retained.* *We note the argument that the Applicable BSC Objectives are not better facilitated by BSC Parties at large providing a hedge for particular BSC Parties.* *In response we would point out that Ofgem considered that a group of BSC Parties providing a straightforward transfer of wealth to another did indeed facilitate the Applicable BSC Objectives; providing a hedge must surely do likewise.* *We would suggest that, in terms of the commercial impact of regulatory intervention, P109 is significantly less disruptive than P82 and would go some way to redressing the distortionary effects of P82.*
	Do you agree that the legal text provided in the draft Modification Report correctly addresses the defect or issue identified in the Modification Proposal? Please give rationale.	**No**	*Legal Drafting - Section R* *The published text of the modified Section R7 is:* *7.4.3 For each Settlement Day, the Interconnector Administrator shall submit to the SAA in accordance with BSCP 04 the BM Unit Metered Volumes for each relevant Interconnector BM Unit in respect of each Settlement Period.:* *(a) the BM Unit Metered Volumes; and* *(b) the BM Unit Allocated Capacity.* *Add new paragraph 7.4.4 as follows:* *7.4.4 For each Settlement Day, the Interconnector Administrator shall submit to the SAA in accordance with BSCP 04 for each relevant Production and Consumption Interconnector BM Unit the sum of the Allocated Capacities for each BM Unit in respect of each Settlement Period.*

Q	Question	Response	Rationale
			This wording in 7.4.4 does not work because it relates the sum of the Allocated Capacities to "each BM Unit". The sum of the Allocated Capacities should be across each of all Production BM Units and all Consumption BM Units. *We would suggest the following drafting:* *For each Settlement Day and in respect of each Settlement Period, the Interconnector Administrator shall submit to the SAA in accordance with BSCP 04:* *a) the BM Unit Metered Volume and the BM Unit Allocated Capacity for each relevant Interconnector BM Unit, and* *b) the sum of the Allocated Capacities for the relevant Production Interconnector BM Units and the sum of the Allocated Capacities for the relevant Consumption BM Units.*
	Do you agree with the Panel's provisional recommendation concerning the Implementation Date for P109? Please give rationale.	**Yes**	*The implementation date for P109 should mirror that of P82 as this will go some way to redressing the distortionary effects of P82.*
	Are there any further comments on P109 that you wish to make?	**Yes**	*ScottishPower urges the Panel to reconsider its decision on P109 and to recommend to Ofgem that the Modification be made.*

P109_DR_012 – *Edison Mission Energy*

Respondent:	*Name Edison Mission Energy*
No. of BSC Parties Represented	2
BSC Parties Represented	*First Hydro Company, Edison First Power*
No. of Non BSC Parties Represented	
Non BSC Parties represented	
Role of Respondent	*Generator*

	Question	Response	Rationale
	Do you agree with the Panel's views on P109 and the provisional recommendation to the Authority contained in the draft Modification Report? Please give rationale.	Yes	There are a number of reasons why EME believes that the modification should not be made. **Complexity and Cost** EME believes that this modification is overly complex. This was clearly evident at the final modification meeting where there were a number of different understandings as to how the modification worked and how hedged volumes were calculated. If the modification group do not understand the workings of the modification will it be clear to the industry in general? In addition the mechanism is costly and there is no proved benefit of the scheme. **Effectiveness** The stated intention of the modification is to reduce the cost of investment by reducing regulatory risk, however this assertion has not been proved. The model used to calculate the cost of capital was particularly sensitive to input parameters and so no weight can be placed on the results of this work. In addition, it is not clear that F factors provide an effective hedging mechanism as they are assigned on an individual BMU basis according to history. However, historic usage takes no account of the flexible way in which many participants operate their portfolios. This flexibility includes mothballing units for a period of time or taking outages at different times of the year in response to market signals. This flexibility improves the efficiency of the system and any signal to be less flexible in order to hedge losses is detrimental to efficiency. The scheme provides certainty of TLFs for participants but does not provide certainty of TLMs which are used to calculate losses. If some extra volatility in TLMs is introduced because of this scheme this extra risk may outweigh the benefits of stable TLFs and the cost of capital will not reduce. **Discrimination** There are 2 issues with regard to discrimination which need to be addressed as these

				could lead to a reduction in competition. Firstly, there is a difference between treatment of existing and new plant in the South. Existing plant in the South has the choice of hedging at the old loss value (TLF=0) or remaining unhedged. However, plant which registers in the South once the scheme is in existence will be able to lock into a beneficial TLF and therefore has an advantage over existing plant which has no such option The second area of possible discrimination is regarding plant in Scotland. Under the proposals, Scottish generators will be able to opt out of P109 for consumption BMUs and opt in for production BMUs, thereby benefiting optimally from the scheme. For Scottish pumped storage plant, the difference in loss factors for generating and pumping can be directly translated into an increase in efficiency. This gives and advantage to Scottish pumped storage units as compared to those in England and Wales. For pumped storage units in E&W there is no possibility of making different hedging decisions for generating and pumping; either both opt in or both opt out.

ANNEX 2 – LEGAL TEXT

See attached separate documents.

Annex 2a – Changes to Section K

Annex 2b – Changes to Section R

Annex 2c – Changes to Section T

Annex 2d – Changes to Annex X2