Modification Proposal P78 'Revised Definitions of System Buy Price and System Sell Price' Consultation Questionnaire Responses
12 June 2002

Responses from P78 Assessment Consultation
Consultation issued 27 May 2002

Representations were received from the following parties:

No	Company	File Number	No. Parties Represented
1.	British Gas Trading	P78_ASS_001	3
2.	TXU Europe	P78_ASS_002	21
3.	Williams Energy Marketing and Trading Europe Ltd	P78_ASS_003	1
4.	Aquila Networks	P78_ASS_004	1
5.	Powergen	P78_ASS_005	3
6.	Combined Heat and Power Association	P78_ASS_006	1
7.	IMMINGHAM CHP LLP	P78_ASS_007	1
8.	London Electricity	P78_ASS_008	4
9.	Scottish and Southern Energy	P78_ASS_009	4
10.	SEEBOARD Energy	P78_ASS_010	1
11.	Scottish Power	P78_ASS_011	4
12.	Damhead Creek Ltd	P78_ASS_012	2
13.	Campbell Carr Ltd	P78_ASS_013	5
14.	Edison Mission	P78_ASS_014	2
15.	Innogy	P78_ASS_015	5
16.	RWE Trading Direct	P78_ASS_016	1
17.	AEP Energy Services	P78_ASS_017	2
18.	InterGen (UK)	P78_ASS_018	1
19.	Eledor Limited	P78_ASS_019	1

P78_ASS_001 – British Gas Trading

Responding on Behalf of: **British Gas Trading Ltd, Centrica King's Lynn Ltd and Centrica Peterborough Ltd**

Q	Question	Response (Please provide rationale where possible)
1.	In your opinion, does Modification Proposal P78 give a better separation of balancing actions (i.e. system vs energy) used in setting the Energy Imbalance Price(s), if so, how? (Section 1.1)	Not directly. P78 does not make the actions of the SO in the Balancing Mechanism any more explicit than under the current regime.
2.	In your opinion, is Modification Proposal P78 valuing actions more correctly, if so, why and if not, why not? (Section 1.5)	No, as a general principle it is inappropriate for a Party to be cashed out at a favourable price as a consequence of being out of balance but in the opposite direction of the system. We believe this will cause participants to give more consideration to the overall system in balance rather than their own position.
3.	In your opinion, how does Modification Proposal P78 change the relative reward for notified and instructed actions and how do you believe this to impact on the Transmission Company's balancing of the system, and do you believe this is appropriate? (Section 1.6 defines notified and instructed action)	As a general principle we believe that a greater value, and hence reward, should be placed on instructed actions over notified and un-notified actions. We believe it is likely that P78 will change the relative reward for notified and instructed actions because cashout prices are likely to become less penal than they are at present and this will inevitably reduce the incentive on parties to match FPN and contracted volumes.
4.	In your opinion, does Modification Proposal P78 more correctly target the cost of energy balancing actions to those causing the imbalance over the current baseline? (Section 1.6)	No
5.	In your opinion, how does Modification Proposal P78 change the perceived risk of Bid - Offer submission, how would it change the level of participation seen in the Balancing Mechanism under the current baseline and how do you believe it would affect system balancing? (Section 1.7)	P78 should not change the level of perceived risk in the submission of Bids and Offers. We would anticipate that the same level of participation would be seen in the BM but there should be greater symmetry between the stacks i.e. fewer bids and more offers. It is conceivable that the offers could be at more expensive prices than currently seen.

Q	Question	Response (Please provide rationale where possible)
		We do not have any comment to make on the impact on system balancing but would be interested to see what the outcome of any modelling done in this area would be.
6.	In your opinion, how do you believe Modification Proposal P78 would affect the level of part loading seen under the current arrangements and in what way do you believe it would be more or less efficient for participants and for the system as a whole? (Section 1.8)	Based on the underlying assumption that is made by this modification, that the result will be lower imbalance prices, we believe there may be less part loading and more plants removed from the system. This could be seen as being less efficient for the market as a whole although possibly not for individual participants.
7.	In your opinion, does Modification Proposal P78 change the incentives to deviate from FPN over the current baseline, if so, how and why? (Section 1.9)	Yes, the financial incentives to deviate from FPN will be changed as the energy imbalance prices will be less penal and there will be a greater incentive to follow the overall system position rather than a participants own position.
8.	In your opinion, (noting the forthcoming implementation of Modification P12 to reduce Gate Closure to one hour), does Modification Proposal P78 increase the incentive on parties to change Physical Notifications shortly before Gate Closure and do you believe this to be a good or bad thing? (Sections 1.9, 1.11, 1.12, 1.13)	Yes there will be an incentive for Parties to change their PNs shortly before Gate Closure assuming that participants will face a greater incentive to follow the system balance rather than their own position. The relative merits of this will depend on NGCs actions pre Gate Closure and also the potential for expensive BM actions being taken. In the discussion that has been undertaken so far the main focus has been on a system that is overall long or short. If this proposal brings participants positions, and the system, into energy balance then there should only be system actions that are required in the BM. If there is a requirement for energy balancing within a half hour, for example due to the loss of a station, then this may result in an extreme price spike due to an expensive action being taken.
9.	In your opinion, to what extent will Modification Proposal P78 address the issue of asymmetric risk? (Section 1.10)	The asymmetric risk will be reduced but there will always some asymmetry in the system due to the relative expense of increasing generation over decreasing it and in demand forecasting.

Q	Question	Response (Please provide rationale where possible)
10.	In your opinion, do you believe that Modification Proposal P78 will change the incentives on parties to balance their individual (contractual) trading positions before Gate Closure, if so, how and why? (Sections 1.12 and 1.13)	This modification will reduce incentives on Parties to balance their individual trading positions and introduces the potential for hunting behaviour to develop as participants look to the most favourable imbalance price.
11.	In your opinion, do you believe that Modification Proposal P78 will change the incentives for parties as a whole (i.e. in total, even if not balanced on an individual basis) to balance the market as a whole before Gate Closure, if so, how and why? (Section 1.11)	No, a market is made up of individual players and so the entity itself cannot be incentivised to balance. The incentives must be on those parties that make up the market.
12.	In your opinion, does Modification Proposal P78 lead Parties to anticipate the 'direction' of the market, and therefore the Energy Imbalance Price. Could this lead to volume volatility and consequential price instability in the market? (Sections 1.12 and 1.13)	Yes.
13.	What effect do you think Modification Proposal P78 will have on liquidity and prices in the forwards and spot markets, the interrelation of forwards and spot markets with Energy Imbalance Prices and also the level of Energy Imbalance Prices themselves? (Sections 1.14, 1.15 and 1.16)	We would anticipate that there would be some impact prices and liquidity in the forwards and spot markets and the level on Imbalance Prices but it is difficult to predict exactly what those interactions and changes will be.
14.	Do you believe that the implementation of Modification Proposal P78 will encourage the development of risk management products and new types of contracts, and what effect do you think this will have on competition and the efficiency of the forwards and spot markets? (Sections 1.17, 1.18, 1.19 and 1.20)	It would be reasonable to assume that there would be some development of new risk management products and contracts if the demand in the market develops for them. For example, more consolidation services could be developed if imbalance prices were lower and less volatile. But this is based on the assumption that the modification proposal has the effect of reducing the imbalance prices we have seen and increases market symmetry.
15.	In your opinion what would be the impact on the risk profile of different categories of party (as listed in section 1.21) from the implementation of Modification Proposal P78? (Section 1.21)	This is very difficult to assess without detailed modelling and analysis. Also the impacts of imbalance prices are only one part of the impact. Consideration of RCRC, BSUoS and the SO incentive scheme is also vital to making a full assessment of the impact on participants' risk profiles.

Q	Question	Response (Please provide rationale where possible)
16.	Do you believe that Modification Proposal P78 better facilitates achievement of the Applicable BSC Objectives, if so, which one(s) and why?	It is too early to say. Some modelling of the impacts of the potential impacts of this modification proposal is required.
17.	Do you believe that an Alternative Modification Proposal better facilitates achievement of the Applicable BSC Objectives than Modification Proposal P78, if so, what is it? (Section 1.23)	It may be that an alternative proposal would be better than the original of P78 but until the modelling work is carried out to make a full assessment of P78 it is hard to judge. In our opinion the major issue is the distinction between system and energy balancing actions taken by the SO. Whilst we recognise that it may not be possible to make an absolute determination between the two it is essential that the best possible and most transparent solution is found and agreed.
18.	Are there any other issues not identified in the supporting document which you believe should be considered during the assessment of Modification Proposal P78.	
19.	Do you believe that further analysis / modelling is required over that currently identified by the PIMG (in the supporting document), and if so, what specific form should this take?	We are concerned that the implications for BSUoS and NGC's incentive scheme have not, and cannot, be discussed here. The impact of this modification has wider implications than simply the imbalance prices and these must be fully assessed.

P78_ASS_002 – TXU Europe

For TXU BSC Parties

Q	Question	Response (Please provide rationale where possible)
1.	In your opinion, does Modification Proposal P78 give a better separation of balancing actions (i.e. system vs energy) used in setting the Energy Imbalance Price(s), if so, how? (Section 1.1)	It is different, but we are not sure it is better.
2.	In your opinion will Modification Proposal P74 / P78 have an impact on system security? (Section 1.1)	No (as NGC make clear they are driven by differences between the sum of Generator FPNs and their Demand Forecast)
3.	In your opinion, what would be the effect on the level of BSUoS charges from the implementation of Modification Proposal P74 / P78, considered in the context of the overall costs of balancing.	Intuitively we believe that the SBP/SSP would be lower/higher respectively if these prices are based on the NIV. This would tend to lower BSUoS per se but would increase the level of Incentive payments to NGC under the SO Incentive Scheme, hence overall our initial reaction is that the effective BSUoS payments made by participants would show little difference.
4.	In your opinion, is Modification Proposal P78 valuing actions more correctly, if so, why and if not, why not? (Section 1.5)	The inference of this is that we are looking for greater “cost-reflectivity” rather than an incentive on participants to balance.
5.	In your opinion, how does Modification Proposal P78 change the relative reward for notified and instructed actions and how do you believe this to impact on your balancing of the system, and do you believe this is appropriate? (Section 1.6 defines notified and instructed action)	It would change the relative reward, but by how much or to what extent is anyones guess.
6.	In your opinion does such a change correctly reflect your perceived value and if not, what costs are not included and how significant do you deem them to be? Could these be calculated and / or estimated in advance?	No idea – if NGC can come up with a convincing answer we will gladly let them do so.
7.	In your opinion, does Modification Proposal P78 more correctly target the cost of energy balancing actions to those causing the imbalance over the current baseline? (Section 1.6)	“Correct” implies that participants have control over the outcome – this seems a bit optimistic. Sometimes they will be lucky and their errors will “help” the SO, sometimes they will not.

Q	Question	Response (Please provide rationale where possible)
8.	In your opinion, how does Modification Proposal P78 change the perceived risk of Bid - Offer submission, how would it change the level of participation seen in the Balancing Mechanism under the current baseline and how do you believe it would affect system balancing? (Section 1.7)	We doubt it will make any difference in practice.
9.	In your opinion, how do you believe Modification Proposal P78 would affect the level of part loading seen under the current arrangements and in what way do you believe it would be more or less efficient for participants and for the system as a whole? (Section 1.8)	We doubt it will make any difference in practice.
10.	In your opinion, does Modification Proposal P78 change the incentives to deviate from FPN over the current baseline, if so, how and why? (Section 1.9)	No (if it does we do not know why)
11.	In your opinion, (noting the forthcoming implementation of Modification P12 to reduce Gate Closure to one hour), does Modification Proposal P78 increase the incentive on parties to change Physical Notifications shortly before Gate Closure and do you believe this to be a good or bad thing? (Sections 1.9, 1.11, 1.12, 1.13)	No (if it does we do not know why)
12.	In your opinion, to what extent will Modification Proposal P78 address the issue of asymmetric risk? (Section 1.10)	Not convinced that it will, but over contracting would cost less.
13.	In your opinion, do you believe that Modification Proposal P78 will change the incentives on parties to balance their individual (contractual) trading positions before Gate Closure, if so, how and why? (Sections 1.12 and 1.13)	No
14.	In your opinion, do you believe that Modification Proposal P78 will change the incentives for parties as a whole (i.e. in total, even if not balanced on an individual basis) to balance the market as a whole before Gate Closure, if so, how and why? (Section 1.11)	No (if it does we do not know why)

Q	Question	Response (Please provide rationale where possible)
15.	In your opinion, does Modification Proposal P78 lead Parties to anticipate the 'direction' of the market, and therefore the Energy Imbalance Price. Could this lead to volume volatility and consequential price instability in the market? (Sections 1.12 and 1.13)	Participants might well try to do this, how successful they would be in practice is debateable.
16.	What, in your opinion, is the effect on the Transmission Company in terms of balancing actions, of a balanced market? (Sections 1.12 and 1.13)	?
17.	What effect do you think Modification Proposal P78 will have on liquidity and prices in the forwards and spot markets, the interrelation of forwards and spot markets with Energy Imbalance Prices and also the level of Energy Imbalance Prices themselves? (Sections 1.14, 1.15 and 1.16)	See response to Q13 for P74
18.	Do you believe that the implementation of Modification Proposal P78 will encourage the development of risk management products and new types of contracts, and what effect do you think this will have on competition and the efficiency of the forwards and spot markets? (Sections 1.17, 1.18, 1.19 and 1.20)	See response to Q14 for P74
19.	Do you believe that Modification Proposal P78 better facilitates achievement of the Applicable BSC Objectives, if so, which one(s) and why?	Not convinced at present.
20.	Do you believe that an Alternative Modification Proposal better facilitates achievement of the Applicable BSC Objectives than Modification Proposal P78, if so, what is it? (Section 1.23)	Not at present
21.	Are there any other issues not identified in the supporting document which you believe should be considered during the assessment of Modification Proposal P78.	
22.	Do you believe that further analysis / modelling is required over that currently identified by the PIMG (in the supporting document), and if so,	

Q	Question	Response (Please provide rationale where possible)
	what specific form should this take?	

