

What stage is this document in the process?

01 Initial Written Assessment

02 Definition Procedure

03 Assessment Procedure

▶ 04 Report Phase

P314 'Reduction in PAR from 500MWh to 350MWh'

This Modification proposes a reduction in the Price Average Reference value from 500MWh to 350MWh during winter 2014/15, with the aim of improving imbalance price signals.

The Workgroup's Alternative Modification would also reduce PAR to 350MWh, but would do so ahead of winter 2014/15.



The BSC Panel recommends **rejection** of the both the P314 Proposed and Alternative Modifications

This Modification is expected to impact:

- ELEXON
- BSC Parties



Any questions?

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About This Document

This is the P314 Final Modification Report, which ELEXON has submitted to the Authority on behalf of the BSC Panel. It includes a summary of the Workgroup's assessment, the Panel's full views and the responses to both the Workgroup's Assessment Consultation and the Panel's Report Phase Consultation. The Authority will consider this report and will decide whether to approve or reject P314.

There are six parts to this document:

- This is the main document. It provides details of the solution, impacts, costs, benefits, drawbacks and proposed implementation approach. It also summarises the Workgroup's key views on the areas set by the Panel in its Terms of Reference, and contains details of the Workgroup's membership and full Terms of Reference.
- Attachment A contains the approved redlined changes to the BSC for both the proposed and alternative Modifications under P314.
- Attachment B contains the full responses received to the Workgroup's Assessment Procedure Consultation.
- Attachment C contains the P304 Workgroup's analysis on a PAR value of 100MWh.
- Attachment D contains the P304 Workgroup's analysis on a PAR value of 250MWh.
- Attachment E contains the P304 and P314¹ Workgroup's analysis on a PAR value of 350MWh.

¹ Please note that this is the P304 Workgroup's PAR350 analysis supplemented with work completed by the P314 Workgroup and that this is different to the PAR350 analysis attached to the P304 Final Modification Report.

Why Change?

The existing imbalance arrangements have the effect of dampening imbalance price signals, meaning that they do not provide sufficient indication to the market of the value of flexible capacity when margins are tight. A potential cause of this price dampening is the level of the Price Average Reversion (PAR), which is currently set at 500MWh. Deriving a weighted average from a volume of 500MWh creates an imbalance price which does not reflect the marginal cost of balancing energy for a given Settlement Period.

P314 contends that a reduction to 350MWh is more appropriate than a reduction to 250MWh, as proposed by Modification P304 and that Parties should be given more time to prepare for a change to PAR.

Proposed Solution

The P314 proposed solution seeks to introduce a reduction in the PAR volume from 500MWh to 350MWh and gives Parties approximately 2½ months' notice of this reduction, with an Implementation Date of:

- **2 January 2015** if an Authority decision is received on or before 17 October 2014; or
- **52 Working Days** following an Authority decision, if it is received after 17 October 2014.

Alternative Solution

The Workgroup's alternative solution also proposes a reduction in PAR to 350MWh but with an alternative Implementation Date (matching that of P304) of:

- **31 October 2014** if an Authority decision is received on or before 17 October 2014; or
- **10 Working Days** following an Authority decision, if it is received after 17 October 2014.

Impacts & Costs

We do not anticipate any direct impacts on BSC Parties due to the implementation of P314. BSC Parties may be indirectly impacted by the effects of the reduced PAR value on imbalance prices.

Recommendation

The Panel **by majority** recommends that:

- The **P314 Proposed Modification** does not better facilitate the Applicable BSC Objectives compared with the current baseline, and should therefore be **rejected**; and
- The **P314 Alternative Modification** better facilitates the Applicable BSC Objectives compared with the Proposed Modification, but does not do so compared with the current baseline, and should therefore be **rejected**.

What are imbalance prices?

Imbalance prices, which are known as 'cash-out' prices, are a key part of the wholesale electricity trading arrangements in Great Britain.

Under the current arrangements, market participants that require electricity for their customers (Suppliers) enter into contracts with organisations that produce electricity (generators). However, contracts between these participants are not always exactly delivered in real time causing an imbalance between energy generation and demand on the Transmission System. This can cause problems as electricity cannot easily be stored economically in large quantities and generation must always match consumer demand in real time if a stable system is to be maintained.

For any given Settlement Period (each half hour), Parties may trade with each other up to Gate Closure, which occurs one hour prior to the start of that Settlement Period. Parties aim to balance their position for a given Settlement Period by Gate Closure to ensure that the amount of energy generated and bought matches the amount of energy consumed and sold. However, there are circumstances where this does not happen. For example, if a generator experiences an unexpected outage that does not allow them to generate their projected amount of energy, or if a Supplier over or under estimates the amount of energy their customers actually use. This leaves the Party in an imbalanced position for that Settlement Period.

To balance energy on the Transmission System the Transmission Company, acting as System Operator (SO), assesses the amount of generation and the amount of demand expected for each Settlement Period. If required, the SO will take balancing actions² to balance the system so that the total amount generated matches the total amount consumed. The SO does this by issuing Bids and Offers via the Balancing Mechanism or Balancing Service Adjustment Actions (BSAA)³ to participants (usually generators) to increase or decrease the amount of energy they need to produce (or consume) to ensure the system is balanced. The SO will do this prior to and throughout the Settlement Period to ensure the system is balanced at all times.

Following the end of a Settlement Period, ELEXON (using the BSC Systems) will compare the amount of energy each Party contracted with its metered volumes for the Settlement Period, accounting for any accepted Bids and Offers and other applicable balancing service volumes. Any surplus or shortfall that the Party has is called the imbalance volume and is paid for using the relevant imbalance price:

- If the Party is **short** (it consumed more energy than it had bought or sold more energy than it had generated) then it pays for its shortfall at the **System Buy Price** (SBP).
- If the Party is **long** (it generated more energy than it had sold or bought more energy than it had consumed) then it is paid for its surplus at the **System Sell Price** (SSP).

² A balancing action is an instruction to a Party, in accordance with agreed rules, to either increase or decrease generation, or increase or decrease demand. Parties must also submit details of their contracts to the BSC Systems.

³ Balancing Service Adjustment Actions (BSAA) are the technical services that the System Operator purchases outside the Balancing Mechanism. This is described in [Balancing Services Adjustment Data \(BSAD\) Methodology Statement](#).

There are two methods for calculating the imbalance price:

- The **Main Price** is based on the costs of energy balancing actions incurred to the Transmission Company for that Settlement Period.
- The **Reverse Price** is based on the short term market price of wholesale electricity traded on the power exchanges for that Settlement Period.

The method (Main Price or Reverse Price) which is to be applied to an imbalance price (SBP or SSP) for each Settlement Period is determined by whether the system as a whole was long (Net Imbalance Volume (NIV) is zero or negative) or short (NIV is positive) for that Settlement Period:

- If the system is long, the SSP will be the Main Price and the SBP will be the Reverse Price.
- If the system is short, the SBP will be the Main Price and the SSP will be the Reverse Price.

As a result, the Main Price is applied to any Party whose imbalance was in the same direction to, and is considered to have contributed to the overall system imbalance. These Parties will therefore face the costs of the balancing actions accepted by the SO to resolve energy imbalance on the system. Conversely, the Reverse Price is applied to any Party whose imbalance was in the opposite direction to the net imbalance, and is considered to have helped to reduce the overall system imbalance. Therefore, these Parties might face the costs they would have incurred had they traded out their imbalance position on the power exchanges near Gate Closure.

Further information on imbalance prices can be found on the [imbalance pricing page](#) of our website.

What is the Price Average Reference volume?

The PAR volume is used in the Main Price calculation. It is a volume of actions in the dominant direction from which a weighted average is calculated.

PAR captures the most expensive actions remaining after a series of “tagging” operations have been conducted by the SO. The tagging process eliminates the most expensive actions in the dominant direction that have a matching volume to any in the reverse direction. The PAR volume (MWh) for the most expensive energy balancing actions remaining is the volume used to set the Main Price.