P78_ASS_003 – Williams Energy Marketing and Trading Europe Ltd

Responding on Behalf of Williams Energy Marketing & Trading Europe Ltd who are a Non Physical Trader

Q	Question	Response (Please provide rationale where possible)
1.	In your opinion, does Modification Proposal P78 give a better separation of balancing actions (i.e. system vs energy) used in setting the Energy Imbalance Price(s), if so, how? (Section 1.1)	Yes. The proposed pricing mechanism for the tall stack (i.e. dominant price) is an improvement on the current use of BRL especially when Ofgem seem unwilling to set BRL at the appropriately low level.
2.	In your opinion, is Modification Proposal P78 valuing actions more correctly, if so, why and if not, why not? (Section 1.5)	Yes. It slightly better values those participants who are helping the system into balance via their contractual imbalance e.g. if the system is long, those who are short are better rewarded than now.
3.	In your opinion, how does Modification Proposal P78 change the relative reward for notified and instructed actions and how do you believe this to impact on the Transmission Company's balancing of the system, and do you believe this is appropriate? (Section 1.6 defines notified and instructed action)	It slightly better values notified actions that are beneficial to the system. It may lead to the Transmission Company needing to take less actions to balance the system, which is appropriate given the aim under NETA should be to design a market which requires minimal intervention.
4.	In your opinion, does Modification Proposal P78 more correctly target the cost of energy balancing actions to those causing the imbalance over the current baseline? (Section 1.6)	Yes, in the sense that those contributing to the balancing of the system via notified actions are less penalised than currently.
5.	In your opinion, how does Modification Proposal P78 change the perceived risk of Bid - Offer submission, how would it change the level of participation seen in the Balancing Mechanism under the current baseline and how do you believe it would affect system balancing? (Section 1.7)	By reducing unfairly penal aspects of cashout prices, the risk-reward balance for generators should shift somewhat such that there may be greater participation from a greater variety of participants.

Q	Question	Response (Please provide rationale where possible)
6.	In your opinion, how do you believe Modification Proposal P78 would affect the level of part loading seen under the current arrangements and in what way do you believe it would be more or less efficient for participants and for the system as a whole? (Section 1.8)	Whilst the level of part loading is affected by a number of factors, the commercial incentives to part load would be somewhat reduced by Mod P78 and thus in general there ought to be somewhat less. This by definition would reflect that it is more efficient operationally and commercially for participants There should be somewhat greater liquidity in the traded market close to Gate Closure and somewhat better use of efficient plant in meeting demand. In terms of the overall economics of the system this is clearly more efficient.
7.	In your opinion, does Modification Proposal P78 change the incentives to deviate from FPN over the current baseline, if so, how and why? (Section 1.9)	Yes. It reduces them, as on balance there is less commercial incentive provided via the cashout spread to do so.
8.	In your opinion, (noting the forthcoming implementation of Modification P12 to reduce Gate Closure to one hour), does Modification Proposal P78 increase the incentive on parties to change Physical Notifications shortly before Gate Closure and do you believe this to be a good or bad thing? (Sections 1.9, 1.11, 1.12, 1.13)	(i) Not significantly. (ii) Any increase is good, as it reflects a more competitive, liquid, efficient, dynamic market working effectively right up to Gate Closure.
9.	In your opinion, to what extent will Modification Proposal P78 address the issue of asymmetric risk? (Section 1.10)	It should reduce natural asymmetric risk to a more reasonable level (i.e. less lop-sided)
10.	In your opinion, do you believe that Modification Proposal P78 will change the incentives on parties to balance their individual (contractual) trading positions before Gate Closure, if so, how and why? (Sections 1.12 and 1.13)	Yes. It will reduce the current incentive to over-contract, due to less asymmetric cashout prices.
11.	In your opinion, do you believe that Modification Proposal P78 will change the incentives for parties as a whole (i.e. in total, even if not balanced on an individual basis) to balance the market as a whole before Gate Closure, if so, how and why? (Section 1.11)	Yes. By reducing participants incentive to over contract by as much, it will reduce the tendency for the system as a whole to be long and the

Q	Question	Response (Please provide rationale where possible)
		degree to which it is long.
12.	In your opinion, does Modification Proposal P78 lead Parties to anticipate the 'direction' of the market, and therefore the Energy Imbalance Price. Could this lead to volume volatility and consequential price instability in the market? (Sections 1.12 and 1.13)	(i) Not to any significantly greater extent than now. (ii) No.
13.	What effect do you think Modification Proposal P78 will have on liquidity and prices in the forwards and spot markets, the interrelation of forwards and spot markets with Energy Imbalance Prices and also the level of Energy Imbalance Prices themselves? (Sections 1.14, 1.15 and 1.16)	The presence of a number of significant vertically integrated players in the market makes this not certain but it should improve depth and liquidity in the traded markets. The likely impact on Energy Imbalance Prices is a reduced and less asymmetric cashout spread, where on average the buy price might be expected to be lower than currently and the sell price higher than currently.
14.	Do you believe that the implementation of Modification Proposal P78 will encourage the development of risk management products and new types of contracts, and what effect do you think this will have on competition and the efficiency of the forwards and spot markets? (Sections 1.17, 1.18, 1.19 and 1.20)	It is not clear that Mod P78 will particularly encourage any new forms of contracts, risk management products etc. Thus from this perspective it will have limited or negligible impact on competition and efficiency of the forwards and spot markets.
15.	In your opinion what would be the impact on the risk profile of different categories of party (as listed in section 1.21) from the implementation of Modification Proposal P78? (Section 1.21)	All risk profiles should be reduced, though portfolio, large or vertically integrated players will continue to enjoy a real advantage. NGC's risk profile should also reduce (which makes sense as it is their proposal).
16.	Do you believe that Modification Proposal P78 better facilitates achievement of the Applicable BSC Objectives, if so, which one(s) and why?	Yes. *"efficient, economic & coordinated operation by the Transmission Company of the Transmission System"* by better incentivising participants *"promoting effective competition in the generation and supply of electricity..."* by improving trading liquidity and more efficient operation.
17.	Do you believe that an Alternative Modification Proposal better facilitates achievement of the Applicable BSC Objectives than Modification Proposal	There are strong concerns over the viability of any defined "market price"

Q	Question	Response (Please provide rationale where possible)
	P78, if so, what is it? (Section 1.23)	for the reverse cashout price under current market conditions. Whilst no specific alternative is suggested here, PIMG should strongly consider a reverse price derived using some measure of NGC actions e.g. forward contracts (exc. system related PGBTs).
18.	Are there any other issues not identified in the supporting document which you believe should be considered during the assessment of Modification Proposal P78.	The document does not fully explore whether in the current market use of a "market price" for the reverse price is viable, given liquidity and representative nature concerns, and thus whether a calculated price based on NGC actions would be preferable – see above.
19.	Do you believe that further analysis / modelling is required over that currently identified by the PIMG (in the supporting document), and if so, what specific form should this take?	Cannot identify any at this stage, although where possible, tangible analysis in the form of scenarios and simulations, even if they require simplifying assumptions and/or subjective refinement, are preferable to pure conjecture. Also, Mod P74 & P78 should be subjected to identical analysis/modelling to enable robust comparison, as inevitably both cannot be implemented and thus evaluating which better meets the BSC objectives is essential.

P78_ASS_004 – Aquila Networks

Please find that Aquila Networks response to P74/P78 Assessment Consultation is 'No Comment'.

regards

Rachael Gardener

Deregulation Control Group & Distribution Support Office

AQUILA NETWORKS

P78_ASS_005 - Powergen

Responding on Behalf of: **Powergen UK plc, Powergen Retail Limited, Cottam Development Centre Limited**

Responding as which type of Party (see list in section 1.21): **Vertically Integrated Company**

Q	Question	Response (Please provide rationale where possible)
1.	In your opinion, does Modification Proposal P78 give a better separation of balancing actions (i.e. system vs energy) used in setting the Energy Imbalance Price(s), if so, how? (Section 1.1)	There will always be some bid/offer acceptances which are taken for both energy and system purposes. The issue is how many of these you allow into the energy price. P78 in removing the whole of the reverse stack and using the NIV for setting the forward stack will change the separation of balancing actions by removing some of these acceptances which were taken for both reasons.
2.	In your opinion, is Modification Proposal P78 valuing actions more correctly, if so, why and if not, why not? (Section 1.5)	For the main price it could be argued that it leads to actions being more accurately valued in as much as it reflects the actions NGC has to take to deal with the net imbalance. However, as the reverse price is based on a market index is not reflective of the actions NGC has had to take.
3.	In your opinion, how does Modification Proposal P78 change the relative reward for notified and instructed actions and how do you believe this to impact on the Transmission Company's balancing of the system, and do you believe this is appropriate? (Section 1.6 defines notified and instructed action)	A bid offer acceptance to achieve market balance is of greater value than imbalances which may just happen to do so. NGC are able to call on bids and offers and be surer of delivery than they can be that people will follow accurately their physical notifications. Therefore, these should be valued more highly than accidental actions to balance. In terms of unnotified action (failure to meet FPN) this is a Grid Code issue, although we agree that a notified action (following FPN) is less problematic for NGC.
4.	In your opinion, does Modification Proposal P78 more correctly target the cost of energy balancing actions to those causing the imbalance over the current baseline? (Section 1.6)	For the reverse price, if a more appropriate split of system and energy is achieved under this proposal then it will deliver a more appropriate targeting of the cost of energy balancing actions. However, as stated above this cannot be the case for the reverse price.
5.	In your opinion, how does Modification Proposal P78 change the perceived risk of Bid - Offer submission, how would it change the level of	We are concerned that the reverse price under this proposal will become

Q	Question	Response (Please provide rationale where possible)
	participation seen in the Balancing Mechanism under the current baseline and how do you believe it would affect system balancing? (Section 1.7)	more easily anticipated and would be easier to game.
6.	In your opinion, how do you believe Modification Proposal P78 would affect the level of part loading seen under the current arrangements and in what way do you believe it would be more or less efficient for participants and for the system as a whole? (Section 1.8)	It may do although you may expect to see part loading to give flexibility to provide offers to the market. P12 is a significant factor. Until we see the market's reaction to its implementation it will be difficult to gauge the incremental effects of P78.
7.	In your opinion, does Modification Proposal P78 change the incentives to deviate from FPN over the current baseline, if so, how and why? (Section 1.9)	It may increase incentives to deviate as the price may be more easily predicted.
8.	In your opinion, (noting the forthcoming implementation of Modification P12 to reduce Gate Closure to one hour), does Modification Proposal P78 increase the incentive on parties to change Physical Notifications shortly before Gate Closure and do you believe this to be a good or bad thing? (Sections 1.9, 1.11, 1.12, 1.13)	P12 is the main factor in this. Whether or not this will increase the incentive to change PNs before gate closure will depend on the amount of trading which occurs up to the hour before.
9.	In your opinion, to what extent will Modification Proposal P78 address the issue of asymmetric risk? (Section 1.10)	There will always be some asymmetric risk as this is the reality of the market as the risk of tripping is the main risk to generators. However, it is to be expected that P78 would dampen the effects of this.
10.	In your opinion, do you believe that Modification Proposal P78 will change the incentives on parties to balance their individual (contractual) trading positions before Gate Closure, if so, how and why? (Sections 1.12 and 1.13)	If P78 is more easily gamed then it would be expected to reduce the incentive for parties to self balance.
11.	In your opinion, do you believe that Modification Proposal P78 will change the incentives for parties as a whole (i.e. in total, even if not balanced on an individual basis) to balance the market as a whole before Gate Closure, if so, how and why? (Section 1.11)	This is difficult to assess with the possibility of gaming opportunities without knowing how the reverse price is to be set. If it simply reduces the risk of going shorter then it may have a similar effect to P74.

Q	Question	Response (Please provide rationale where possible)
12.	In your opinion, does Modification Proposal P78 lead Parties to anticipate the 'direction' of the market, and therefore the Energy Imbalance Price. Could this lead to volume volatility and consequential price instability in the market? (Sections 1.12 and 1.13)	This is possibly more of an issue for P74 than P78.
13.	What effect do you think Modification Proposal P78 will have on liquidity and prices in the forwards and spot markets, the interrelation of forwards and spot markets with Energy Imbalance Prices and also the level of Energy Imbalance Prices themselves? (Sections 1.14, 1.15 and 1.16)	It is very difficult to predict the effects of P78 without knowing how the reverse price is to be set.
14.	Do you believe that the implementation of Modification Proposal P78 will encourage the development of risk management products and new types of contracts, and what effect do you think this will have on competition and the efficiency of the forwards and spot markets? (Sections 1.17, 1.18, 1.19 and 1.20)	This is more of an issue for P74 as P78 is still a dual price mechanism.
15.	In your opinion what would be the impact on the risk profile of different categories of party (as listed in section 1.21) from the implementation of Modification Proposal P78? (Section 1.21)	Could be expected to have similar effects to P78. However, as with many of the above questions it is impossible to speculate until more is known about how the reverse price is to be calculated.
16.	Do you believe that Modification Proposal P78 better facilitates achievement of the Applicable BSC Objectives, if so, which one(s) and why?	No.
17.	Do you believe that an Alternative Modification Proposal better facilitates achievement of the Applicable BSC Objectives than Modification Proposal P78, if so, what is it? (Section 1.23)	N/A

Q	Question	Response (Please provide rationale where possible)
18.	Are there any other issues not identified in the supporting document which you believe should be considered during the assessment of Modification Proposal P78.	The main problems with P78 are: 1. It is not reflective of NGC's balancing actions. 2. It is unclear how the reverse price is to be calculated. 3. The reverse price is likely to be easily gamed. As with P74 we do not believe that now is the right time to implement such a change. We need experience of P12 first.
19.	Do you believe that further analysis / modelling is required over that currently identified by the PIMG (in the supporting document), and if so, what specific form should this take?	It is essential that the modelling takes into account the effects of P12. To model on the basis of 3½ hour gate closure would be of little use to the debate.

P78_ASS_006 – Combined Heat and Power Association

The Combined Heat and Power Association has consistently argued that the adoption of a single cash-out price in the Balancing Mechanism will be an important contributing factor in addressing the difficult trading conditions facing many CHP generators as a consequence of the introduction of NETA.

In this regard, the Association has considered the analysis presented in the attached paper prepared by Campbell Carr Ltd, and on the basis of the information presented would support the view that, of the two modification proposals P74 and P78, P74 is likely to offer the greatest prospects for securing the BSC objectives while simultaneously diminishing the risk faced by CHP and other small or independent generators. Both would appear to offer advantages over the present arrangements.

However, it remains apparent that considerable uncertainty will surround the precise impact of either of the proposed modifications upon CHP plant. It may therefore be, that while these modifications provide some amelioration of the impacts of NETA, they may not in isolation deliver a comprehensive relief from the commercial pressures presently faced by a number of CHP plant.

Graham Meeks

Deputy Director

Combined Heat and Power Association

Q	Question	Response (Please provide rationale where possible)
1.	In your opinion, does Modification Proposal P74/P78 give a better separation of balancing actions (i.e. system vs energy) used in setting the Energy Imbalance Price(s), if so, how? (Section 1.1)	In the current arrangements, despite changes to definition (such as P18A), the long market leads to a very small number of Acceptances setting SBP. The impact of any action for systems reasons therefore has a disproportionate effect on SBP. P74 does not directly address the split between system balancing and energy balancing actions but, by leading to a more balanced market – system balancing actions on the buy side will be "diluted" by energy actions, lessening their impact without a significant adverse impact on SSP likely. The resulting price is less likely to be extreme and will better reflect the price at which NGC is a net buyer of energy than is the case at present. P78 deems all actions in the opposite direction to be for systems reasons and so it will strip them away from the price mechanism. It also strips equivalent volumes from the main price setting a lower price. It is impossible to be certain that actions for energy reasons have not been stripped away as well but it seems likely that the resultant main price will be a better reflection of the cost of energy needed for pure energy balancing reasons. The reverse price used in P78 is an approximate spot market price and this is a significantly better reflection of the value of reverse actions than is the case at present and will certainly exclude systems actions although it is less certain that the price is a proper reflection of energy cost to the system.
2.	In your opinion, is Modification Proposal P74/P78 valuing actions more correctly, if so, why and if not, why not? (Section 1.5)	P74 values actions in the direction of system balance in the same way as at present. The change is in the valuation of the reverse price. NGC balances the system based on the difference between generator FPNs and their own forecast of demand (with no reference to contract position which they do not know until up to 14 months later). The deviations from FPN are caused by generators tripping (or being late) and due to consumers in aggregate deviating from the NGC forecast. Suppliers' contract positions relative to their individual forecast of their own customers' demand (e.g. over-contracting as at present) will not alter the actions taken by NGC because the deviations of customer offtake relative to the NGC forecast will be the same. Therefore the value of actions taken by NGC will be the same regardless of any supplier's contract position and the single price proposed in P74 reflects this. P78 potentially better reflects the value of energy actions in the main price than does P74 but there seems a less soundly based case for the valuation of the reverse price because it is still applied to contract positions which NGC knows nothing of at the time of the action taken. However, the market price used for the reverse price is definitely more cost-reflective than the current SBP/SSP.
3.	In your opinion, how does Modification	NGC expresses the opinion that an instructed action (through a BM Acceptance) is worth more than an

Q	Question	Response (Please provide rationale where possible)
	Proposal P74/P78 change the relative reward for notified and instructed actions and how do you believe this to impact on the Transmission Company's balancing of the system, and do you believe this is appropriate? (Section 1.6 defines notified and instructed action)	unnotified delivery or offtake that is in the direction of system balance, and do not see why P74 should thereby reward such actions better than acceptances (by definition some BM acceptances must be at a less favourable price than the price proposed in P74). However, this mistakes the value of such spill/shortfall because, in a BM acceptance, the price is one that is acceptable to the bidder or offerer, whereas in unnotified spill/shortfall the risk is that the price will be unfavourable and is as likely to be a loss or a gain. This is interpreted by NGC as a reward for gambling when going against the direction of the system but it is really simply paying the value of your position to the system (i.e. it is cost-reflective) bearing in mind that there will be very few parties who will take a physical position in this way intentionally rather than due to errors in their forecasts of their own metered position. P78 asserts that the value of an action that helps the system accidentally is worth no more than the market price but offers no justification for this view. It is certainly a better valuation than the current arrangement, which punishes such "accidental" help regardless but this is still not a proper reflection of the value of the offsetting volumes, which allow NGC to take less balancing actions than they would otherwise have taken.
4.	In your opinion, does Modification Proposal P74/P78 more correctly target the cost of energy balancing actions to those causing the imbalance over the current baseline? (Section 1.6)	P74 targets the cost of energy imbalance on those causing it and gives the benefit to those who help the system whereas the current system punishes regardless and certainly mis-targets the costs on positions that help the system. P78 targets the costs of net imbalance on those who are out of balance in the same direction as the system. It values contractual imbalances that help the system better than the present mechanism but does not offer the full reward for that help.
5.	In your opinion, how does Modification Proposal P74/P78 change the perceived risk of Bid - Offer submission, how would it change the level of participation seen in the Balancing Mechanism under the current baseline and how do you believe it would affect system balancing? (Section 1.7)	This is a complex area. Currently generators are operating at part load excessively in order to provide capacity for self-reserve. Generators are offering self-reserve volumes as BM offers at present (it may, however, be worth examining the extent to which they are setting MEL to FPN to prevent such offers being accepted). If generators reduce the volume of self-reserve by selling more gensets fully and not operating on others then the volumes available as BM offers could reduce. This would be more efficient for the system overall although the cost borne by NGC for carrying reserve would increase. The phrasing of the actual question is about the risks of bid/offer submission. P74 reduces the risk of bid/offer submission because if an acceptance is made that cannot be delivered (e.g. due to a generator trip) then the cost of that failure is not necessarily changed. Given that self-reserve is

Q	Question	Response (Please provide rationale where possible)
		offered to NGC as offers at present, the main expected change will be in the price at which such offers are made which should be lower if the cost of failure is lower. This would not otherwise affect system balancing. P78 has a similar effect to P74 but, by reducing the potential upside to cash-out in the event of failure to deliver, it can be expected to have a lesser effect on bid/offer pricing than P74. P78, by maintaining a buy-sell spread may have a lower impact on the failure risk than P74 but would still be much better than at present.
6.	In your opinion, how do you believe Modification Proposal P74/P78 would affect the level of part loading seen under the current arrangements and in what way do you believe it would be more or less efficient for participants and for the system as a whole? (Section 1.8)	P74 would reduce part-loading to an extent for the following reasons: • In a more balanced market, fewer bids would be taken, reducing part loading on pulled back plant; • The cost of generator trip would be reduced and so self-reserve would be less necessary – this suggests fewer plant operating at fuller load. However, on the reverse side: • A more balanced market increases the probability of an offer being accepted, which increases the reward for part-loading (to an extent); • With fewer plant scheduled by participants onto the bars, NGC may need to schedule more part loaded plant via reserve contracts. The effect of P78 is similar but to a lesser extent.
7.	In your opinion, does Modification Proposal P74/P78 change the incentives to deviate from FPN over the current baseline, if so, how and why? (Section 1.9)	Currently, there are two incentives on generators to deviate from FPN: • To replace a failed plant from the portfolio when SBP is expected to be high (which is easily done from part-loaded plant but which will be used rarely); • Generating to the upper end of the expected level of output in order to avoid a marginal shortfall at SBP – this gives a lot of very small volumes of persistent spill. P74 will reduce the first of these in some circumstances (while recognising that if a large set fails completely it could tip the system short anyway), and will eliminate the bias in the second as the cost of going short will be reduced. Generators may still seek to over-deliver against FPN when they see the network going short but they risk this breach of the grid code only netting SSP anyway (especially if others do the same) and they would almost certainly be better off contracting with NGC (as PGBTs or Offers) given that they would only be doing this spill when they have good reason to believe that NGC will need the energy. In any case such opportunities will be vanishingly rare under a 1-hour gate closure.

Q	Question	Response (Please provide rationale where possible)
		P78 will not offer the same potential incentives to deviate from FPN and will reduce the existing incentives.
8.	In your opinion, (noting the forthcoming implementation of Modification P12 to reduce Gate Closure to one hour), does Modification Proposal P74/P78 increase the incentive on parties to change Physical Notifications shortly before Gate Closure and do you believe this to be a good or bad thing? (Sections 1.9, 1.11, 1.12, 1.13)	P12 is the latest Modification approved that explicitly facilitates contracting close to gate closure. Given that IPNs will usually represent the contracted position at the time rather than an expectation of striking contracts, it can be expected that changes up to FPN will be more frequent. P74 will only increase opportunities for late changes to FPN to the extent that there is extra information indicating a specific direction to system balance. Opportunities for price-seeking by changing a physical position will only arise to the extent that there is extra information about system balance available. Given that IPNs will be less useful as a predictor of system balance due to these same late changes from other parties, excessive speculation on the physical position of the market will be muted. It should be noted that parties may still speculate on the direction of the market in the current situation in that a rising price in the spot market suggesting that the market is short will raise the expected cost of a supplier going short and so they might choose to go even longer. Some "opportunities" will still arise from P78 because an expectation of a more balanced market will change parties' perceptions of optimal position (if the spot price is rising, it suggests the system might be short, which increases the risk-adjusted value of spill so that other parties might seek to go longer). P74 does allow notifications much closer to gate closure because the risk of notification failure can be managed financially under a single price. Both P74 and P78 therefore may make system management more difficult for NGC but the big change in difficulty arose from P12 and the difficulty was thought to be outweighed by the improvements due to parties being able to balance more closely.
9.	In your opinion, to what extent will Modification Proposal P74/P78 address the issue of asymmetric risk? (Section 1.10)	There is confusion as to what is meant by asymmetric risk. Asymmetry in price risk arises primarily where the spot price (the price of buying out of the price risk) is closer to a risk-weighted expected SSP than to a risk-weighted expected SBP. The relative volatility in SBP simply raises its risk-weighted expected price. P74 will raise the opportunity cost of spilling because, as generators have the opportunity to spill at a potentially higher price, they will not offer power to suppliers at a prompt price that does not reflect this opportunity. This raises the spot price and makes the risks more symmetrical. P74 therefore addresses the causes of the observed (i.e. ex post) asymmetry in prices. P74 does not directly address the more fundamental asymmetry in volatility in SBP relative to SSP for

Q	Question	Response (Please provide rationale where possible)
		which there are good economic reasons although some of the volatility caused by pollution of the energy price by systems actions will be diluted because these actions will only affect the "main" price, which will include much more energy in its calculation. P78 seeks to more directly address price pollution from systems actions by extensive tagging out and as such will produce a less volatile main price although the underlying relative volatility inherent in short-notice incrementing will remain. In other respects the impact of P78 will be similar to P74 but more muted.
10.	In your opinion, do you believe that Modification Proposal P74/P78 will change the incentives on parties to balance their individual (contractual) trading positions before Gate Closure, if so, how and why? (Sections 1.12 and 1.13)	As explained in *9* above, P74 will raise the cost of excessive spill, which will thereby reduce, leading to a more balanced market. Similarly, as the cost of going short remains a high price (although relatively reduced), the incentive on all parties with uncertainty about their ex post physical position remains to balance. P78 has similar incentives but is more muted because the up side of getting it wrong are less (leading to a probably longer market than P74).
11.	In your opinion, do you believe that Modification Proposal P74/P78 will change the incentives for parties as a whole (i.e. in total, even if not balanced on an individual basis) to balance the market as a whole before Gate Closure, if so, how and why? (Section 1.11)	P74 will lead to a more balanced market because balancing decisions will be informed by expected market balance – which is not the case at present. Also, if suppliers seek to be closer to balance individually (by spilling less), the market will be closer to balance. P78 will be similar but the effects are more muted and so the market is likely to be longer than under P74 but less long than at present.
12.	In your opinion, does Modification Proposal P74/P78 lead Parties to anticipate the 'direction' of the market, and therefore the Energy Imbalance Price. Could this lead to volume volatility and consequential price instability in the market? (Sections 1.12 and 1.13)	Parties will only price-seek under P74 to the extent that they have good information about the direction of market imbalance. The fear of hunting has to be vastly exaggerated. Generators have a slightly better view of market balance to the extent that they know if their own plant is at risk of failure. However, they will be price-takers (the "hunted") in such a scenario – not hunters. Such generators will seek to contract out of their own adverse balance. Other generators will usually be better off by offering their flexibility to NGC rather than speculating. P78 is similar in effect – it won't lead to significant hunting of the market direction. There is not enough information out there to make it worthwhile.
13.	What effect do you think Modification	P74 will vastly increase liquidity in the spot markets because it eliminates notification risk (a failure to

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	Proposal P74/P78 will have on liquidity and prices in the forwards and spot markets, the interrelation of forwards and spot markets with Energy Imbalance Prices and also the level of Energy Imbalance Prices themselves? (Sections 1.14, 1.15 and 1.16)	notify can be covered financially in a single-price environment). P74 will impact on spot prices because it changes the value of buying out of imbalance. It will have less effect on forward prices. P78 will have similar effects other than on liquidity in the spot market, which will be muted by the remaining dual cash-out price effect on notification risk. It has been asserted that, under P74, parties will not contract and simply take a "Pool" price. This misunderstands the nature of the Pool in which generators were guaranteed revenue based on the day-ahead price. Without a contract, generators can only be guaranteed a low ex post spill price and so will not generator without a contract (either notified before gate closure or else on a CfD). If generators don't generate then the market will be short so suppliers have an incentive to contract to avoid SBP. The incentive to contract remains and, given that the market was about 90% contracted under the Pool, there is no reason to believe that contracting will be any less than at present (except that the market will be contracted to balance rather than being over-contracted).
14.	Do you believe that the implementation of Modification Proposal P74/P78 will encourage the development of risk management products and new types of contracts, and what effect do you think this will have on competition and the efficiency of the forwards and spot markets? (Sections 1.17, 1.18, 1.19 and 1.20)	Under a single cash-out price as in P74, volume risk management can be offered across the system rather than just behind the meter. Much of this will probably be via CfDs but traders will offer other products as well because they would be able to take a physical position if the price risk was not always negative. This is fundamentally efficient and normal because risk is moving to the parties most willing to bear it. P78 does not offer the same opportunities because, although downside risk is reduced, there is no upside risk available for the risk manager.
15.	In your opinion what would be the impact on the risk profile of different categories of party (as listed in section 1.21) from the implementation of Modification Proposal P74/P78? (Section 1.21)	• Small suppliers will benefit from both Mods but especially form P74 because the artificial penalty applied to small portfolios (with a statistically greater imbalance risk) is removed (by P74) or reduced (by P78). • Larger suppliers benefit like smaller ones in not needing to over-contract – and they can buy better risk management across the system. However, they benefit less than small suppliers because their artificial relative advantage in portfolio size is removed. • Licence Exempt Generators (LEGs) are significant winners from both Mods but especially from P74. This is because the value of spill – the price that many embedded generators have been offered in contracts – has increased to incorporate a possibility of earning either from a market price (P78) or