Originally under the current arrangements, imbalance prices were calculated as an average of all actions taken by the SO to balance the system. This was subsequently changed to the most expensive 500MWh of actions under [P205 'Increase in PAR level from 100MWh to 500MWh'](#) in November 2006. This level of 500MWh has since been maintained.

Further information on PAR can be found on the [imbalance pricing page](#) of our website.

What is the Electricity Balancing Significant Code Review?

In August 2012, Ofgem launched the [Electricity Balancing Significant Code Review](#) (EBSCR) to address long-standing concerns on electricity balancing arrangements raised in its 2010 [Project Discovery Report](#). In particular, Ofgem expressed concerns that imbalance

prices are not creating the correct signals to allow the market to balance, leading to increased risks to future security of supply.

Ofgem completed its review of the electricity balancing arrangements and published its [Final Policy Decision](#) on 15 May 2014. The final decision document lays out Ofgem's conclusions and builds on the extensive analysis and stakeholder engagement conducted during the EBSCR.

P304 and P305

Ofgem published its [Final Policy Decision](#) on the EBSCR on 15 May 2014 and directed National Grid (as the Transmission Company) to raise the relevant Modifications to put the package of reforms in place.

National Grid raised [P304 'Reduction in PAR from 500MWh to 250MWh'](#) and [P305 'Electricity Balancing Significant Code Review Developments'](#) to progress a package of changes that came out of the EBSCR, as follows:

- initial reduction in the PAR value to 250MWh (under P304);
- further reduction in the PAR value following P304 (50MWh from winter 2015/16, then 1MWh from winter 2018/19) and changes to the Replacement PAR (RPAR) volume which is currently set at 100MWh;
- a single imbalance price, calculated using the main price calculation;
- the introduction of Reserve Scarcity Pricing (RSP); and
- the introduction of Value of Lost Load (VoLL) pricing for Demand Control actions.

What is the issue?

P314 contends that the existing imbalance arrangements have the effect of dampening imbalance price signals, meaning that they do not provide sufficient indication to the market of the value of flexible capacity when margins are tight. As a result, imbalance price signals may have failed to create appropriate incentives for investment in flexible capacity (such as flexible generation, Demand Side Response (DSR) services and storage).

A potential cause of this price dampening is the level of PAR, which is currently set at 500MWh. Deriving a weighted average from a volume of 500MWh creates an imbalance price which does not reflect the marginal cost of balancing energy for a given Settlement Period. This is especially true at times of system stress when differences between the costs of accepted balancing actions are greatest.

P304 was also raised to address this issue, but the Proposer of P314 believes that a more modest reduction of PAR to 350MWh would be a more appropriate first step, and that Parties should be given more notice of the reduction in PAR to allow more time to prepare.

Request for Urgency

Interactions with P304

In order to assess whether a PAR value of 250MWh was the most appropriate value, the P304 Workgroup completed analysis on PAR values of 100MWh, 250MWh and 350MWh.

This analysis indicated that, under the current arrangements, there would be some adverse impacts across different types of industry participant, in particular independent Suppliers (i.e. Suppliers who were not part of a vertically integrated Party). This analysis also showed that the higher the PAR value the smaller the impact on industry participants.

There is no alternative solution under P304. Though, at the final Workgroup meeting a member suggested a possible alternative solution for consideration by the Workgroup that was similar to the P314 proposed solution, as detailed below:

- a reduction in PAR to 375MWh (as the higher the PAR value the smaller the impact);
- PAR reverting back to 500MWh at the end of 2015; and
- suggested implementation in January 2015 (to allow the industry more time to assess the effects of a lower PAR value).

The Workgroup did not take this potential solution forward as the majority of members did not support a PAR value of 375MWh and were uncomfortable with the idea of PAR reverting back to a value of 500MWh as it could create uncertainty under the current arrangements.

Full details of the P304 Workgroup discussions can be found in the Assessment Report published on the [P304 page](#) of the ELEXON website. The analysis completed under P304 can be found in Attachment C (100MWh), Attachment D (250MWh) and Attachment E (350MWh).

Proposer's rationale for Urgency

The Proposer requested that P314 be treated as an Urgent Modification Proposal to allow the Authority to make a decision on both P314 and P304 at the same time.

The Proposer also requested urgency due to potential negative commercial impacts to the industry following the announcement that a large nuclear generation plant will be taken offline during winter 2014/15.

Panel's views

The Panel considered the Proposer's request for Urgent status on 8 September 2014. Following its consideration, the Panel unanimously agreed that P314 should be treated as an Urgent Modification Proposal due to potential significant commercial impacts (as noted by the Proposer, above) and to allow the Authority to consider P314 alongside P304.

Authority's decision

The Authority consented to P314 being treated as an Urgent Modification Proposal on 10 September 2014. The Authority's decision on Urgency for P314 can be found on the [P314 page](#) of the ELEXON website.

Proposed Solution

First Utility raised [P314 'Reduction in PAR from 500MWh to 350MWh'](#) on 4 September 2014. This Modification proposes a reduction in the PAR volume to 350MWh. The Proposer contends that reducing PAR to a value of 350MWh will improve the strength of imbalance price signals during winter 2014/15. The Proposer also contends that Parties should be given appropriate notice of this reduction so they can better understand the effects of a lower PAR value and prepare for any impacts.

[P304](#) was raised by National Grid on 30 May 2014 and is currently in the Report Phase of its progression. P304 proposes a reduction in the PAR volume from 500MWh to 250MWh on 31 October 2014. The P304 Workgroup's analysis confirmed that a reduced PAR value under the current dual priced regime does have some adverse distributional effects on different types of industry participant. This is especially the case at times of system scarcity and potentially adversely affects competition in the market.

The P314 Proposer believes that a reduction in PAR to a value of 350MWh with an Implementation Date of 2 January 2015 will help prepare the market for a move towards a more marginal price and provide an increased signal of scarcity on the system (but limit the adverse impacts under the current dual priced market). They also believe that implementing a reduction in PAR later will allow for the expected nuclear plant outage to end (as it may result in exceptionally high imbalance prices). The Proposer contends that the P314 proposed solution allows the objectives of the ESBCR to be achieved but at a reduced risk to market participants.

The P314 proposal originally included a 'sunset clause' so that PAR would revert back to 500MWh on 5 November 2015. However, the Proposer decided to remove this aspect from the proposed solution following the initial discussions of the P314 Workgroup.

In summary, the P314 proposed solution is to:

- reduce the PAR volume from 500MWh to 350MWh; and
- implement this change on 2 January 2014, giving Parties approximately 2½ months' notice of the reduction.

Alternative solution

The majority of the Workgroup did not agree with an implementation date for P314 of 2 January 2015, but acknowledged that the implementation lead time that drives this date reflects that the Proposer believes Parties should be given time to prepare for the PAR reduction; which is integral to the P314 proposed solution.

The Workgroup therefore developed an alternative solution that would introduce the same reduction in PAR, from 500MWh to 350MWh, but with an implementation date of 31 October 2014. This is because a reduction in PAR could have more of an effect over winter 2014/15 and provide Ofgem with an option that more closely reflects P304 (which proposes the same Implementation Date).

In summary, the P314 alternative solution is to:

- reduce the PAR volume from 500MWh to 350MWh; and
- implement this change on 31 October 2014, giving Parties 10 Working Days' notice.

Full details of the Workgroup's development of these solutions, and on the proposed Implementation Dates, can be found in Sections 5 and 6.

Proposed draft legal text changes

This Modification proposes changes to BSC [Section T 'Settlement and Trading Charges'](#) to introduce a reduction in the PAR volume from 500MWh to 350MWh, as shown in Attachment A.

Please note that the draft legal text changes are the same for both the proposed and alternative solutions, as the only difference between the two is the recommended Implementation Date and implementation lead times from the point of approval.

Estimated central implementation costs of P314

The estimated central implementation costs associated with P314 (for both the proposed and alternative solutions) are minimal. It will take approximately one ELEXON man day (equating to £240) to implement changes to the BSC and to change a central system parameter as part of business-as-usual operations to reduce the PAR value to 350MWh.