Q	Question	Response (Please provide rationale where possible)
		from SBP (P74). Suppliers will therefore be able to offer prices to embedded generators at a price reflecting this. In addition, in a more balanced market, NGC will provide more of the reserve (rather than suppliers doing so via over-contracting) and so embedded benefits will improve. For LEGs in CVA, the cost of consolidation will be removed by P74 and reduced by P78. • Unpredictable generators will benefit by being able to contract to their average expected output rather than to the minimum because shortfalls will not always be punished at SBP. They will therefore spill less. • Non-portfolio generators face lower trip risk and so will earn at a higher rate. To the extent that the average spot price increases, they may be able to strike better contracts, but if the forward market does not move then this will not be the case. • Portfolio generators will lose market power and so will be slightly worse off, but to the extent that their effective trip insurance cost will be lower, they will benefit. • Vertically integrated parties will similarly lose market power but will still operate in a more efficient, lower cost, market. • Non-physical traders will have the opportunity to take on a degree of physical risk under P74 (but not under P78) and so will benefit from being able to offer a fuller range of risk management products. • The transmission company will not be directly financially affected by either of these proposals because it passes through costs anyway. Longer term it stands to lose out to the extent that the growth of embedded generation will no longer be stunted by the current penal pricing system. The Consultation document fails to mention the following relevant parties: • Flexible plant will benefit from a balanced market where NGC contracts for rapid reserve when needed rather than only varying the extent to which excessive plant is pulled back. • Consolidators will lose out under P74 – they will be redundant. • Exchanges will benefit from improved liquidity under P74 due to reduced notification risk. • Consumers will benefit from a more efficient market whereby suppliers are not over-contracting and generators are not self-reserving. The spot market may move up but, to the extent that forward prices are driven by Europe through arbitrage across both the gas and electricity interconnectors, it is far from certain that consumer contract prices will move to any great degree. Longer term, consumers can only benefit from a rational market in which the risk of a “California”

Q	Question	Response (Please provide rationale where possible)
		scenario – where uneconomic generating plant is excessively mothballed because market returns are so depressed so that the market is rapidly tipped into shortage – is reduced.
16.	Do you believe that Modification Proposal P74/P78 better facilitates achievement of the Applicable BSC Objectives, if so, which one(s) and why?	P74 clearly better facilitates the Applicable BSC Objectives: • It is more cost-reflective in that it correctly values balancing energy, which is independent of contract positions, which NGC knows nothing about at the time of the balancing action. It also targets those costs on those causing the imbalance rather than penalising parties who are helping the system (by contracting to a position that does not force excess balancing actions). It therefore facilitates competition. • It will lead to a more balanced system, reducing NGC's need to take balancing actions, which is more economic and efficient. P78 also better facilitates the Applicable BSC Objectives: • It prevents more system balancing actions from polluting the energy imbalance price, making that price more cost-reflective and it sets the reverse price as less penal, which is more cost-reflective. It therefore facilitates competition. • It reduces the incentive to spill excessively leading to more economic and efficient operation of the balancing mechanism.
17.	Do you believe that an Alternative Modification Proposal better facilitates achievement of the Applicable BSC Objectives than Modification Proposal P74/P78, if so, what is it? (Section 1.23)	N/a
18.	Are there any other issues not identified in the supporting document which you believe should be considered during the assessment of Modification Proposal P74/P78.	The Consultation Document fails to address the specific problems faced by embedded generation in the current mechanism. As noted above, the only way for such players to participate in the current process is to: • Either go into CVA and be consolidated, which is an administratively expensive process relative to the scale of generation and is not currently offering any attractive prices anyway; • Or to sell to suppliers in SVA and be offered the derisory spill price. The reason that suppliers are offering embedded generation such low prices is not related to inherent variability of output (which Ofgem has already demonstrated is generally not the case) but because the product that an embedded generator must offer to suppliers is different to the one offered by CVA

Q	Question	Response (Please provide rationale where possible)
		generation. This is because CVA generation delivers firm energy through contracts with the generator able to manage its own meter risk, whereas an embedded generator must sell that meter risk to the supplier and has no opportunity to manage it. Another factor not covered has also been raised above. Because the current mechanism is not rewarding upward flexibility properly (because the spill market means that excessive downward flexibility is being taken), consumers are being forced to overpay for self-reserve rather than for the product that NGC would otherwise contract for. This depresses BSUoS, which has an adverse impact on embedded benefits.
19.	Do you believe that further analysis / modelling is required over that currently identified by the PIMG (in the supporting document), and if so, what specific form should this take?	N/a

P78_ASS_007 - Immingham CHP LLP

Thank you for the opportunity for commenting on the P74/P78 Assessment Criteria. There is a hardening feeling in the market that the current imbalance price setting rules fail to deliver the intended outcomes. In particular, they load imbalance charges, including some associated with system balance, on out of balance parties. The methodology is therefore punitive and penal in effect.

As a general remark, we consider that both P74/P78 would better meet the applicable objectives, and the proposed assessment criteria and process seem to capture the key issues. The judgments we have made are preliminary based solely on the information provided by Elexon to date. There are some obvious omissions in the information available at this stage - the construction of the market price under P78 is an obvious example.

Either of the proposed changes, if implemented, would effect a fundamental change to the formulation of cashout prices and need to be very carefully thought through and modeled in detail. Because of the potentially wide ranging competitive effects, it is important that the proposals are worked up in considerably more detail and that modeling focuses on participant impacts by type of player as well as the position in the round.

Government has already highlighted in its 4 April 2002 response the need to establish a more cost reflective methodology for imbalance pricing, and one that does not unfairly disadvantage smaller participants and intermittent generators. It is clearly important that the modification group proceeds with due

urgency. At the same time the changes proposed are fundamental to the NETA design and participant cash flows, and it is essential that the right choice is made. In this context it is not clear that the two proposals made by Electricity Direct and NGC are the only choices.

A word about the process. We would observe that PIMG, which is dealing with P74/78, is dominated by the larger incumbent players. This situation is not surprising as they have the depth of resource to tackle complex and challenging issues. We would urge you and Ofgem (to whom I am copying this letter) to open up the process and undertake focused workshops to enable the wider market get to grips with the issues.

Immingham CHP LLP

Q	*Question*	**Response (Please provide rationale where possible)**
1	In your opinion, does Modification Proposal P74/P78 give a better separation of balancing actions (i.e. system vs energy) used in setting the Energy Imbalance Price(s), if so, how? (Section 1.1)	In the current arrangements, despite changes such as P18A, the long market leads to a very small number of Acceptances setting SBP. The impact of any action for systems reasons therefore has a disproportionate effect on SBP. Neither P74 nor P78 directly address the split between system balancing and energy balancing actions but, by leading to a more balanced market, system balancing actions on the buy side could be "diluted" by energy actions, lessening their impact. The resulting price is less likely to be extreme and will better reflect the price at which NGC is a net buyer of energy. P78 deems all actions in the opposite direction to be for systems reasons and it will strip them away from the price mechanism. It also strips equivalent volumes from the main price setting a lower price. The resultant main price should be a better reflection of the cost of energy needed for pure energy balancing reasons. The reverse price used in P78 is an approximate spot market price and this is a significantly better proxy for the value of reverse actions than is the case at present.
2	In your opinion, is Modification Proposal P74/P78 valuing actions more correctly. If so, why and if not, why not? (Section 1.5)	P74 values actions in the direction of system balance in the same way as at present. The change is in the valuation of the reverse price, and there is no direct relationship between reverse actions and the single price. P78 potentially better reflects the value of energy actions in the main price than does P74. The market price used for the reverse price is definitely more cost-reflective than

Q	*Question*	**Response (Please provide rationale where possible)**
		the current SBP/SSP.
3	In your opinion, how does Modification Proposal P74/P78 change the relative reward for notified and instructed actions and how do you believe this to impact on the Transmission Company's balancing of the system, and do you believe this is appropriate? (Section 1.6 defines notified and instructed action).	The reward for notified actions will be unaffected, and will still depend on BOAs, but the relative reward of unnotified actions should increase. NGC expresses the opinion that an instructed action (through a BM Acceptance) is worth more to it than an unnotified delivery or offtake that is in the direction of system balance and do not see why P74 should thereby reward such actions better than acceptances (by definition some BM acceptances must be at a less favourable price than the price proposed in P74). However, there is still a difference in the value under P74/P78. In a BM acceptance, the price is one that is acceptable to the bidder or offerer, whereas in unnotified spill/shortfall the price will be uncertain, and the participant is a price taker. P78 assumes that the value of an action that helps the system accidentally is worth no more than the market price. It is certainly a better valuation than the current arrangement, which punishes such "accidental" help regardless.
4	In your opinion, does Modification Proposal P74/P78 more correctly target the cost of energy balancing actions to those causing the imbalance over the current baseline? (Section 1.6)	P74 targets the cost of energy imbalance on those causing it and gives the benefit to those who help the system. The current system punishes regardless and certainly mis-targets the costs on positions that can help the system. P78 targets the costs of net imbalance on those who are out of balance in the same direction as the system. It values imbalances that help the system better than the present mechanism but does not offer the full reward for that help.
5	In your opinion, how does Modification Proposal P74/P78 change the perceived risk of Bid-Offer submission, how would it change the level of participation seen in the Balancing Mechanism under the current baseline and how do you believe it would affect system balancing? (Section 1.7)	Assuming there are less strong incentives to over contract under both P74 and P78, participants may see more opportunities for offering marginal supply into the BM, and they may be less inclined to hold plant in reserve to self balance. The impact of fewer balancing actions to back off excess generation also needs to be taken into account, and again should increase options available to the SO through the BM.

Q	*Question*	**Response (Please provide rationale where possible)**
6	In your opinion, how do you believe Modification Proposal P74/P78 would affect the level of part loading seen under the current arrangements and in what way do you believe it would be more or less efficient for participants and for the system as a whole? (Section 1.8)	Both P74 and P78 should reduce part-loading for the following reasons: • in a more balanced market, fewer bids would be taken, reducing the possible commercial upside of part loading on pulled back plant; • the cost of generator trip would be reduced and so self-reserve would be less necessary; and • a more balanced market increases the probability of an offer being accepted.
7	In your opinion, does Modification Proposal P74/P78 change the incentives to deviate from FPN over the current baseline. If so, how and why? (Section 1.9)	No. Arguably there are weaker incentives (owing to lower penalties) from adhering to contract notifications but there is no reason why FPNs should be less reliable, all other things being equal.
8	In your opinion (noting the forthcoming implementation of Modification P12 to reduce Gate Closure to one hour), does Modification Proposal P74/P78 increase the incentive on parties to change Physical Notifications shortly before Gate Closure and do you believe this to be a good or bad thing? (Sections 1.9, 1.11, 1.12, 1.13)	We do not believe either would have a detrimental effect, not least because NGC is likely to continue to rely on its own demand forecasts. The impacts are likely to be inconsequential compared to changes arising from P12. If there is gaming of FPNs, this should be dealt with through regulatory action.
9	In your opinion, to what extent will Modification Proposal P74/P78 address the issue of asymmetric risk? (Section 1.10)	Both will mitigate risks of exposure to SBP assuming the system remains ordinarily net long.
10	In your opinion, do you believe that Modification Proposal P74/P78 will change the incentives on parties to balance their individual (contractual) trading positions before Gate Closure. If so, how and why? (Sections 1.12 and 1.13)	There will remain incentives on all parties to at least balance under both proposals. If it is assumed that P78 will give rise to a wider spread in the prices than P74, then the incentives avoid negative imbalance (ie, be short) should be stronger than under P74.
11	In your opinion, do you believe that Modification Proposal P74/P78 will change the incentives for parties as a whole (i.e. in total, even if not balanced	No. As above.

Q	*Question*	**Response (Please provide rationale where possible)**
	on an individual basis) to balance the market as a whole before Gate Closure. If so, how and why? (Section 1.11)	
12	In your opinion, does Modification Proposal P74/P78 lead parties to anticipate the 'direction' of the market, and therefore the Energy Imbalance Price. Could this lead to volume volatility and consequential price instability in the market? (Sections 1.12 and 1.13)	Parties will always seek to anticipate the direction of the market. As we have noted under both P74/P78, there will continue to be incentives to avoid being short.
13	What effect do you think Modification Proposal P74/P78 will have on liquidity and prices in the forwards and spot markets, the interrelation of forwards and spot markets with Energy Imbalance Prices and also the level of Energy Imbalance Prices themselves. (Sections 1.14, 1.15 and 1.16)	P74 should increase much needed liquidity in the spot markets because it reduces the impact of notification risk which therefore changes the costs of buying out of imbalance. This change should mean it will have less effect on forward prices, though fewer volumes overall should be contracted over whatever timeframes. P78 will have similar effects other than on liquidity in the spot market, which could be muted by the remaining dual cash-out price effect on notification risk.
14	Do you believe that the implementation of Modification Proposal P74/P78 will encourage the development of risk management products and new types of contracts, and what effect do you think this will have on competition and the efficiency of the forwards and spot markets? (Sections 1.17, 1.18, 1.19 and 1.20)	We would expect liquidity to increase under both proposals, with a consequential beneficial impact on risk management products.
15	In your opinion, what would be the impact on the risk profile of different categories of party (as listed in Section 1.21) from the implementation of Modification Proposal P74/P78 (Section 1.21)	It is premature to say in advance of more detailed analysis and modelling. However, based on a preliminary assessment, we have concerns about the ability of larger players to influence market prices. This does not mean that the changes should not be pursued , but simply that there will need to be transparency and appropriate regulatory action in the event of abuse.
16	Do you believe that Modification Proposal P74/P78 better facilitates achievement of the	P74 better facilitates the Applicable BSC Objectives:

Q	*Question*	**Response (Please provide rationale where possible)**
	Applicable BSC Objectives. If so, which one(s) and why?	• It is more cost-reflective in that it reduces panel charges arising from balancing energy. It also targets costs on those causing the imbalance rather than penalising parties who are helping the system. It therefore facilitates competition; and • It will lead to a more balanced system, reducing NGCs need to take balancing actions, which is more economic and efficient. P78 also better facilitates the Applicable BSC Objectives: • It prevents system balancing actions from polluting the energy imbalance price, making that price more cost-reflective and its sets the reverse price as less penal, which is more cost-reflective. It therefore facilitates competition; and • It reduces the incentive to over contract and can lead to more economic and efficient operation of the balancing mechanism.
17	Do you believe that an alternative Modification Proposal better facilitates achievement of the Applicable BSC Objectives than Modification Proposal P74/P78. If so, what is it? (Section 1.23)	Not at the moment.
18	Are there any other issues not identified in the supporting document which you believe should be considered during the assessment of Modification Proposal P74/P78.	The BSC applicable objectives do not take into account wider government objectives. We would refer the group to the government's draft CHP strategy issued in May.
19	Do you believe that further analysis/modelling is required over that currently identified by the PIMG (in the supporting document), and if so, what specific form should this take?	Yes. The modelling needs to be much more thorough. It should explicitly consider the effect on intermittent generators and CHP participants.