Indicative industry costs of P314

There are no direct implementation impacts on BSC Parties or Party Agents for either the P314 proposed or alternative solution. However, if industry participants have elected to store or use the value of PAR in their systems there may be a cost associated with changing the value. Some respondents to the Assessment Consultation indicated that any costs associated with system changes to implement P314 would be minimal.

All respondents to the Assessment Consultation noted indirect impacts as a result of P314 being implemented. Some respondents indicated that the impacts would be positive on their organisation. Others noted that, due to the consequential rise in imbalance prices and imbalance charges (as a consequence of reducing the PAR value), there would be additional cost to their organisation. For example, additional imbalance costs, additional costs associated with actions to attempt to mitigate risk, increased credit requirements and changes to operational processes and systems. It was also noted that there may be additional hedging costs to manage the increased risks.

One respondent advised that its initial calculations show that P314 will result in its organisation having to increase working capital between £1m and £2m. The respondent confirmed that estimated increase in working capital would be to cover additional imbalance charges. The respondent noted that the only difference between the proposed and alternative solutions is simply when the increase in working capital would occur.

Full details of the Assessment Consultation Responses can be found in Attachment B.

P314 impacts

Impact on BSC Parties and Party Agents

We do not anticipate direct implementation impacts on participants as the imbalance prices, in which PAR is used, are calculated centrally. Participants systems will only be impacted if they have elected to store or use the value of PAR within their systems (e.g. to calculate the system prices themselves) which they would do voluntarily. Participants may also be indirectly impacted by the effects of the reduced PAR value on imbalance prices.

Impact on Transmission Company

We do not anticipate there to be an impact on the Transmission Company.

Impact on BSC Agent/service provider

BSC Agent/service provider contract	Potential Impact
SAA	The SAA will set the value of PAR within central systems to 350MWh effective from the P314 Implementation Date. This value will apply to all Settlement Days from this date onwards.

Impact on Code

Code Section	Potential Impact
Section T	Changes will be required to implement this Modification, as detailed in Attachment A.

Recommended Implementation Date

Proposed solution

The Workgroup recommends an Implementation Date for the P314 proposed solution of:

- **2 January 2015** if an Authority decision is received on or before 17 October 2014; or
- **52 Working Days** following an Authority decision, if it is received after 17 October 2014.

The Proposer contends that a lower PAR value may require indirectly impacted BSC Parties to alter their strategies and commercial positions in order to prepare for the change. They also believe that the expected reduction in nuclear capacity over part of winter 2014/15 will add to the risk of scarcity events occurring. If a scarcity event does occur during this period it may result in higher imbalance prices which could be exacerbated by the implementation of a reduced PAR value, further impacting the industry. The Proposer therefore recommends that P314 is implemented on 2 January 2015 to help mitigate the risks to the industry of introducing the reduction in PAR.

Whilst the majority of the Workgroup did not agree with this rationale they acknowledged that it is an integral aspect of the proposed solution.

Alternative solution

The Workgroup recommends an Implementation Date for the P314 alternative solution of:

- **31 October 2014** if an Authority decision is received on or before 17 October 2014; or
- **10 Working Days** following an Authority decision, if it is received after 17 October 2014.

The Workgroup considered the potential commercial impacts on industry participants if P314 were to be implemented ahead of winter 2014/15. Some members indicated a clear steer from Ofgem and the Transmission Company that there will be issues with scarcity on the Transmission System this coming winter. It was also noted that the Implementation Date for P314 should be aligned with P304 so that Ofgem have a clear decision between a PAR value of 250MWh (under P304) and 350MWh (under P314). Ofgem can then determine the best solution based on the value of PAR only, without a different Implementation Date (and the P314 proposed solution is available if Ofgem accept the rationale for a later Implementation Date).

A majority of the Workgroup believe that P314 should be implemented ahead of winter 2014/15 to enable the benefits of providing a better signal to the market when System margins are tight to be realised. It is therefore the majority view of the Workgroup that a solution be put forward with an alternative Implementation Date of 31 October 2014.

Fall back dates and decision dates

The Workgroup considered whether it was appropriate to recommend a fall back decision dates and implementation dates for P314 as although the required changes are straightforward to implement they have implications for market participants. The Workgroup agreed to put forward the above fall back dates to be consistent with P304 (which uses the date approach).

Full details of the Workgroups discuss can be found in Section 6.

Workgroup discussions

Consideration of a 'sunset clause'

In addition to a reduction in PAR from 500MWh to 350MWh, the Proposer raised P314 with the inclusion of a 'sunset clause'. It was the Proposer's original intention for PAR to revert back to 500MWh on 5 November 2015.

A Workgroup member questioned how the inclusion of a 'sunset clause' (seeing the PAR value revert back to 500MWh) would better facilitate the Applicable BSC Objectives if the reduction in PAR proposed under P314 would also better facilitate the Objectives. The member questioned whether it would be more pragmatic to just raise a Modification should there be an issue with a reduction in PAR in the future.

It was noted that the idea of P314 was to change the incentives and behaviours of industry participants. A member contended that the inclusion of a 'sunset clause' may result in such behaviours not being realised given that the reduction in PAR would be temporary. They added that the forward modelling suggested that the margins for next winter will be even tighter than this winter.

The Proposer advised that a number of respondents to the P304 Assessment Consultation indicated that a reduction in PAR should only be progressed under a single price regime. The Proposer believed that a reduction in PAR will result in more accurate signals of scarcity but could cause a long term issue for smaller Parties in a dual priced market. They considered that P305 (which seeks to introduce a single price, amongst other things) is targeted for implementation in November 2015, but if the introduction of a single price were to be delayed it could adversely impact smaller Parties. The Proposer believed that it would be more efficient to include a 'sunset clause' rather than raise a new Modification to put the PAR value back up to 500MWh should a single priced market not be introduced (under P305 or any other Modification).

It was noted by a member that there needs to be clear rationale as to why the PAR value reverting back to 500MWh would better facilitate the applicable BSC Objectives.

It was suggested by a member that the 'sunset clause' be removed as, if there is an issue with the approval or implementation of P305 (or the introduction of a single priced market), there will be plenty of time to consider raising a Modification to either put PAR back to 500MWh or introduce a single price. They could not see how a 'sunset clause' could be justified against the Objectives. The Proposer noted that there is no guarantee that such a Modification(s) would be approved.

The Proposer considered the Workgroup's views and decided not to take the inclusion of a 'sunset clause' forward under the P314 proposed solution.

What is the most appropriate Implementation Date?

The Proposer explained that implementing P314 in January 2015 will allow for the expected nuclear plant outage (announced in September 2014) to end (i.e. give time for the plant to come back online). They added that their intention is to miss out any scarcity event during the outage period (which is expected to end in December 2014) as it may result in exceptionally high imbalance prices which could be exacerbated by a lower PAR value. It will also allow the industry more time to react to a lower PAR value overall.

A member noted they believed the purpose of reducing PAR was to provide a better signal of scarcity in the market for winter 2014/15, so by implementing in January you may lose some of the benefit (i.e. by missing a period of scarcity when such signals would be beneficial). Another member argued that the introduction of Demand Side Balancing Reserve (DSBR) and Supplementary Balancing Reserve (SBR) will further dampen price signals if either service is used in the Main Price calculation, meaning that cheaper actions will be used when the System scarcity gets even tighter. Some members therefore suggested that P314 be implemented on 31 October 2014, to ensure a reduction in PAR is implemented ahead of winter 2014/15. This date will also align P314 with P304, which will be considered by the Authority at the same time.

The Workgroup considered the date of the 'start of winter', as P304 proposes an implementation date of 31 October 2014 but winter under the BSC is defined as starting on 1 December. A member believed that a date of 1 December 2014 would be a better reflection of the start of the winter period and would allow the industry a bit of extra time to react to a lower PAR value, compared with a 31 October Implementation Date. The P304 Workgroup looked to get a reduction in PAR in prior to winter 2014/15 which is why they opted for implementation on 31 October 2014.

The Workgroup therefore considered three Implementation Dates for P314:

- 31 October 2014;
- 1 December 2014; or
- 2 January 2015.

The Proposer advised the Workgroup that they still believe an Implementation Date of 2 January 2015 is the most appropriate for the reasons previously given. A minority of the Workgroup supported this view.

A majority of Workgroup members did not agree with the Proposer's view and preferred an Implementation Date of 31 October 2014. It was therefore suggested that an alternative solution be put forward which would see reduction in PAR to 350MWh but with an Implementation Date of 31 October 2014.

One Workgroup member did not agree with the Proposer or the majority view and believed that a 1 December 2014 Implementation date would be more appropriate.

The Workgroup consulted upon the above three Implementation Dates. The majority of respondents indicated a preference for an Implementation Date of 31 October 2014. The Workgroup noted this view. Further information on responses received to the Assessment Consultation can be found in Section 8 and Attachment B.

Consideration of Assessment Consultation Responses

Interpretation of responses

Workgroup members noted that some respondents to the Assessment Consultation had 'Yes/No' responses that appeared to contradict the rationale provided. One respondent had already amended their 'Yes/No' answer to one question from that originally submitted, in order to correctly reflect the rationale.

The Workgroup believed that some respondents may have been confused by the questions and that both P314 Proposed and Alternative Modifications (which are very similar) may have been seen as an alternative compared to P304. However, the Workgroup agreed that

the responses were adequate for it to proceed with its assessment of P314, and that any clarifications received subsequently should be clearly noted.

The attached responses are not those considered by the Workgroup. This is because we have since been in contact with a respondent who has requested that their 'Yes/No' answers to question 1 was changed. ELEXON will continue to attempt to contact respondents with apparently contradictory responses to clarify and confirm their answers. ELEXON will update the Panel of any clarifications received following submission of this Draft Modification Report and will document them in the Final Modification Report.

Analysis on a reduction in PAR

A Workgroup member noted that there have been a number of concerns raised in the industry (both in the P314 and P304 consultations) regarding the lack of robust analysis conducted on the reduction of PAR. Other members noted that the analysis was sufficient and that the BSC Panel indicated at its September meeting that a considerable amount of analysis had been conducted.

The Workgroup referenced analysis conducted under P304 which look at the effects of a PAR value of 250MWh during 5 specific periods of scarcity. The Workgroup agreed that it would be pragmatic to re-run these 5 periods with a PAR value of 350MWh. Details of this analysis can be found in Attachment E.

As part of the P314 Assessment Consultation the Workgroup asked whether there was any further information that could be provided to help the industry assess the effects of a lower PAR value on their organisation. Some respondents indicated that imbalance modelling to show the potential effects of a lower PAR value over sustained periods of scarcity would go some way to better assessing the impacts. It was also noted that a lower value needs to be assessed in a more stressed market overall. The lack of analysis on behavioural changes was also referenced by respondents.

The Workgroup noted the Assessment Consultation responses and agreed that, given the timetable for P314, there would not be further analysis requested. The Workgroup agreed that there was sufficient information for members to make an informed decision on a recommendation to the Panel and the Authority.

Withholding generation and a lack of liquidity in the market

A Workgroup member noted that one respondent to the Assessment Consultation indicated that withholding generation and a lack of liquidity in the market will exacerbate the effects of a lower PAR value. The member did not agree with this view and questioned why anyone would withhold generation.

It was noted that Parties cannot withhold generation and that there would be significant legal implications in doing so. It was also questioned why a generator would not want to sell their product. One member clarified that, rather than simply 'withhold', the response was intended to reflect that a generator, at times of scarcity, may wait until the last moment to sell in order to get the best value for money. The member added that there will be perfectly rational decisions made which might be detrimental to liquidity and cause issues for smaller Parties.

A Workgroup member questioned whether there was a link between 'withholding' generation and the lack of liquidity comments made by respondents. Another member

noted that in 2006 – 2008 there was a fundamental change in liquidity. Some Parties may be in a better position than others to trade when they need liquidity. Industry participants that are concerned that they may not be able to trade out of imbalance (due to lack of liquidity) would tend to go long to manage risks resulting from a lower PAR value.

The Workgroup considered whether or not [Secure and Promote](#) would apply when addressing liquidity issues. Some members questioned how Secure and Promote would encourage liquidity during a sustained period of scarcity when everyone is trying to manage their positions.

A member argued that short term liquidity has not been identified as a problem, and that Parties should seek to forward contract in order to manage their imbalance risk. Some Workgroup members argued that, given Secure & Promote reforms, liquidity should be forth-coming meaning that parties will have the tools they need to manage this risk.

Longer positions and contradictions between the EBSCR and new balancing services

It was noted that this Modification (along with P304) was raised to give an accurate signal of scarcity to the market to encourage Parties to balance their positions ahead of Gate Closure.

Some members agreed with respondents' views that the implementation of P314 will actually encourage Parties to adopt a longer position to mitigate the risks associated with higher imbalance prices, which may be seen as inefficient. It was questioned how creating an incentive to produce more energy (i.e. make more than you need) would be efficient. Other members disagreed with this view and questioned why taking a longer position would be inefficient as it is a tool that the industry uses to mitigate unexpected risk. It was noted that if a Party has a long position, with a PAR value of 350MWh, and the system is long, the Party will be paid less due to the mechanism of 'cash-out'. Therefore, in practice Parties should not be encouraged to go long.

A Workgroup member commented that the introduction of the New Electricity Trading Arrangements (NETA) was intended to ensure that each Party balances their positions themselves, meaning that the Transmission Company would only need to perform marginal actions to balance the system out. Some members believe the intention for Parties to balance is still there but that currently the market largely relies on the Transmission Company to balance the system.

There was a split view amongst Workgroup members as to whether or not encouraging participants to take a longer position was cheaper and more efficient than having the Transmission Company balance the system. One member asserted that a key aim of the EBSCR reforms is to ensure a more efficient share of balancing between the SO and the market. Therefore, if parties go longer as prices become more cost reflective this should enhance efficiency.

The Workgroup considered the link between the new balancing services (DSBR and SBR) introduced by the Transmission Company and Ofgem's EBSCR conclusions. A member noted that at its September meeting the Panel discussed a possible contradiction in services being introduced by the Transmission Company and Ofgem's EBSCR conclusions. The Transmission Company has elected not to price DSBR and SBR actions, which will potentially further dilute the imbalance price signals to the market at times of scarcity. If so, this would act in a contrary spirit to Ofgem's EBSCR policy which identifies the need for a sharper imbalance price signal at times of system scarcity to encourage Parties to

balance. An attendee noted that the assertion that DSBR and SBR actions will dilute prices is an assumption and unproven. It was also noted that while DSBR and SBR address the symptom of tightening margins, PAR reform is necessary to address the root-cause of the issue.

Workgroup's alternative solution

It was the majority view of the Workgroup that an alternative solution should be put forward under P314. The Workgroup's alternative is identical to the proposed solution, in that it seeks to reduce the PAR value from 500MWh to 350MWh, with the only difference being an Implementation Date of 31 October 2014 (i.e. a shorter associated implementation lead time).

Some Workgroup members believed that, in order for the industry to realise the benefits of a reduced PAR value, and see a better reflection of scarcity in the market, a reduction in PAR needs to be made ahead of winter 2014/15.

Some members believed that, given part of the Authority's rationale for granting urgency was based on submitting both P314 and P304 to the Authority at the same time, it would be pragmatic to align the proposed Implementation Dates for both Modifications. This means that in addition to the P314 Proposed Modification the Authority will also, in essence, have a choice between a reduction in PAR on 31 October to either 250MWh (under P304) or 350MWh (under P314 alternative).

Other alternatives considered by the Workgroup

Introduction of a single price with a reduction in PAR to 350MWh

A Workgroup member questioned why a single price was not considered under P304 as it seems the Assessment Consultation respondents were in favour of a reduction in PAR in a single priced market, and suggested that this might be considered under P314. The Workgroup noted that the introduction of a single price was considered. However, due to the time it would take to assess such an introduction (in the context of the timetable for the assessment of P304) and the scope of P304 it was not taken forward.