P78_ASS_008 – London Electricity Group

Responding on Behalf of **LEG plc (representing London Electricity plc, Sweb Ltd, Jade Power Generation Ltd, and Sutton Bridge Power Ltd).**

Responding as which type of Party (see list in section 1.21): **Vertically integrated player**

Q	Question	Response (Please provide rationale where possible)
1.	In your opinion, does Modification Proposal P78 give a better separation of balancing actions (i.e. system vs energy) used in setting the Energy Imbalance Price(s), if so, how? (Section 1.1)	No, modification P78 does not improve the discrimination of system and energy related acceptances. It would, if approved, effectively set BRL to zero and therefore set "in aspic" that none of the acceptances are energy-related, regardless of future circumstances. The fact that, further, this approach then, under P78, influences one imbalance cashout price, the other being set by power exchange prices, is also undesirable, as we do not believe that any measure of forward trading prices should directly influence energy imbalance cashout prices, because of the circularity involved.
2.	In your opinion, is Modification Proposal P78 valuing actions more correctly, if so, why and if not, why not? (Section 1.5)	No, see reply to question 1, above
3.	In your opinion, how does Modification Proposal P78 change the relative reward for notified (FPN does not equal contracted volume [i.e. spill or top-up in terms of imbalance cash-out], but FPN adhered to) and instructed (a BOA is issued by NGC) actions and how do you believe this to impact on the Transmission Company's balancing of the system, and do you believe this is appropriate ?	The reward for "instructed" actions is unchanged– the action itself is still payable at the bid or offer price (except in the event of non-delivery), and the acceptance is taken account of in the calculation of energy imbalance cashout payments both with current cashout calculations and with P78, and so (except in the event of non-delivery) the successful deliverer of notified actions is neutral to P78. In terms of account imbalances, whether from "instructed" or "notified" actions, P78 would substitute a measure of forward trading prices for the existing "shorter stack"-derived cashout price. We believe that the use of forward prices in this way is inherently wrong – see reply to (1). Insofar as the forward price is less deleterious, from the participant's point of view, than the existing "shorter stack"-derived cashout price, this change also reduces incentives to balance.

Q	Question	Response (Please provide rationale where possible)
		We note that the existing, very strong, licence requirement, via the Grid Code, to submit accurate FPNs will remain in place. See also our response to questions 7,8 and 19
4.	In your opinion, does Modification Proposal P78 more correctly target the cost of energy balancing actions to those causing the imbalance ?	No. Forward prices are not correct for use in energy imbalance cashout. Nor is there a case for fixing BRL forever at zero, which this modification effectively does. Discrimination issues in the "main" price as between energy and system balancing actions will remain.
5.	In your opinion, how does Modification Proposal P78 change the risks associated with Bid - Offer submission, how would it change the level of participation seen in the Balancing Mechanism, and how do you believe it might affect system balancing?	P78 does not change the risks associated with Bid - Offer submission. We have no particular reason to believe it would change the level of participation seen in the Balancing Mechanism, for which payment is made at bid or offer price, not at imbalance cashout price. It should neither impede nor assist system balancing. SBP would be slightly lower, due to setting BRL effectively to zero, meaning that participants with relatively unreliable offer delivery would face potential exposure to a lower SBP; however, this would be offset by the possibility, asserted by the proposer, of a system more in balance. If this were true, under P78 parties in general, being less "long", would be exposed to SBP more frequently.
6.	In your opinion, how do you believe Modification Proposal P78 would affect the level of part loading seen under the current arrangements and in what way do you believe it would be more or less efficient for participants and for the system as a whole?	The prime driver for part-loading is not energy imbalance prices. It is clear that power exchanges cannot facilitate trading within 30 minutes of gate closure. We cannot forsee a systematic change in part-loading as a response to P78.
7.	In your opinion, does Modification Proposal P78 change the incentives to deviate from FPN over the current baseline, if so, how and why?	No. Further, we note that the existing, very strong, licence requirement, via the Grid Code, to submit accurate FPNs, will remain in place.
8.	In your opinion, (noting the forthcoming implementation of Modification P12 to reduce Gate Closure to one hour), does Modification Proposal P78 increase the incentive on parties to change Physical Notifications shortly	We cannot see why the incentive to change PNs just before gate closure should alter under P78.

Q	Question	Response (Please provide rationale where possible)
	before Gate Closure and do you believe this to be a good or bad thing? (Sections 1.9, 1.11, 1.12, 1.13)	
9.	In your opinion, to what extent will Modification Proposal P78 address the issue of asymmetric imbalance cashout exposure risk? (Section 1.10)	The asymmetry may be less insofar as using BRL=0 for the "longer" price, for example SBP in a short market, would appear to lessen (make less extreme, less positive) System Buy Prices. However, the use of a forward price for the counterposing cashout price is not theoretically justified, is not related to NGC's cost of balancing actions, and could have perverse effects during unusual forward trading conditions.
10.	In your opinion, do you believe that Modification Proposal P78 will change the incentives on parties to balance their individual (contractual) trading positions before Gate Closure, if so, how and why ?	Incentives to balance will not be greatly affected, however there could be a small reduction due to the effect explained in our reply to question 9.
11.	In your opinion, do you believe that Modification Proposal P78 will change the incentives for parties as a whole (i.e. in total, even if not balanced on an individual basis) to balance the market as a whole before Gate Closure, if so, how and why?	As above
12.	In your opinion, does Modification Proposal P78 lead Parties to anticipate the 'direction' of the market, and therefore the Energy Imbalance Price. Could this lead to volume volatility and consequential price instability in the market ?	Use of forward prices for imbalance cashout may lead to unintended effects including price instability
13.	What effect do you think Modification Proposal P78 will have on liquidity and prices in the forwards and spot markets, the interrelation of forwards and spot markets with Energy Imbalance Prices and also the level of Energy Imbalance Prices themselves?	See replies to questions 9 to 12
14.	Do you believe that the implementation of Modification Proposal P78 will encourage the development of risk management products and new types of contracts ? (If so what effect do you think this will have on competition and the efficiency of the forwards and spot markets ?)	It is possible that the use of a power exchange price for the short-stack-price may facilitate this, however it is not clear how a party could determine the quantity to hedge when hedging against exposure to cashout penalties; so in practice, no.

Q	Question	Response (Please provide rationale where possible)
15.	In your opinion what would be the relative impact on the risk profile of different categories of party* from the implementation of Modification Proposal P78? (Section 1.21) – * for example, Small Suppliers; Large Suppliers; Licence Exemptable Generators; Unpredictable generators; Non portfolio generators; Portfolio generators; Vertically integrated players; Non Physical Traders; and The Transmission Company.	Not possible to say
16.	Do you believe that Modification Proposal P78 better facilitates achievement of any of the Applicable BSC Objectives, if so, which one.	None would be better facilitated
17.	Do you believe that an Alternative (variant) Modification Proposal better facilitates achievement of the Applicable BSC Objectives than Modification Proposal P78 ? If so, what is it ?	No
18.	Are there any other issues which you believe should be considered during the assessment of Modification Proposal P78.	-
19.	Do you believe that further analysis / modelling is required over that currently identified by the PIMG (in the supporting document), and if so, what specific form should this take?	We particularly welcome the plan to obtain modelling that would give an indication of the likely Energy Imbalance Prices and may enable a more informed view to be taken of the likely buy - sell spread and its volatility, which may assist in an assessment of the likely incentives to balance and to contract.

P78_ASS_009 – Scottish and Southern

Responding on Behalf of: **Scottish & Southern Energy Plc, Southern Electric Ltd, Keadby Generation Ltd and SSE Energy Supply Ltd.**

Responding as which type of Party (see list in section 1.21): **Vertically Integrated Player**

Q	Question	Response (Please provide rationale where possible)
1.	In your opinion, does Modification Proposal P78 give a better separation of balancing actions (i.e. system vs energy) used in setting the Energy Imbalance Price(s), if so, how? (Section 1.1)	P78 - Yes – BRL is set to zero and therefore a much greater volume of bids and offers will be tagged as system related. Only the Net Imbalance energy for the period will set cashout prices. NGC costs derived from the difference between the cost of offers and the cost of bids for equal and opposite volumes of system balancing will be recovered through smear charges rather than imbalance charges. P74 does not include any change to the imbalance price calculation for net imbalance energy and therefore does not improve the separation of system and energy balancing costs. The relatively attractive “reverse” price simply transfers profits to participants who “happen” to have the right position.
2.	In your opinion, is Modification Proposal P78 valuing actions more correctly, if so, why and if not, why not? (Section 1.5)	See above
3.	In your opinion, how does Modification Proposal P78 change the relative reward for notified and instructed actions and how do you believe this to impact on the Transmission Company’s balancing of the system, and do you believe this is appropriate? (Section 1.6 defines notified and instructed action)	P78 doesn’t encourage position taking in the opposite sense to the system as P74 could (See 7). Therefore P78 is more likely to result in participants following their submitted PNs and it should reduce the volume of actions required by NGC.
4.	In your opinion, does Modification Proposal P78 more correctly target the cost of energy balancing actions to those causing the imbalance over the current baseline? (Section 1.6)	Both P74 and P78 target the net cost of imbalances on those who caused the imbalance. However, P78 holds participant with a helpful position neutral whereas P74 allows these participants to profit fortuitously at the expense of the other players.
5.	In your opinion, how does Modification Proposal P78 change the perceived risk of Bid - Offer submission, how would it change the level of	P78 should reduce the risk involved in being short and therefore encourage participation in the balancing mechanism. It should also result

Q	Question	Response (Please provide rationale where possible)
	participation seen in the Balancing Mechanism under the current baseline and how do you believe it would affect system balancing? (Section 1.7)	in participants holding a less long position at gate closure.
6.	In your opinion, how do you believe Modification Proposal P78 would affect the level of part loading seen under the current arrangements and in what way do you believe it would be more or less efficient for participants and for the system as a whole? (Section 1.8)	As above, the risks involved in being short should be reduced leading to a reduction in the amount of reserve held by participants and an increase in overall system efficiency.
7.	In your opinion, does Modification Proposal P78 change the incentives to deviate from FPN over the current baseline, if so, how and why? (Section 1.9)	P78 - No – the final imbalance prices will not be known until some time after the event. It would be extremely difficult to predict the "market price" and therefore there is little or no incentive to deviate from the FPN. P74 – With P74, participants will know that if NGC have accepted a large volume of offers then the cashout price is likely to be high. Likewise if NGC accept a large volume of bids the cashout price is likely to be low. This could give an incentive to deviate from submitted FPNs.
8.	In your opinion, (noting the forthcoming implementation of Modification P12 to reduce Gate Closure to one hour), does Modification Proposal P78 increase the incentive on parties to change Physical Notifications shortly before Gate Closure and do you believe this to be a good or bad thing? (Sections 1.9, 1.11, 1.12, 1.13)	Participants should be free to change PNs up to gate closure irrespective of the cashout regime. If changing PNs close to gate closure is a problem it should be addressed by modification to the gate closure period not the cashout regime. However, we believe that P74 is likely to increase the extent to which notifications are changed immediately prior to gate closure.
9.	In your opinion, to what extent will Modification Proposal P78 address the issue of asymmetric risk? (Section 1.10)	P78 should significantly reduce the asymmetric nature of the present cashout regime but will probably retain a small incentive to hold length as the weighted average cashout price for a short position is likely to be slightly more penal than the weighted average long price.
10.	In your opinion, do you believe that Modification Proposal P78 will change the incentives on parties to balance their individual (contractual) trading positions before Gate Closure, if so, how and why? (Sections 1.12	See 5,6 & 9 P78 should reduce the incentive to hold length and therefore result in an overall reduction in account imbalances which tend under the current

Q	Question	Response (Please provide rationale where possible)
	and 1.13)	system to be long.
11.	In your opinion, do you believe that Modification Proposal P78 will change the incentives for parties as a whole (i.e. in total, even if not balanced on an individual basis) to balance the market as a whole before Gate Closure, if so, how and why? (Section 1.11)	P78 should significantly improve the overall system balance. Under the current regime, all participants tend to adopt a similar position at gate closure. Ie Long. This sums to a considerable overall system imbalance. P78 should reduce this incentive on individuals, introducing an element of diversity whereby some participants may adopt a short position at gate closure. The overall system imbalance should therefore be greatly reduced.
12.	In your opinion, does Modification Proposal P78 lead Parties to anticipate the 'direction' of the market, and therefore the Energy Imbalance Price. Could this lead to volume volatility and consequential price instability in the market? (Sections 1.12 and 1.13)	P78 – This is unlikely with P78 as the "market price" will not be known for some time after the event. P74 – With P74 it would be possible for participants to anticipate whether to cashout price is going to be System Sell or System Buy by monitoring NGC's actions in the balancing mechanism. This could therefore lead to volume instability.
13.	What effect do you think Modification Proposal P78 will have on liquidity and prices in the forwards and spot markets, the interrelation of forwards and spot markets with Energy Imbalance Prices and also the level of Energy Imbalance Prices themselves? (Sections 1.14, 1.15 and 1.16)	P74 could result in the development of financial contracts for differences struck against the single cashout price. This could have the effect of reducing liquidity in the physical market and increasing the volume of energy cashout out in the balancing mechanism. (As with the Pool).
14.	Do you believe that the implementation of Modification Proposal P78 will encourage the development of risk management products and new types of contracts, and what effect do you think this will have on competition and the efficiency of the forwards and spot markets? (Sections 1.17, 1.18, 1.19 and 1.20)	See 13.
15.	In your opinion what would be the impact on the risk profile of different categories of party (as listed in section 1.21) from the implementation of Modification Proposal P78? (Section 1.21)	N/A

Q	Question	Response (Please provide rationale where possible)
16.	Do you believe that Modification Proposal P78 better facilitates achievement of the Applicable BSC Objectives, if so, which one(s) and why?	P78 is more likely to target energy imbalance costs at those who cause that imbalance and therefore better satisfies that objective of the BSC. P74 is likely to provide windfall gains which do not reflect the cost of imbalance energy and leave this cost with the same participants who are paying for the net imbalance. It therefore does not help to achieve this objective of the BSC.
17.	Do you believe that an Alternative Modification Proposal better facilitates achievement of the Applicable BSC Objectives than Modification Proposal P78, if so, what is it? (Section 1.23)	N/A
18.	Are there any other issues not identified in the supporting document which you believe should be considered during the assessment of Modification Proposal P78.	No
19.	Do you believe that further analysis / modelling is required over that currently identified by the PIMG (in the supporting document), and if so, what specific form should this take?	No

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P78_ASS_010 – SEEBOARD Energy

Responding on Behalf of (please list all BSC Parties): SEEOARD Energy

Responding as which type of Party (see list in section 1.21): Supplier

Q	Question	Response (Please provide rationale where possible)
1.	In your opinion, does Modification Proposal P78 give a better separation of balancing actions (i.e. system vs energy) used in setting the Energy Imbalance Price(s), if so, how? (Section 1.1)	Yes. This proposal fully removes system balancing actions.
2.	In your opinion, is Modification Proposal P78 valuing actions more correctly, if so, why and if not, why not? (Section 1.5)	Yes. BOA will continue to be 'paid as bid' therefore the value of actions by the SO is the same as now. The main imbalance price will continue to

Q	Question	Response (Please provide rationale where possible)
		reflect those actions but the reverse price will reflect the market value of the energy uncontaminated by system balancing actions. Also, as the BRL is effectively set to zero the more extreme bids and offers will be netted off making imbalance prices (in the direction of the system imbalance) less extreme.
3.	In your opinion, how does Modification Proposal P78 change the relative reward for notified and instructed actions and how do you believe this to impact on the Transmission Company's balancing of the system, and do you believe this is appropriate? (Section 1.6 defines notified and instructed action)	The consequence of notified actions would be less penal but instructed actions would continue to have greater value. This is appropriate.
4.	In your opinion, does Modification Proposal P78 more correctly target the cost of energy balancing actions to those causing the imbalance over the current baseline? (Section 1.6)	Yes. We believe that costs of balancing actions will fall more on those that are imbalanced in the same direction as the system and prices will be more cost reflective. Also, there will be less smearing via RCRC.
5.	In your opinion, how does Modification Proposal P78 change the perceived risk of Bid - Offer submission, how would it change the level of participation seen in the Balancing Mechanism under the current baseline and how do you believe it would affect system balancing? (Section 1.7)	Parties may hold less pre gate closure self reserve if the consequences of imbalance are less punitive. This may in turn increase the number and bids and offers into the Balancing Mechanism.
6.	In your opinion, how do you believe Modification Proposal P78 would affect the level of part loading seen under the current arrangements and in what way do you believe it would be more or less efficient for participants and for the system as a whole? (Section 1.8)	We accept the evidence that would suggest that the asymmetric risk of imbalance prices is not key in determining the extent of part loading. We do not believe, therefore, P78 would have any material impact.
7.	In your opinion, does Modification Proposal P78 change the incentives to deviate from FPN over the current baseline, if so, how and why? (Section 1.9)	No
8.	In your opinion, (noting the forthcoming implementation of Modification P12 to reduce Gate Closure to one hour), does Modification Proposal P78 increase the incentive on parties to change Physical Notifications shortly	No, we do not believe there is an increased incentive. In any event we assume current measures in place are sufficient to prevent abuse and we would not be unduly concerned.