It was noted that Ofgem's EBSCR considered a reduction in PAR with in a single priced market. A member added that P304 was raised with the expectation that the system margins would tighten regardless of the recent developments. The Ofgem representative indicated that a PAR value of 250MWh was seen to be a suitable stepping stone towards a move to a more marginal price.

The P314 Proposer believed that it may not have been quite so evident during Ofgem's EBSCR that independent Suppliers would be adversely impacted in the current dual priced market. They also believed that there is potential for larger Parties to benefit from a lower PAR value.

It was noted that, due to the 'missing money' issue in the imbalance price, a lower PAR value will benefit generators in addressing the issue. Suppliers have all hedged already for this winter and will therefore be more adversely affected by a change. A Workgroup member accepted the arguments about reducing PAR in a single priced market having less of an impact than under the current arrangements, but believed that a reduction in PAR for winter 2014/15 will benefit the market overall, even taking into account potential adverse impacts on small Suppliers.

A member recognised that there will be winners and losers even amongst Suppliers; on average, vertically integrated Suppliers will benefit whilst small Suppliers will have a disadvantage, but questioned whether this was simply the nature of competition. Another member added that the analysis conducted as part of P304 indicated a range of impacts across different types of Supplier. However, it needs to be recognised that there were limitations to this analysis as the Workgroup and ELEXON were not able to take into account prospective behaviour changes (i.e. the analysis was based on applying a different PAR value to past data and didn't take into account potential behavioural changes due to a change in PAR). Another member believed that the overall impact of a reduced PAR value is unknown, especially at times of system scarcity. The member was therefore concerned that the impacts could be unmanageable. It was noted that extrapolating from the 5 Settlement Periods of scarcity identified by ELEXON in the P304 analysis could indicate a considerable adverse distributional impact on industry participants.

The Proposer advised the Workgroup that they conducted analysis on the data published by ELEXON, under P304, in order to determine how a PAR value of 250MWh may affect the industry at a time of scarcity (as a result of higher demand). The Proposer filtered the data provided by ELEXON relating to 20 December 2010. The Proposer noted that this was not a scarcity event as such but a very cold day during the winter period. The idea of filtering the data was so the impacts and benefits across the industry could be better understood. Their results indicated that, during December 2010, a single company could benefit by approximately £2 million.

With respect to the suggestion that the Workgroup consider the introduction of a single priced market regime under P314, a member commented that such a change would be quite material to the industry. It may not be a difficult change to central systems or Party systems but the industry have already hedged for this winter based on a dual priced market. Therefore, there is not sufficient time for either ELEXON or the industry to properly assess the impacts of a reduced PAR value with the introduction of a single price market regime, given the P314 timetable.

It was considered that, if the Workgroup were to propose the introduction of a single priced market but there was not sufficient analysis on the impacts of a single price, Ofgem would most likely send P314 back to the Workgroup. A member added that a reduction in PAR under a single priced market appears very different to the Modification the Authority granted Urgent status for. The member did not think the Authority would have treated this Modification as urgent if it included a move to a single priced market. They suggested that, notwithstanding the introduction of a single price (which has its merits), the Workgroup needed to look at what it can do for this winter.

It was the unanimous view of the Workgroup that, taking the above discussions into consideration, it would not be appropriate to include the introduction of a single priced market regime under the P314 proposed or alternative solution.

Views on reduction of PAR to 350MWh compared with 250MWh

Whilst recognising that P314 and P304 are separate Modifications and must be assessed on their own merits against the Applicable BSC Objectives, the Workgroup considered that it would be helpful to industry participants, the Panel and Ofgem for it to give its views on the different PAR values proposed by the two Modifications, i.e. 350MWh for P314 and 250MWh for P304.

The Workgroup noted that a PAR value of 250MWh (under P304) would give the market an increased signal of scarcity when system margins are tight. However, they also note the potential for adverse distributional impacts on smaller Parties, due to reducing PAR too much under the current arrangements. A majority of the Workgroup therefore believed that a reduction in PAR to 350MWh would be more appropriate as it will provide the market with an increased signal of scarcity but limit the adverse impacts to the industry.

Ranking P304, the P314 solutions and the baseline

Subsequent to the industry consultation, the Workgroup also considered that it might be helpful to the Panel and the Authority to rank the following 4 potential outcomes, listed here in order of 'most change' to 'least change', from 1-4 (1 being the most preferred and 4 being the least preferred):

- approval and implementation of P304 (reduce PAR to 250MWh by November 2014);
- approval and implementation of the P314 alternative solution (reduce PAR to 350MWh by November 2014);
- approval and implementation of the P314 proposed solution (reduce PAR to 350MWh by January 2015); and
- rejection of both P304 and P314 (i.e. do nothing solution).

	P304	P314 Alternative	P314 Proposed	Do Nothing (keep baseline)
Number of first preferences	5	0	0	6
Number of second preferences	0	7	4	0
Number of third preferences	1	4	6	0
Number of fourth preferences	5	0	1	5

7 Assessment Consultation Responses

This section summarises the responses to the Workgroup's Assessment Consultation. You can find the full responses in Attachment B.

Summary of P314 Assessment Consultation Responses				
Question	Yes	No	Neutral/ No Comment	Other
Do you agree with the Workgroup's initial majority view that the P314 alternative solution would better facilitate the Applicable BSC Objectives compared with the proposed solution and the current baseline, and should therefore be approved?	8	10	0	1
Do you agree with the Workgroup's initial majority view that the P314 proposed solution would better facilitate the Applicable BSC Objectives compared with the current baseline?	10	8	0	1
Do you agree with the Workgroup's majority view that PAR should be reduced to a volume of 350MWh ?	8	9	1	1
Do you agree with the Workgroup's majority view that a reduction in PAR to a volume of 350MWh is preferable to a reduction to 250MWh?	11	7	1	0
Do you agree with the Workgroup that the draft legal text in Attachment A delivers the intention of both P314 proposed and alternative solutions?	16	0	3	0
Do you agree with the Workgroup's recommended Implementation Dates for the P314 proposed and alternative solutions (including associated lead times)?	13	3	1	2
Will P314 impact your organisation?	19	0	0	0
Will your organisation incur any costs in implementing P314?	9	10	0	0
Will the current Credit arrangements be impacted if there is a reduction in PAR to 350MWh?	16	2	1	0
Are there any potential Alternative Modifications within the scope of P314 which would better facilitate the Applicable BSC Objectives that the Workgroup should consider?	2	16	1	0
Do you believe that any further information would help you and/or the Workgroup assess P314?	7	10	2	0

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Are there any potential Alternative Modifications that the Workgroup should consider?

Two respondents to the Assessment Consultation suggested an alternative solution for consideration by the P314 Workgroup. Both respondents believe that consideration needs to be given to introducing a reduction in the PAR value coupled with the introduction of a single priced market regime.

The P314 Workgroup unanimously agreed that it would not be appropriate to include the introduction of a single priced market regime under the P314 proposed or alternative solution. Details of the Workgroup's discussion on the introduction of a single priced market under P314 can be found in Section 6.

Implementation approach

The P314 Workgroup considered three different Implementation dates:

- 31 October 2014;
- 1 December 2014; and
- 2 January 2015.

The Workgroup and the Proposer agreed on their proposed implementation approaches but wanted to obtain the industries views on all three of the above dates. ELEXON received 18 responses to the P314 Assessment Consultation, of which the majority indicated an overall preference for a 31 October 2014 implementation date for a reduction in the PAR value.

The table below summarises respondents overall preferred implementation date (i.e. their first choice):

31 Oct 14	1 Dec 14	2 Jan 15	Other
10	1	6	2

Two of the 18 respondents did not indicate an overall preference. One respondent does not support the P314 proposed or alternative solutions and therefore does not support any of the implementation dates. Another respondent simply indicated that the Implementation Date for P314 should reflect the trade-off between the potential for capacity shortfalls this winter and the impact on Supplier hedging strategies.

Should PAR be reduced to a volume of 350MWh?

A **slight majority** of nine respondents to the Assessment Consultation indicated that they did not agree that PAR value should be reduced to 350MWh.

One respondent believes that introducing a value of 350MWh ahead of the winter 2014/15 will not go far enough and will only provide a marginal benefit. Other respondents echoed this view indicating support for Modification P304 and a reduction in PAR to 250MWh.

A **minority** of eight respondents agreed that a reduction in the PAR value to 350MWh should be made.

One respondent supports the move to more marginal price and agrees that the proposed PAR volume of 350MWh is an improvement when compared with the current baseline. Another respondent supports the introduction of a lower PAR to ensure that imbalance charges better reflect the value of more flexible generation.

It was noted by one respondent that it was the P314 Proposer's is to given the Authority a simple choice of PAR values to consider (i.e. 350MWh under P314 and 250MWh under P304). They added that PAR350 was chosen as a value that reduced distributional effects from retaining a dual price structure. Therefore it is appropriate to allow this alternative value to be presented to the Authority for consideration.

Reducing the PAR value from 500MWh to 350MWh strengthens the signal to Parties to balance their positions before Gate Closure by making the main imbalance price signal more reflective of the marginal actions taken by the system operator to balance the system.

One respondent expressed a **neutral** view as they do not believe that P314 should be approved.

Single priced market

Some respondents who did not agree with a reduced PAR value to 350MWh indicated that they would only support a reduction in PAR if it was combined with the introduction of a single priced market.

One respondent believes that maintaining PAR at 500MWh would better achieve the BSC Objectives of promoting efficient system use and competition for this winter in the absence of single cash-out prices. Another respondent believes that imposing a lower value without a single price has not been properly tested and disrupts the commercial baseline assumed by trading parties.

Full details of responses to the Assessment Consultation can be found in Attachment B.

Summary of initial views against the Applicable BSC Objectives

Proposed and Alternative solutions compared with the baseline

The initial majority Workgroup view was that both the P314 proposed solution and the P314 alternative solution do better facilitate Objectives (b) and (c).

The following table summarises the Workgroup and the Proposer's **initial views** of both the P314 proposed and alternative solutions compared with the existing baseline against the Applicable BSC Objectives.

As the Workgroup's alternative solution is identical to the proposed, in that it seeks to introduce a reduction in PAR to 350MWh, with the only difference between the two being the Implementation Dates, the Workgroup's views against the Objectives for both the proposed solution and the alternative solution were the same, differing only in the degree to which they apply (which is drawn out in the Workgroup's comparison of the P314 Proposed and Alternative solutions). The Workgroup unanimously agreed P314 was neutral against Objectives (a), (e) and (f).



What are the Applicable BSC Objectives?

(a) The efficient discharge by the Transmission Company of the obligations imposed upon it by the Transmission Licence

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

(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

(d) Promoting efficiency in the implementation of the balancing and settlement arrangements

(e) Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency [for the Co-operation of Energy Regulators]

(f) Implementing and administering the arrangements for the operation of contracts for difference and arrangements that facilitate the operation of a capacity market pursuant to EMR legislation

Does P314 better facilitate the Applicable BSC Objectives?		
Obj	Yes (benefits)	No (drawbacks) ⁴
(b)	<ul style="list-style-type: none"> Majority (including Proposer): Making the main imbalance price signal more cost reflective strengthens the incentive on market participants to balance their positions ahead of Gate Closure, reducing the number of balancing actions required by the SO. A sharper imbalance price will signal the commencement of reforms designed to better reflect the value of flexible plant in the balancing arrangements. It may therefore contribute to deferring the mothballing of flexible plant and help counteract potential tightening of margins. Making the imbalance price sharper through a step change, starting with PAR350 this mid-winter, provides parties with the time required to get used to lower PAR values and to change behaviours accordingly. Minority: only a marginal benefit; a step in the right direction to help incentivise forward contracting 	<ul style="list-style-type: none"> Minority: A lower PAR value will more likely encourage Parties to take a long position, increasing the number of SO actions required. Adverse impact on liquidity as parties may hold their options until just before Gate Closure.

⁴ Shows the different views expressed by the other Workgroup members – not all members necessarily agree with all of these views.

Does P314 better facilitate the Applicable BSC Objectives?		
Obj	Yes (benefits)	No (drawbacks) ⁴
	resulting in a more efficiently run market.	
(c)	<ul style="list-style-type: none"> • Majority (including Proposer): Strengthening the energy imbalance price signal should incentivise market participants to trade to balance their positions ahead of Gate Closure, increasing liquidity in the forward market and benefitting competition by encouraging investment in flexible capacity (flexible generation, demand participation and other technologies) - however some of the Workgroup that identified this as a benefit believed it is marginal. • Minority: Addresses the recognised defect in the market that there needs to be a better signal of scarcity on the system. 	<ul style="list-style-type: none"> • Minority: Reduction in PAR under the current dual priced market would not better facilitate competition. Adverse distributional impacts and increased uncertainty will mean Parties might change tactics and may hinder small suppliers competing for customers. as the higher the imbalance prices the more credit cover Parties may need.
(d)	<ul style="list-style-type: none"> • Majority: Neutral 	<ul style="list-style-type: none"> • Minority: Inefficient to have what is considered a temporary reduction in PAR progressed knowing that another Modification (P305) has been raised to further reduce the value of PAR. Potentially inefficient and contradictory to propose a reduction in the PAR value for one winter whilst putting in place balancing actions (SBR and DSBR) that will further dilute the imbalance price.

Proposed solution compared with the Alternative solution

The initial majority view of the Workgroup is that the P314 alternative solution would better facilitate the Applicable BSC Objectives compared with the proposed solution because implementation ahead of winter 2014/15 would enable the benefits of a reduced PAR value to be more fully realised.

A minority of the Workgroup believed that the P314 proposed solution would better facilitate the Applicable BSC Objectives compared with the alternative solution. This was because the later implementation date would enable Parties to better prepare for a PAR reduction, even though the later implementation would reduce the extent to which the benefits of a reduced PAR could be realised over for winter 2013/14 (i.e. they believed a later date represented a reasonable compromise between realising benefits and avoiding unjustified adverse impacts on Parties).

Summary of final views against the Applicable BSC Objectives

Proposed and Alternative solutions compared with the baseline

The final majority Workgroup view is that both the P314 proposed solution and the P314 alternative solution do not better facilitate Objectives (b) and (c).

The Proposer's views on P314 changed since the Assessment Consultation. The Proposer does not believe that P314 will better facilitate the Objectives compared with the current baseline. However, the Proposer does believe it is better than P304. The Proposer therefore elected not to withdraw the Modification given the industry support expressed for P314 in the Assessment Consultation responses and the opportunity to present the Authority with an alternative to P304.

The following table summarises the final Workgroup and the Proposer's views on both the P314 proposed and alternative solutions compared with the existing baseline against the Applicable BSC Objectives.

Because the Workgroup's alternative solution is identical to the proposed, in that it seeks to introduce a reduction in PAR to 350MWh, with the only difference between the two being the Implementation Dates, the Workgroup's views against the Objectives for both the proposed solution and the alternative solution were the same, differing only in the degree to which they apply (which is drawn out in the Workgroup's comparison of the P314 Proposed and Alternative solutions).

The Workgroup unanimously agreed P314 was neutral against Objectives (a), (e) and (f).

Does P314 better facilitate the Applicable BSC Objectives?		
Obj	No (drawbacks)	Yes (benefits) ⁵
(b)	<ul style="list-style-type: none"> Majority (including Proposer): Unconvinced that the sharpening of prices will bring forward any additional generation or demand response this winter, and believe the initiatives taken by NGC will have a greater impact. Believe the sharper prices will encourage parties to go longer and result in more sell actions by NGC resulting in a less efficient market. Minority: Adverse impact on liquidity as parties may hold their options until just before Gate Closure. 	<ul style="list-style-type: none"> Minority: Making the main imbalance price signal more cost reflective strengthens the incentive on market participants to balance their positions ahead of Gate Closure, reducing the number of balancing actions required by the SO. A sharper imbalance price will signal the commencement of reforms designed to better reflect the value of flexible plant in the balancing arrangements. It may therefore contribute to deferring the mothballing of flexible capacity and help counteract potential tightening of margins. Making the imbalance price sharper though a step change, starting with PAR350 this mid-winter, provides parties with the time required to get used to lower PAR values and to



What are the Applicable BSC Objectives?