Q	Question	Response (Please provide rationale where possible)
	before Gate Closure and do you believe this to be a good or bad thing? (Sections 1.9, 1.11, 1.12, 1.13)	
9.	In your opinion, to what extent will Modification Proposal P78 address the issue of asymmetric risk? (Section 1.10)	We believe that there is a mitigation of asymmetric risk.
10.	In your opinion, do you believe that Modification Proposal P78 will change the incentives on parties to balance their individual (contractual) trading positions before Gate Closure, if so, how and why? (Sections 1.12 and 1.13)	We believe the incentive remains to balance individual positions before gate closure.
11.	In your opinion, do you believe that Modification Proposal P78 will change the incentives for parties as a whole (i.e. in total, even if not balanced on an individual basis) to balance the market as a whole before Gate Closure, if so, how and why? (Section 1.11)	No
12.	In your opinion, does Modification Proposal P78 lead Parties to anticipate the 'direction' of the market, and therefore the Energy Imbalance Price. Could this lead to volume volatility and consequential price instability in the market? (Sections 1.12 and 1.13)	No
13.	What effect do you think Modification Proposal P78 will have on liquidity and prices in the forwards and spot markets, the interrelation of forwards and spot markets with Energy Imbalance Prices and also the level of Energy Imbalance Prices themselves? (Sections 1.14, 1.15 and 1.16)	It is arguable whether there is or should be any interrelation between the forwards and spot market and imbalance prices. Whatever the view, we are not convinced that this mod would have any great impact on forwards and spot markets. We believe that there would be some mitigation in Energy Imbalance Price volatility.
14.	Do you believe that the implementation of Modification Proposal P78 will encourage the development of risk management products and new types of contracts, and what effect do you think this will have on competition and the efficiency of the forwards and spot markets? (Sections 1.17, 1.18, 1.19 and 1.20)	We do not believe that there would be any great impact on competition. We accept that in theory a system that encourages balancing (as opposed to over cover) should promote greater efficiency. We also agree that a system that encourages more precise and efficient contracting may lead to the trading of half-hourly products and consolidation for example. We have no evidence that this will be the case.

Q	Question	Response (Please provide rationale where possible)
15.	In your opinion what would be the impact on the risk profile of different categories of party (as listed in section 1.21) from the implementation of Modification Proposal P78? (Section 1.21)	We believe that this mod provides greater stability and cost reflectivity of cash-out prices. This should be beneficial to all participants but especially to those who cannot precisely control their output/demand.
16.	Do you believe that Modification Proposal P78 better facilitates achievement of the Applicable BSC Objectives, if so, which one(s) and why?	Promotes effective competition in the generation and supply of electricity. See 15.
17.	Do you believe that an Alternative Modification Proposal better facilitates achievement of the Applicable BSC Objectives than Modification Proposal P78, if so, what is it? (Section 1.23)	No
18.	Are there any other issues not identified in the supporting document which you believe should be considered during the assessment of Modification Proposal P78.	No
19.	Do you believe that further analysis / modelling is required over that currently identified by the PIMG (in the supporting document), and if so, what specific form should this take?	We note that what represents an appropriate market price is left to the Modification Group and we look forward to your analysis on the subject in due course. We would just like to stress the point that whatever formulation is used it should be free from manipulation and not predictable. It should also, of course, be truly representative of the value of short- term energy.

P78_ASS_011 - ScottishPower
Responding on Behalf of: Scottish Power UK Plc.; Scottish Power Energy Trading Ltd.; Scottish Power Generation Ltd.; Scottish Power Energy Retail Ltd.;
Responding as which type of Party (see list in section 1.21): Large Suppliers; Portfolio generators; Vertically integrated players

Q	Question	Response (Please provide rationale where possible)
1.	In your opinion, does Modification Proposal P78 give a better separation of balancing actions (i.e. system Vs energy) used in setting the Energy Imbalance Price(s), if so, how? (Section 1.1)	P78 uses net balancing which would give more transparency (and better separation) to the balancing actions that the System Operator was required to take.
2.	In your opinion, is Modification Proposal P78 valuing actions more correctly, if so, why and if not, why not? (Section 1.5)	Given that P78 would provide better separation to energy and system balancing actions, it could be assumed that the valuing of these actions would be more adequately addressed. Although it is almost impossible to remove all system balancing actions from the cost, as long as those actions that unduly 'skew' the cost were identified and removed, the cost would be more reflective of true energy balancing.
3.	In your opinion, how does Modification Proposal P78 change the relative reward for notified and instructed actions and how do you believe this to impact on the Transmission Company's balancing of the system, and do you believe this is appropriate? (Section 1.6 defines notified and instructed action)	No, we do not think that P78 (on its own merits) will change the actions of those currently submitting PNs into the market.
4.	In your opinion, does Modification Proposal P78 more correctly target the cost of energy balancing actions to those causing the imbalance over the current baseline? (Section 1.6)	We think the modification addresses more costs than the current baseline method as most of these are incurred in the 'shorter' stack (bids when the system is short and offers when the system is long).
5.	In your opinion, how does Modification Proposal P78 change the perceived risk of Bid - Offer submission, how would it change the level of participation seen in the Balancing Mechanism under the current baseline and how do you believe it would affect system balancing? (Section 1.7)	It is also difficult to quantify this, in the light of P12 coming into play very shortly. We do think that the level of submissions into the BM will become more volatile as some players may hold back plant for BM participation or may decide to forwardly contract the bulk of it, depending on prevailing market conditions. P12 will amplify this as it gives a further 2½ hours worth of analysis before a decision has to be made.

Q	Question	Response (Please provide rationale where possible)
6.	In your opinion, how do you believe Modification Proposal P78 would affect the level of part loading seen under the current arrangements and in what way do you believe it would be more or less efficient for participants and for the system as a whole? (Section 1.8)	Part loading of plant is similar to building in length to a PN position – it gives the generator 'slack' to pick up a position if it is short as a result of a trip or a load dip at a station. Part loading is an inefficient method of operation, and one that has not been seen in the market for some months (with most generators operating at high load factors or indeed at their MEL). We think this is a moot point as it is not an inherent market characteristic and will not be wholly addressed by P78 on its own.
7.	In your opinion, does Modification Proposal P78 change the incentives to deviate from FPN over the current baseline, if so, how and why? (Section 1.9)	The modification may go some way to reducing the level of SBP, and therefore may encourage participants to change their current PN actions.
8.	In your opinion, (noting the forthcoming implementation of Modification P12 to reduce Gate Closure to one hour), does Modification Proposal P78 increase the incentive on parties to change Physical Notifications shortly before Gate Closure and do you believe this to be a good or bad thing? (Sections 1.9, 1.11, 1.12, 1.13)	The introduction of P12 gives more time for parties to change PN submissions and also more time to monitor market conditions and make PN adjustments accordingly. This will not necessarily mean that more accurate PN submissions will be made – it could provide opportunities for certain larger players to influence the market thus providing potential 'gaming opportunities'.
9.	In your opinion, to what extent will Modification Proposal P78 address the issue of asymmetric risk? (Section 1.10)	Asymmetric risk can only be fully eliminated if the market becomes more balanced. As already discussed, P78 could potentially go some way to achieving this, but only reducing the risk, not fully addressing it.
10.	In your opinion, do you believe that Modification Proposal P78 will change the incentives on parties to balance their individual (contractual) trading positions before Gate Closure, if so, how and why? (Sections 1.12 and 1.13)	As discussed, P78 may influence some participants to enter more accurate PN submissions, however, the modification alone will not encourage this across the board.
11.	In your opinion, do you believe that Modification Proposal P78 will change the incentives for parties as a whole (i.e. in total, even if not balanced on an individual basis) to balance the market as a whole before Gate Closure, if so, how and why? (Section 1.11)	As discussed, P78 may influence some participants to enter more accurate PN submissions, however, the modification alone will not encourage this across the board.

Q	Question	Response (Please provide rationale where possible)
12.	In your opinion, does Modification Proposal P78 lead Parties to anticipate the 'direction' of the market, and therefore the Energy Imbalance Price. Could this lead to volume volatility and consequential price instability in the market? (Sections 1.12 and 1.13)	We think that all participants will try and anticipate the 'direction' of the market and adjust their position accordingly. This will be enhanced by the forthcoming P12 modification as there is an additional 2½ hours to monitor market conditions and change submissions accordingly. It is impossible to say that P78 would be responsible for leading participants to act in this manner.
13.	What effect do you think Modification Proposal P78 will have on liquidity and prices in the forwards and spot markets, the interrelation of forwards and spot markets with Energy Imbalance Prices and also the level of Energy Imbalance Prices themselves? (Sections 1.14, 1.15 and 1.16)	The modification may go some way in persuading participants to be more accurate in PN submissions, therefore freeing up more capacity to participate in the forwards and spot markets. This would help increase market liquidity and could potentially help reduce energy imbalance costs.
14.	Do you believe that the implementation of Modification Proposal P78 will encourage the development of risk management products and new types of contracts, and what effect do you think this will have on competition and the efficiency of the forwards and spot markets? (Sections 1.17, 1.18, 1.19 and 1.20)	We do not think that the modification would encourage the development of new risk management products and new types of contracts. Given any increase in market liquidity, it could be said that competition would have to increase and the markets would become more efficient as a result.
15.	In your opinion what would be the impact on the risk profile of different categories of party (as listed in section 1.21) from the implementation of Modification Proposal P78? (Section 1.21)	Small Suppliers: Will continue to submit long PNs to ensure they are not subject to large imbalance charges. Large Suppliers: Will continue to submit some length in PNs until confidence (if any) is built up in the methodology used to calculate SBP. Licence Exemptable Generators: Will continue to submit long PNs to ensure they are not subject to large imbalance charges. Unpredictable Generators: Will continue to submit long PNs to ensure they are not subject to large imbalance charges. Non Portfolio Generators: Will continue to submit some length in PNs until confidence (if any) is built up in the methodology used to calculate SBP.

Q	Question	Response (Please provide rationale where possible)
		Portfolio Generators: Will continue to submit some length in PNs until confidence (if any) is built up in the methodology used to calculate SBP. Vertically Integrated Players: Will continue to submit some length in PNs until confidence (if any) is built up in the methodology used to calculate SBP. Non Physical Traders: Will continue to submit some length in PNs until confidence (if any) is built up in the methodology used to calculate SBP. Transmission Company: There may possibly be an initial reduction in the length submitted through PNs, therefore energy and system balancing actions required to be completed may reduce. If confidence is build up (as is intended by the modification) these actions should reduce and be made up of mainly system balancing.
16.	Do you believe that Modification Proposal P78 better facilitates achievement of the Applicable BSC Objectives, if so, which one(s) and why?	Possibly. The proposal would help to promote more effective competition in the generation and supply of electricity as it could potentially increase market liquidity, though some participants may still consider taking withhold positions. If more accuracy were gained from PN submissions, this would help the role of the System Operator in its obligations imposed under the transmission licence to balance the system in an economic and efficient manner.
17.	Do you believe that an Alternative Modification Proposal better facilitates achievement of the Applicable BSC Objectives than Modification Proposal P78, if so, what is it? (Section 1.23)	It would be unwise to rule out such a modification at this stage, or indeed propose an alternative calculation. However, as with any such wide-reaching modification, it would be wise to allow more time for the market to settle down (ideally another NETA winter) and possibly there may be some further self-regulation with the introduction of P12. If such a cash-out method is still thought to be effective in ensuring compliance with applicable BSC objectives, it should be rethought at the start of 2003.

Q	Question	Response (Please provide rationale where possible)
18.	Are there any other issues not identified in the supporting document which you believe should be considered during the assessment of Modification Proposal P78.	No.
19.	Do you believe that further analysis / modelling is required over that currently identified by the PIMG (in the supporting document), and if so, what specific form should this take?	In defining the 'market price', consideration should be given as to how power exchange prices will be affected by the implementation of P12. Further, it should be noted that one definition of a 'market price' is already in use, in the context of the NIRP definition in NGC's 2002/03 System Operator incentive scheme. The interaction with this price should be considered as part of further detailed analysis.

P78_ASS_012 – Damhead Creek Ltd

Responding on Behalf of (please list all BSC Parties): Damhead Creek Limited (DCL); Entergy Koch Trading Europe (EKT)

Responding as which type of Party (see list in section 1.21): Non portfolio generator; Non physical trader

Q	Question	Response (Please provide rationale where possible)
1.	In your opinion, does Modification Proposal P78 give a better separation of balancing actions (i.e. system vs energy) used in setting the Energy Imbalance Price(s), if so, how? (Section 1.1)	Better separation of system vs energy actions is achieved through removing actions in the opposite direction, although we cannot be sure that energy actions have not also been removed. Imbalance prices, however, will still be 'polluted' by system actions in the same direction, for example, actions associated with transmission constraints.
2.	In your opinion, is Modification Proposal P78 valuing actions more correctly, if so, why and if not, why not? (Section 1.5)	Through not penalising participants for 'helping' the system, actions are valued more correctly.
3.	In your opinion, how does Modification Proposal P78 change the relative reward for notified and instructed actions and how do you believe this to impact on the Transmission Company's balancing of the system, and do you believe this is appropriate? (Section 1.6 defines notified and	The relative reward for notified and instructed actions is not changed by P78. The Transmission Company's view that P78 represents a "measured approach that avoids penalising those whose errors are not causing an energy imbalance problem, but does not pay a premium price that will encourage participants to spill rather than sell their output pre

Q	Question	Response (Please provide rationale where possible)
	instructed action)	Gate Closure" is supported. If the market price is determinable, there may be an incentive to spill and so promote a corresponding increase in Bid/Offer prices.
4.	In your opinion, does Modification Proposal P78 more correctly target the cost of energy balancing actions to those causing the imbalance over the current baseline? (Section 1.6)	Those participants that are out of balance in the same direction as the system are targeted. Those participants that are out of balance in the opposite direction will receive, in principle, market price for their actions. This is an improvement on the present arrangements.
5.	In your opinion, how does Modification Proposal P78 change the perceived risk of Bid - Offer submission, how would it change the level of participation seen in the Balancing Mechanism under the current baseline and how do you believe it would affect system balancing? (Section 1.7)	P78 should tend to reduce the perceived risk of Bid-Offer submission. It is also thought likely that P78 should tend to reduce the risk of trading in the power exchanges. Both effects should encourage participation in the Balancing Mechanism and system balancing should not be affected.
6.	In your opinion, how do you believe Modification Proposal P78 would affect the level of part loading seen under the current arrangements and in what way do you believe it would be more or less efficient for participants and for the system as a whole? (Section 1.8)	The risk of exposure to imbalance prices is one of the reasons for the increase in part loading of plant, although, as argued in the consultation paper it is recognised that it is not the sole reason. Consequently, a move towards more cost reflective pricing in the Balancing Mechanism will tend to reduce the extent of part loaded plant on the system, that is, plant that is part loading in an attempt to protect against extreme System Buy Prices. Balancing action taken by the System Operator should be on a more efficient basis in terms of the system as a whole rather than, for example, through the provision of free reserve by participants choosing to take long positions into the Balancing Mechanism.
7.	In your opinion, does Modification Proposal P78 change the incentives to deviate from FPN over the current baseline, if so, how and why? (Section 1.9)	P78 reduces the incentive for generators to deviate from FPN in the case of unforced outages as SBP will be less penal.
8.	In your opinion, (noting the forthcoming implementation of Modification P12 to reduce Gate Closure to one hour), does Modification Proposal P78 increase the incentive on parties to change Physical Notifications shortly	As with P12 and P4, P78 should increase within day trading. This would be a positive development in that it should encourage participants to balance closer to real time. At present there is a stronger incentive to

Q	Question	Response (Please provide rationale where possible)
	before Gate Closure and do you believe this to be a good or bad thing? (Sections 1.9, 1.11, 1.12, 1.13)	deviate from Physical Notifications so as to avoid SBP. There remains, however, the need to safeguard against the provision of mis-information to the System Operator.
9.	In your opinion, to what extent will Modification Proposal P78 address the issue of asymmetric risk? (Section 1.10)	With a dual cash-out mechanism the preference is for a relatively constant buy-sell spread, that is, energy price symmetry. P78 will not remove the present energy price asymmetry. However, removal of 'polluting' system actions from the imbalance prices should dampen volatility in the buy-sell spread.
10.	In your opinion, do you believe that Modification Proposal P78 will change the incentives on parties to balance their individual (contractual) trading positions before Gate Closure, if so, how and why? (Sections 1.12 and 1.13)	P78 reduces the risk of imbalance to all parties. Therefore, the incentive for parties to balance their contractual positions prior to Gate Closure, rather than go long should be greater. It is believed that the reduction in imbalance risk may encourage non-physical players to take on imbalance risk post Gate Closure. This should improve liquidity in the short term markets.
11.	In your opinion, do you believe that Modification Proposal P78 will change the incentives for parties as a whole (i.e. in total, even if not balanced on an individual basis) to balance the market as a whole before Gate Closure, if so, how and why? (Section 1.11)	P78 should encourage parties to 'read' the market and if appropriate trade in the short term markets. Such activity should assist in balancing the market as a whole (individual balancing is not believed to be incompatible with market balancing). As mentioned in 10 above, P78 may facilitate non-physical related trading for risk management purposes, this should improve the incentive on physical players, both individually and collectively, to balance prior to Gate Closure.
12.	In your opinion, does Modification Proposal P78 lead Parties to anticipate the 'direction' of the market, and therefore the Energy Imbalance Price. Could this lead to volume volatility and consequential price instability in the market? (Sections 1.12 and 1.13)	Improved competition and liquidity in the market should tend towards rational market behaviour on the part of the players. The extent to which players' actions may lead to volume volatility and price instability will be dependent on the quality of market imbalance information.
13.	What effect do you think Modification Proposal P78 will have on liquidity and prices in the forwards and spot markets, the interrelation of forwards and spot markets with Energy Imbalance Prices and also the level of	P78 should improve liquidity. The purpose of P78 is to move towards cost reflective energy imbalance prices - any inter-relation between forwards and spot markets with imbalance prices is believed to be

Q	Question	Response (Please provide rationale where possible)
	Energy Imbalance Prices themselves? (Sections 1.14, 1.15 and 1.16)	irrelevant.
14.	Do you believe that the implementation of Modification Proposal P78 will encourage the development of risk management products and new types of contracts, and what effect do you think this will have on competition and the efficiency of the forwards and spot markets? (Sections 1.17, 1.18, 1.19 and 1.20)	As mentioned in 10 and 11 above, it is anticipated that non physical players will become active in bearing the risk of imbalance, and this should see the development of risk management products and new types of contracts. As a result competition and efficiency of the markets should improve.
15.	In your opinion what would be the impact on the risk profile of different categories of party (as listed in section 1.21) from the implementation of Modification Proposal P78? (Section 1.21)	Small Suppliers: Benefit from reduced imbalance risk. Large Suppliers: Benefit in the same way as small suppliers. Licence Exempt Generators: Benefit from the 'enhanced' value of spill. Unpredictable Generators: (includes renewables and commissioning plant) Benefit through less punitive SBP and from the 'enhanced' value of spill. Non Portfolio Generators: Benefit through lower 'trip' risk through less punitive SBP. Portfolio Generators: Loss of market power, but will benefit through lower 'trip' risk. Vertically Integrated Players: Loss of market power, but will benefit from improved efficiency of market as a whole. Non Physical Traders: Benefit through the opportunity to take on physical imbalance risk and offer risk management products. Transmission Company: Not financially affected except through its ability to hit incentive targets if BSUoS increases. Likely to have concerns about parties deviating from FPN and accuracy of information pre Gate Closure.
16.	Do you believe that Modification Proposal P78 better facilitates achievement of the Applicable BSC Objectives, if so, which one(s) and	Improved removal of 'polluting' system balancing actions from the energy imbalance price tends towards a more cost reflective imbalance

Q	Question	Response (Please provide rationale where possible)
	why?	price. A less penal reverse price is also more cost reflective. This improved cost reflectivity better meets the Applicable BSC Objective to further promote effective competition in the generation and supply, and sale and purchase of electricity. The incentive for parties to balance, both individually and collectively, prior to Gate Closure better meets the Applicable BSC Objective to ensure the efficient discharge by the Transmission Company of the obligations imposed under the Transmission Licence.
17.	Do you believe that an Alternative Modification Proposal better facilitates achievement of the Applicable BSC Objectives than Modification Proposal P78, if so, what is it? (Section 1.23)	DCL and EKT believe that while P78 improves the calculation of energy imbalance prices there are a number of flaws. It still does not address the problems of energy imbalance prices being polluted by system actions such as transmission constraints and actions that are not tradable in the forward markets. Further the determination of a market price will be difficult with the lack of liquidity in the half hourly forward markets. Therefore, as a 'straw man' the following is presented for consideration: o Retain the definition of NIV, so removing the need for BRL; o Calculate the EIP from the 'main' stack as the average volume weighted price of all the offers/bids that would have been necessary to balance the system, after arbitrage and CADL have been applied and including BSAD volumes and prices. This must be done strictly in price order and so the defaulting rules being considered for P79 should be used, that is, it has to be possible for the System Operator to accept a submitted bid or offer. That way if the system is short 1000MW and there are 3 offers available each for 500MW at prices of £20, £21 and £30 respectively but the offer at £30 has to be accepted to relieve a transmission constraint as it also helps balance the system then the SBP would be £20.50, with the difference (£9.50) being used

Q	Question	Response (Please provide rationale where possible)
		in the calculation of BSUoS; o Calculate the 'reverse' price as being the average volume weighted price of the first 25MWh of bids/offers that could have been accepted after CADL and arbitrage have been taken into account and by applying the same default rules as above. Using a small volume of bids/offers to derive the calculation will prevent gaming of the rules by parties submitting spurious prices for very small volumes and should be a fair reflection of a market price as the Balancing Mechanism is more liquid than the power exchanges; o Change CADL to 30 minutes so that only system actions traded in the half hourly forward markets are included in EIPs.
18.	Are there any other issues not identified in the supporting document which you believe should be considered during the assessment of Modification Proposal P78.	The purity of the imbalance price should be further considered. As mentioned in 1 and 17 above, imbalance prices will still be 'polluted' by system actions in the same direction, for example, actions associated with transmission constraints.
19.	Do you believe that further analysis / modelling is required over that currently identified by the PIMG (in the supporting document), and if so, what specific form should this take?	No.

P78_ASS_013 – Campbell Carr Ltd

Responding on Behalf of (please list all BSC Parties)**:**

Electricity Direct	**Small Supplier**
BizzEnergy	**Small Supplier**
South Coast Power	**Single site generator**
Nedalo (UK) Ltd	**Embedded generator**
British Sugar	**Embedded generator**

Q	Question	Response (Please provide rationale where possible)
1.	In your opinion, does Modification Proposal P74/P78 give a better separation of balancing actions (i.e. system vs energy) used in setting the Energy Imbalance Price(s), if so, how? (Section 1.1)	In the current arrangements, despite changes to definition (such as P18A), the long market leads to a very small number of Acceptances setting SBP. The impact of any action for systems reasons therefore has a disproportionate effect on SBP. P74 does not directly address the split between system balancing and energy balancing actions but, by leading to a more balanced market – system balancing actions on the buy side will be "diluted" by energy actions, lessening their impact without a significant adverse impact on SSP likely. The resulting price is less likely to be extreme and will better reflect the price at which NGC is a net buyer of energy than is the case at present. P78 deems all actions in the opposite direction to be for systems reasons and so it will strip them away from the price mechanism. It also strips equivalent volumes from the main price setting a lower price. It is impossible to be certain that actions for energy reasons have not been stripped away as well but it seems likely that the resultant main price will be a better reflection of the cost of energy needed for pure energy balancing reasons. The reverse price used in P78 is an approximate spot market price and this is a significantly better reflection of the value of reverse actions than is the case at present and will certainly exclude systems actions although it is less certain that the price is a proper reflection of energy cost to the system.
2.	In your opinion, is Modification Proposal P74/P78 valuing actions more correctly, if so, why and if not, why not? (Section 1.5)	P74 values actions in the direction of system balance in the same way as at present. The change is in the valuation of the reverse price. NGC balances the system based on the difference between generator FPNs and their own forecast of demand (with no reference to contract position which they do not know until up to 14 months later). The deviations from FPN are caused by generators tripping (or being late) and due to consumers in aggregate deviating from the NGC forecast. Suppliers' contract positions relative to their individual forecast of their own customers' demand (e.g. over-contracting as at present) will not alter the actions taken by NGC because the deviations of customer

Q	Question	Response (Please provide rationale where possible)
		offtake relative to the NGC forecast will be the same. Therefore the value of actions taken by NGC will be the same regardless of any supplier's contract position and the single price proposed in P74 reflects this. P78 potentially better reflects the value of energy actions in the main price than does P74 but there seems a less soundly based case for the valuation of the reverse price because it is still applied to contract positions which NGC knows nothing of at the time of the action taken. However, the market price used for the reverse price is definitely more cost-reflective than the current SBP/SSP.
3.	In your opinion, how does Modification Proposal P74/P78 change the relative reward for notified and instructed actions and how do you believe this to impact on the Transmission Company's balancing of the system, and do you believe this is appropriate? (Section 1.6 defines notified and instructed action)	NGC expresses the opinion that an instructed action (through a BM Acceptance) is worth more than an unnotified delivery or offtake that is in the direction of system balance, and do not see why P74 should thereby reward such actions better than acceptances (by definition some BM acceptances must be at a less favourable price than the price proposed in P74). However, this mistakes the value of such spill/shortfall because, in a BM acceptance, the price is one that is acceptable to the bidder or offerer, whereas in unnotified spill/shortfall the risk is that the price will be unfavourable and is as likely to be a loss or a gain. This is interpreted by NGC as a reward for gambling when going against the direction of the system but it is really simply paying the value of your position to the system (i.e. it is cost-reflective) bearing in mind that there will be very few parties who will take a physical position in this way intentionally rather than due to errors in their forecasts of their own metered position. P78 asserts that the value of an action that helps the system accidentally is worth no more than the market price but offers no justification for this view. It is certainly a better valuation than the current arrangement, which punishes such "accidental" help regardless but this is still not a proper reflection of the value of the offsetting volumes, which allow NGC to take less balancing actions than they would otherwise have taken.
4.	In your opinion, does Modification Proposal P74/P78 more correctly target the cost of energy balancing actions to those causing the imbalance over the current baseline? (Section 1.6)	P74 targets the cost of energy imbalance on those causing it and gives the benefit to those who help the system whereas the current system punishes regardless and certainly mis-targets the costs on positions that help the system. P78 targets the costs of net imbalance on those who are out of balance in the same direction as the system. It values contractual imbalances that help the system better than the present mechanism but does not offer the full reward for that help.
5.	In your opinion, how does Modification	This is a complex area. Currently generators are operating at part load excessively in order to provide

Q	Question	Response (Please provide rationale where possible)
	Proposal P74/P78 change the perceived risk of Bid - Offer submission, how would it change the level of participation seen in the Balancing Mechanism under the current baseline and how do you believe it would affect system balancing? (Section 1.7)	capacity for self-reserve. Generators are offering self-reserve volumes as BM offers at present (it may, however, be worth examining the extent to which they are setting MEL to FPN to prevent such offers being accepted). If generators reduce the volume of self-reserve by selling more gensets fully and not operating on others then the volumes available as BM offers could reduce. This would be more efficient for the system overall although the cost borne by NGC for carrying reserve would increase. The phrasing of the actual question is about the risks of bid/offer submission. P74 reduces the risk of bid/offer submission because if an acceptance is made that cannot be delivered (e.g. due to a generator trip) then the cost of that failure is not necessarily changed. Given that self-reserve is offered to NGC as offers at present, the main expected change will be in the price at which such offers are made which should be lower if the cost of failure is lower. This would not otherwise affect system balancing. P78 has a similar effect to P74 but, by reducing the potential upside to cash-out in the event of failure to deliver, it can be expected to have a lesser effect on bid/offer pricing than P74. P78, by maintaining a buy-sell spread may have a lower impact on the failure risk than P74 but would still be much better than at present.
6.	In your opinion, how do you believe Modification Proposal P74/P78 would affect the level of part loading seen under the current arrangements and in what way do you believe it would be more or less efficient for participants and for the system as a whole? (Section 1.8)	P74 would reduce part-loading to an extent for the following reasons: • In a more balanced market, fewer bids would be taken, reducing part loading on pulled back plant; • The cost of generator trip would be reduced and so self-reserve would be less necessary – this suggests fewer plant operating at fuller load. However, on the reverse side: • A more balanced market increases the probability of an offer being accepted, which increases the reward for part-loading (to an extent); • With fewer plant scheduled by participants onto the bars, NGC may need to schedule more part loaded plant via reserve contracts. The effect of P78 is similar but to a lesser extent.
7.	In your opinion, does Modification Proposal P74/P78 change the incentives to deviate from FPN over the current baseline, if so, how and why? (Section 1.9)	Currently, there are two incentives on generators to deviate from FPN: • To replace a failed plant from the portfolio when SBP is expected to be high (which is easily done from part-loaded plant but which will be used rarely); • Generating to the upper end of the expected level of output in order to avoid a marginal shortfall at SBP – this gives a lot of very small volumes of persistent spill.