(a) The efficient discharge by the Transmission Company of the obligations imposed upon it by the Transmission Licence

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

(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

(d) Promoting efficiency in the implementation of the balancing and settlement arrangements

(e) Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency [for the Co-operation of Energy Regulators]

(f) Implementing and administering the arrangements for the operation of contracts for difference and arrangements that facilitate the operation of a capacity market pursuant to EMR legislation

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⁵ Shows the different views expressed by the other Workgroup members – not all members necessarily agree with all of these views.

Does P314 better facilitate the Applicable BSC Objectives?		
Obj	No (drawbacks)	Yes (benefits) ⁵
		change behaviours accordingly.
(c)	<p>• Majority (including Proposer):</p> <p>Adverse distortional effects will have an adverse impact on the ability of smaller non-vertically integrated parties to compete. It is not certain that any tools will be widely available in the market to assist smaller independent Parties especially domestic suppliers in managing their risk. We are especially concerned that at times of scarcity liquidity in the market may dry up (as has happened before).</p> <p>Minority:</p> <p>Strengthening the energy imbalance price signal should incentivise market participants to trade to balance their positions ahead of Gate Closure, increasing liquidity in the forward market and benefitting competition by encouraging investment in flexible capacity (flexible generation, demand participation and other technologies).</p>	<p>• Minority:</p> <p>Reduction in PAR under the current dual priced market would not better facilitate competition.</p> <p>Adverse distributional impacts and increased uncertainty will mean Parties might change tactics and may hinder small suppliers competing for customers.</p> <p>The higher the imbalance prices the more credit cover Parties may need.</p> <p>•</p>
(d)	<p>• Majority: Inefficient to have what is considered a temporary reduction in PAR progressed knowing that another Modification (P305) has been raised to further reduce the value of PAR.</p> <p>Potentially inefficient and contradictory to propose a reduction in the PAR value for one winter whilst putting in place balancing actions (SBR and DSBR) that will further dilute the imbalance price</p>	<p>• Majority: Neutral</p>

Proposed solution compared with the Alternative solution

The final majority view of the Workgroup is that the P314 alternative solution would not better facilitate the Applicable BSC Objectives. However, the Workgroup do believe that the alternative solution is better than the proposed. This is because the implementation of

P314 will adversely impact the industry, though, having a reduction in PAR implemented ahead of winter 2014/15 would enable the intended benefits to be realised.

In order for an Alternative Modification to be valid it needs to be considered better than the Proposed Modification (meaning it does not need to also better facilitate the Applicable BSC Objectives compared to the baseline).

A minority of the Workgroup believed that the P314 proposed solution would better facilitate the Applicable BSC Objectives compared with the alternative solution. This was because the later implementation date would enable Parties to better prepare for a PAR reduction, even though the later implementation would reduce the extent to which the benefits of a reduced PAR could be realised over for winter 2013/14 (i.e. they believed a later date represented a reasonable compromise between realising benefits and avoiding unjustified adverse impacts on Parties).

It is the Workgroup's final majority view that the Alternative Modification is better than the Proposed Modification but that neither better facilitate the Applicable BSC Objectives compared to the current baseline and that both should therefore be rejected.



Recommendation

The BSC Panel recommends that both the P314 Proposed and Alternative Modification are rejected.

The Panel discussed P314 and P304 'Reduction in PAR from 500MWh to 250MWh', together due to their similarity. The Panel considered that the views, whether in favour or against, applied to both P304 and P314. The Panel views varied only in the degree to which they applied to each of the three solutions (P304, P314 Proposed and P314 Alternative), reflecting the magnitude of the reduction and how quickly it would be implemented. That is:

- panel Members that did not support an increase in PAR felt that the larger the reduction, and the sooner it was made, the greater the disadvantages would be.
- conversely, Panel Members that support a reduction felt that a larger, earlier reduction would deliver greater benefits sooner (i.e. before Winter 2014).

The Panel's initial discussions on P304, as documented in the P304 Final Modification Report, can also therefore be considered relevant to P314.

Panel discussions

A Panel Member noted that the analysis completed by the P304 Workgroup (and supplemented by the P314 Workgroup) on a reduction in PAR clearly shows that there may be significant impacts on some BSC Parties, with independent Suppliers being the most impacted. The Member added that there is clearly value in new generation and supply as new players are coming into the market. They did not see how the approval of a Modification that may impact smaller participants would be better for the industry and that it's important to ensure that new generation is safeguarded.

Another Member added that the industry needs to encourage generation given the expected system scarcity and plant outages and that a reduced PAR value would provide signals to the market to encourage flexible capacity. The Member believes that a reduction in PAR to 350MWh would benefit the industry. However, they consider this benefit to be marginal compared to smaller values (for example, 250MWh and 50MWh). The Member noted that this is a market for both generation and supply and whilst distributional effects are important, so is making sure the lights stay on and there is an accurate signal of scarcity. A Member added that there is no evidence showing that a reduction in PAR will help security of supply.

A Member advised the Panel that the intention to strengthen price signals is there but in practice the advantages of reducing PAR would not outweigh the disadvantages to smaller Parties.

A Panel Member noted that following the industry consultation the P314 Proposer had changed their views, and no longer believed that P314 better facilitated the Applicable BSC Objectives. The Member understands the Proposer's intentions and believes that they only raised P314 as it would have less of an impact compared to P304.

Reduction in PAR under a single price

A Member advised the Panel that they did not see case proven for a reduction in PAR under the current arrangements. However, there is a clear appetite for a reduction in PAR under a single price market. Other Panel Members agreed with this view.

A Member noted that the impacts to the industry would be smaller under P314 than under P304. However, the benefits would also be smaller. The Member commended the Authority's intention to introduce a phased reduction in PAR but believes that PAR reduction would only be beneficial under a single price market regime, which would remove some of the risk to the industry.

A Member believed that there is justification to encourage flexible generation but noted that some respondents (who operate on the generation side of the market) did not believe that a reduction in PAR at this point in time would allow the intended benefits to be realised.

A Member added that consumers will be putting their faith in the Transmission Company and other BSC Parties to get their forecast right in order to ensure security of supply. They believed that a reduction in PAR would be preferable under a single price market, to mitigate the risk to the industry, but support the move to a more marginal imbalance price to promote security of supply.

A Member noted that they did not accept the argument, expressed in some consultation responses, that Parties will take longer trading positions and that this will be inefficient. The Member considered that on the contrary an efficient market should have representative price signals. While accepting that improving price signals will affect Parties in different ways, the Member considered that such distributional effects are a separate issue to efficiency.

Ability of Parties to react to a reduction in PAR

The Panel noted that some respondents to the Report Phase Consultation indicated that they have already hedged for winter 2014/15 and would therefore not be able to react and effectively adjust their hedging strategies if a reduction in PAR was introduced for this winter.

A Panel Member agreed noting that Parties will have already prepared for this winter and will not be able to effectively react to a reduction in PAR at this point in time. They added that the economic theory may indicate that a reduction in PAR should be able to cause a reaction as a result of strengthened signals, even if notice of the reduction is relatively short, but in reality industry participants do not have time to react and make behavioural changes based on a reduced PAR value this winter. Other Panel Members agreed with this view.

The Transmission Company Representative noted the arguments for and against P314 but cautioned against giving too much weight to analysis that is based on the application of different PAR values to historic data with no account taken of potential behavioural changes. They also questioned whether the ability of Parties to respond to price signals was being understated.

Panel's views on P314 against the Applicable BSC Objectives

Having considered the Modification and the Workgroup and industry views on P314 the **majority** view of the Panel is that both the P314 Proposed Modification and Alternative Modification should be **rejected**.

The Panel expressed the views below against the Applicable BSC Objectives for both the Proposed and Alternative solutions.

Because the Workgroup's alternative solution is identical to the proposed, in that it seeks to introduce a reduction in PAR to 350MWh, with the only difference between the two being the Implementation Dates, the Panel's views against the Objectives for both the proposed solution and the alternative solution were the same, differing only in the degree to which they apply.

Applicable BSC Objective (b)

A **majority** of Panel Members agreed that P314 **would** better facilitate the achievement of Applicable BSC Objective (b) for the reasons given by the Workgroup, as it:

- makes the main imbalance price signal more cost reflective;
- strengthens incentive to balance positions ahead of Gate Closure; and
- reduces the number of balancing actions required.

A **minority** of Panel Members agreed that P314 **would not** better facilitate the achievement of Applicable BSC Objective (b) for the reasons given by the Workgroup, as:

- there is a questionable benefit that P314 will make the main imbalance price more cost reflective; and
- there could be an increased incentive to move towards longer positions at Gate Closure.

Applicable BSC Objective (c)

A **majority** of Panel Members agreed that P314 **would not** better facilitate the achievement of Objective (c) for the reasons given by the Workgroup, as:

- under the current dual priced market there would disproportionate impacts on small Suppliers as a result of a reduced PAR value; and
- there has not been sufficient time to allow ELEXON and the industry to determine the full extent of these effects.

This majority of Panel Members indicated that the detrimental impacts against this objective would outweigh any benefits against Objective (b).

A **minority** of Panel Members agreed that P314 **would** better facilitate the achievement of Objective (c) for the reasons given by the Workgroup, as:

- strengthening the imbalance price signal should incentivise market participants to trade in order to balance positions;
- it benefits competition by encouraging investment in flexible capacity; and
- it increases liquidity in the forward market.

Applicable BSC Objective (d)

A **majority** of Panel Members agreed that P314 **would not** better facilitate the achievement of Applicable BSC Objective (d) as:

- it is not efficient to progress a Modification to implement a temporary solution with little benefit to the industry.

This majority of Panel Members indicated that the detrimental impacts against this objective would outweigh any benefits against Objective (b).

A **minority** of Panel Members had a neutral view against Applicable BSC Objective (d).

Panel's views on the draft legal text changes

The Panel **unanimously** agrees that the proposed changes to the BSC in Attachment A deliver the intention of P314 Proposed and Alternative Modifications.

Panel's views on the recommended Implementation Dates

The Panel **unanimously** agrees with the proposed Implementation Dates for both the P314 Proposed Modification and Alternative Modification.

Recommendation

The Panel by **majority** recommends that:

- the P314 **Proposed Modification** does not better facilitate the Applicable BSC Objectives compared with the current baseline, and should therefore be **rejected**; and
- the P314 **Alternative Modification** better facilitates the Applicable BSC Objectives compared with the Proposed Modification, but does not do so compared with the current baseline, and should therefore be **rejected**.

10 Recommendations

The BSC Panel recommends to the Authority:

- That the P314 Proposed Modification and Alternative Modification should be **rejected**;
- An Implementation Date for the P314 Proposed Modification of:
 - 2 January 2015 if an Authority decision is received on or before 17 October 2014; or
 - 52 Working Days following an Authority decision if it is received after 17 October 2014;
- An Implementation Date for the P314 Alternative Modification of:
 - 31 October 2014 if an Authority decision is received on or before 17 October 2014; or
 - 10 Working Days following an Authority decision if it is received after 17 October 2014;
- The BSC legal text for the P314 Proposed Modification; and
- The BSC legal text for the P314 Alternative Modification.

Appendix 1: Workgroup Details

Urgent Modification timetable

P314 Assessment Timetable	
Event	Date
Urgent Panel Meeting	8 Sep 14
Workgroup Meeting 1	15 Sep 14
Assessment Procedure Consultation	16 – 30 Sep 14
Workgroup Meeting 2	2 Oct 14
Panel considers Draft Modification Report	9 Oct 14
Issue Final Modification Report to Authority	10 Oct 14

Workgroup membership and attendance

P314 Workgroup Attendance			
Name	Organisation	15 Sep 14	02 Oct 14
Members			
Dean Riddell	ELEXON (<i>Chair</i>)	✓	✓
Talia Addy	ELEXON (<i>Lead Analyst</i>)	✓	✓
Jeremy Guard	First Utility (<i>Proposer</i>)	✓	✓
Martin Mate	EDF Energy	✓	✓
Esther Sutton	E.ON	✓	✓
Sarah Owen	Centrica	✓	✓
Tom Edwards	Cornwall Energy	✓	☎
Cem Suleyman	Drax	✓	✓
Libby Glazebrook	GDF Suez	☎	✓
Andrew Colley	SSE	✓	✓
Olaf Islei	APX Commodities	✓	X
Bill Reed	RWE	✓	✓
Chris Elder	INTERGEN	☎	✓
Keith Munday	Independent Consultant	☎	☎
Sally Lewis	National Grid	✓	X
Lisa Waters	Waters & Wye	✓	✓
Nick Haines	Good Energy	✓	✓
Hannah McKinney	Dong Energy	✓	✓
Ian Tanner	UK Power Reserve	✓	✓
Graham Wilcox	EnDCo	☎	X
Steve Bradford	Flow Energy	✓	☎

P314 Workgroup Attendance			
Name	Organisation	15 Sep 14	02 Oct 14
Attendees			
Oliver Xing	ELEXON (<i>Design Authority</i>)	✓	✓
Nick Brown	ELEXON (<i>Lead Lawyer</i>)	✓	X
Dominic Scott	Ofgem	✓	✓
David Beaumont	Ofgem	✓	✓
Jonathan Windeatt	Flow Energy	X	✓

Appendix 2: Estimated Progression Effort

The following tables contain the estimated effort in progressing P314:

Assessment Effort	
Participant	Effort (man days)
ELEXON	20
Workgroup members	70
Total	90

Consultation Response Effort	
Consultation	No. of responses
Report Phase Consultation	19
Total	19

Appendix 3: Glossary & References

Acronyms

Acronyms used in this document are listed in the table below.

Glossary of Defined Terms	
Acronym	Definition
BSAA	Balancing Services Adjustment Actions
BSAD	Balancing Services Adjustment Data
DSBR	Demand Side Balancing Reserve
DSR	Demand Side Response
EBSCR	Electricity Balancing Significant Code Review
NIV	Net Imbalance Volume
PAR	Price Average Reference
RSP	Reverse Scarcity Price
SBP	System Buy Price
SBR	Supplementary Balancing Reserve
SO	System Operator
SSP	System Sell Price
VoLL	Value of Lost Load

External links

A summary of all hyperlinks used in this document are listed in the table below.

All external documents and URL links listed are correct as of the date of this document.

External Links		
Page(s)	Description	URL
2	P304 page of ELEXON Website	http://www.elexon.co.uk/mod-proposal/p304/
4	P305 page of ELEXON website	http://www.elexon.co.uk/mod-proposal/p305/
4	BSAD Methodology Statement	http://www2.nationalgrid.com/UK/Industry-information/Electricity-transmission-operational-data/Codes-principles-methodologies/Methodologies/
5	Imbalance pricing information webpage	http://www.elexon.co.uk/reference/credit-pricing/imbalance-pricing/
5	P205 page of ELEXON website	http://www.elexon.co.uk/mod-proposal/p205-increase-in-par-level-from-100mwh-to-500mwh/

External Links		
Page(s)	Description	URL
5	EBSCR webpage	https://www.ofgem.gov.uk/electricity/wholesale-market/market-efficiency-review-and-reform/electricity-balancing-significant-code-review
6	Final EBSCR Policy Decision	https://www.ofgem.gov.uk/publications-and-updates/electricity-balancing-significant-code-review-final-policy-decision
7	P314 page of ELEXON website	http://www.elexon.co.uk/mod-proposal/p314/
9	BSC Section T	http://www.elexon.co.uk/wp-content/uploads/2014/03/Section_T_v23.0.pdf