Q	Question	Response (Please provide rationale where possible)
		P74 will reduce the first of these in some circumstances (while recognising that if a large set fails completely it could tip the system short anyway), and will eliminate the bias in the second as the cost of going short will be reduced. Generators may still seek to over-deliver against FPN when they see the network going short but they risk this breach of the grid code only netting SSP anyway (especially if others do the same) and they would almost certainly be better off contracting with NGC (as PGBTs or Offers) given that they would only be doing this spill when they have good reason to believe that NGC will need the energy. In any case such opportunities will be vanishingly rare under a 1-hour gate closure. P78 will not offer the same potential incentives to deviate from FPN and will reduce the existing incentives.
8.	In your opinion, (noting the forthcoming implementation of Modification P12 to reduce Gate Closure to one hour), does Modification Proposal P74/P78 increase the incentive on parties to change Physical Notifications shortly before Gate Closure and do you believe this to be a good or bad thing? (Sections 1.9, 1.11, 1.12, 1.13)	P12 is the latest Modification approved that explicitly facilitates contracting close to gate closure. Given that IPNs will usually represent the contracted position at the time rather than an expectation of striking contracts, it can be expected that changes up to FPN will be more frequent. P74 will only increase opportunities for late changes to FPN to the extent that there is extra information indicating a specific direction to system balance. Opportunities for price-seeking by changing a physical position will only arise to the extent that there is extra information about system balance available. Given that IPNs will be less useful as a predictor of system balance due to these same late changes from other parties, excessive speculation on the physical position of the market will be muted. It should be noted that parties may still speculate on the direction of the market in the current situation in that a rising price in the spot market suggesting that the market is short will raise the expected cost of a supplier going short and so they might choose to go even longer. Some “opportunities” will still arise from P78 because an expectation of a more balanced market will change parties’ perceptions of optimal position (if the spot price is rising, it suggests the system might be short, which increases the risk-adjusted value of spill so that other parties might seek to go longer). P74 does allow notifications much closer to gate closure because the risk of notification failure can be managed financially under a single price. Both P74 and P78 therefore may make system management more difficult for NGC but the big change in difficulty arose from P12 and the difficulty was thought to be outweighed by the improvements due to parties being able to balance more closely.
9.	In your opinion, to what extent will	There is confusion as to what is meant by asymmetric risk. Asymmetry in price risk arises primarily

Q	Question	Response (Please provide rationale where possible)
	Modification Proposal P74/P78 address the issue of asymmetric risk? (Section 1.10)	where the spot price (the price of buying out of the price risk) is closer to a risk-weighted expected SSP than to a risk-weighted expected SBP. The relative volatility in SBP simply raises its risk-weighted expected price. P74 will raise the opportunity cost of spilling because, as generators have the opportunity to spill at a potentially higher price, they will not offer power to suppliers at a prompt price that does not reflect this opportunity. This raises the spot price and makes the risks more symmetrical. P74 therefore addresses the causes of the observed (i.e. ex post) asymmetry in prices. P74 does not directly address the more fundamental asymmetry in volatility in SBP relative to SSP for which there are good economic reasons although some of the volatility caused by pollution of the energy price by systems actions will be diluted because these actions will only affect the "main" price, which will include much more energy in its calculation. P78 seeks to more directly address price pollution from systems actions by extensive tagging out and as such will produce a less volatile main price although the underlying relative volatility inherent in short-notice incrementing will remain. In other respects the impact of P78 will be similar to P74 but more muted.
10.	In your opinion, do you believe that Modification Proposal P74/P78 will change the incentives on parties to balance their individual (contractual) trading positions before Gate Closure, if so, how and why? (Sections 1.12 and 1.13)	As explained in *9* above, P74 will raise the cost of excessive spill, which will thereby reduce, leading to a more balanced market. Similarly, as the cost of going short remains a high price (although relatively reduced), the incentive on all parties with uncertainty about their ex post physical position remains to balance. P78 has similar incentives but is more muted because the up side of getting it wrong are less (leading to a probably longer market than P74).
11.	In your opinion, do you believe that Modification Proposal P74/P78 will change the incentives for parties as a whole (i.e. in total, even if not balanced on an individual basis) to balance the market as a whole before Gate Closure, if so, how and why? (Section 1.11)	P74 will lead to a more balanced market because balancing decisions will be informed by expected market balance – which is not the case at present. Also, if suppliers seek to be closer to balance individually (by spilling less), the market will be closer to balance. P78 will be similar but the effects are more muted and so the market is likely to be longer than under P74 but less long than at present.

Q	Question	Response (Please provide rationale where possible)
12.	In your opinion, does Modification Proposal P74/P78 lead Parties to anticipate the 'direction' of the market, and therefore the Energy Imbalance Price. Could this lead to volume volatility and consequential price instability in the market? (Sections 1.12 and 1.13)	Parties will only price-seek under P74 to the extent that they have good information about the direction of market imbalance. The fear of hunting has to be vastly exaggerated. Generators have a slightly better view of market balance to the extent that they know if their own plant is at risk of failure. However, they will be price-takers (the "hunted") in such a scenario – not hunters. Such generators will seek to contract out of their own adverse balance. Other generators will usually be better off by offering their flexibility to NGC rather than speculating. P78 is similar in effect – it won't lead to significant hunting of the market direction. There is not enough information out there to make it worthwhile.
13.	What effect do you think Modification Proposal P74/P78 will have on liquidity and prices in the forwards and spot markets, the interrelation of forwards and spot markets with Energy Imbalance Prices and also the level of Energy Imbalance Prices themselves? (Sections 1.14, 1.15 and 1.16)	P74 will vastly increase liquidity in the spot markets because it eliminates notification risk (a failure to notify can be covered financially in a single-price environment). P74 will impact on spot prices because it changes the value of buying out of imbalance. It will have less effect on forward prices. P78 will have similar effects other than on liquidity in the spot market, which will be muted by the remaining dual cash-out price effect on notification risk. It has been asserted that, under P74, parties will not contract and simply take a "Pool" price. This misunderstands the nature of the Pool in which generators were guaranteed revenue based on the day-ahead price. Without a contract, generators can only be guaranteed a low ex post spill price and so will not generator without a contract (either notified before gate closure or else on a CfD). If generators don't generate then the market will be short so suppliers have an incentive to contract to avoid SBP. The incentive to contract remains and, given that the market was about 90% contracted under the Pool, there is no reason to believe that contracting will be any less than at present (except that the market will be contracted to balance rather than being over-contracted).
14.	Do you believe that the implementation of Modification Proposal P74/P78 will encourage the development of risk management products and new types of contracts, and what effect do you think this will have on competition and the efficiency of the forwards and spot markets? (Sections 1.17, 1.18, 1.19 and 1.20)	Under a single cash-out price as in P74, volume risk management can be offered across the system rather than just behind the meter. Much of this will probably be via CfDs but traders will offer other products as well because they would be able to take a physical position if the price risk was not always negative. This is fundamentally efficient and normal because risk is moving to the parties most willing to bear it. P78 does not offer the same opportunities because, although downside risk is reduced, there is no upside risk available for the risk manager.

Q	Question	Response (Please provide rationale where possible)
15.	In your opinion what would be the impact on the risk profile of different categories of party (as listed in section 1.21) from the implementation of Modification Proposal P74/P78? (Section 1.21)	• Small suppliers will benefit from both Mods but especially form P74 because the artificial penalty applied to small portfolios (with a statistically greater imbalance risk) is removed (by P74) or reduced (by P78). • Larger suppliers benefit like smaller ones in not needing to over-contract – and they can buy better risk management across the system. However, they benefit less than small suppliers because their artificial relative advantage in portfolio size is removed. • Licence Exempt Generators (LEGs) are significant winners from both Mods but especially from P74. This is because the value of spill – the price that many embedded generators have been offered in contracts – has increased to incorporate a possibility of earning either from a market price (P78) or from SBP (P74). Suppliers will therefore be able to offer prices to embedded generators at a price reflecting this. In addition, in a more balanced market, NGC will provide more of the reserve (rather than suppliers doing so via over-contracting) and so embedded benefits will improve. For LEGs in CVA, the cost of consolidation will be removed by P74 and reduced by P78. • Unpredictable generators will benefit by being able to contract to their average expected output rather than to the minimum because shortfalls will not always be punished at SBP. They will therefore spill less. • Non-portfolio generators face lower trip risk and so will earn at a higher rate. To the extent that the average spot price increases, they may be able to strike better contracts, but if the forward market does not move then this will not be the case. • Portfolio generators will lose market power and so will be slightly worse off, but to the extent that their effective trip insurance cost will be lower, they will benefit. • Vertically integrated parties will similarly lose market power but will still operate in a more efficient, lower cost, market. • Non-physical traders will have the opportunity to take on a degree of physical risk under P74 (but not under P78) and so will benefit from being able to offer a fuller range of risk management products. • The transmission company will not be directly financially affected by either of these proposals because it passes through costs anyway. Longer term it stands to lose out to the extent that the growth of embedded generation will no longer be stunted by the current penal pricing system. The Consultation document fails to mention the following relevant parties:

Q	Question	Response (Please provide rationale where possible)
		• Flexible plant will benefit from a balanced market where NGC contracts for rapid reserve when needed rather than only varying the extent to which excessive plant is pulled back. • Consolidators will lose out under P74 – they will be redundant. • Exchanges will benefit from improved liquidity under P74 due to reduced notification risk. • Consumers will benefit from a more efficient market whereby suppliers are not over-contracting and generators are not self-reserving. The spot market may move up but, to the extent that forward prices are driven by Europe through arbitrage across both the gas and electricity interconnectors, it is far from certain that consumer contract prices will move to any great degree. Longer term, consumers can only benefit from a rational market in which the risk of a "California" scenario – where uneconomic generating plant is excessively mothballed because market returns are so depressed so that the market is rapidly tipped into shortage – is reduced.
16.	Do you believe that Modification Proposal P74/P78 better facilitates achievement of the Applicable BSC Objectives, if so, which one(s) and why?	P74 clearly better facilitates the Applicable BSC Objectives: • It is more cost-reflective in that it correctly values balancing energy, which is independent of contract positions, which NGC knows nothing about at the time of the balancing action. It also targets those costs on those causing the imbalance rather than penalising parties who are helping the system (by contracting to a position that does not force excess balancing actions). It therefore facilitates competition. • It will lead to a more balanced system, reducing NGC's need to take balancing actions, which is more economic and efficient. P78 also better facilitates the Applicable BSC Objectives: • It prevents more system balancing actions from polluting the energy imbalance price, making that price more cost-reflective and it sets the reverse price as less penal, which is more cost-reflective. It therefore facilitates competition. • It reduces the incentive to spill excessively leading to more economic and efficient operation of the balancing mechanism.
17.	Do you believe that an Alternative Modification Proposal better facilitates achievement of the Applicable BSC Objectives than Modification Proposal P74/P78, if so, what is it? (Section 1.23)	N/a

Q	Question	Response (Please provide rationale where possible)
18.	Are there any other issues not identified in the supporting document which you believe should be considered during the assessment of Modification Proposal P74/P78.	The Consultation Document fails to address the specific problems faced by embedded generation in the current mechanism. As noted above, the only way for such players to participate in the current process is to: • Either go into CVA and be consolidated, which is an administratively expensive process relative to the scale of generation and is not currently offering any attractive prices anyway; • Or to sell to suppliers in SVA and be offered the derisory spill price. The reason that suppliers are offering embedded generation such low prices is not related to inherent variability of output (which Ofgem has already demonstrated is generally not the case) but because the product that an embedded generator must offer to suppliers is different to the one offered by CVA generation. This is because CVA generation delivers firm energy through contracts with the generator able to manage its own meter risk, whereas an embedded generator must sell that meter risk to the supplier and has no opportunity to manage it. Another factor not covered has also been raised above. Because the current mechanism is not rewarding upward flexibility properly (because the spill market means that excessive downward flexibility is being taken), consumers are being forced to overpay for self-reserve rather than for the product that NGC would otherwise contract for. This depresses BSUoS, which has an adverse impact on embedded benefits.
19.	Do you believe that further analysis / modelling is required over that currently identified by the PIMG (in the supporting document), and if so, what specific form should this take?	N/a

P78_ASS_014 – Edison Mission Energy

Responding on Behalf of (please list all BSC Parties): First Hydro Company, Edison First Power

Responding as which type of Party (see list in section 1.21): Non portfolio generator

Q	Question	Response (Please provide rationale where possible)
1.	In your opinion, does Modification Proposal P78 give a better separation of balancing actions (i.e. system vs energy) used in setting the Energy Imbalance Price(s), if so, how? (Section 1.1)	No. The BM balances on a real time basis. P78 makes the assumption that only the Net Imbalance Volume is attributable to energy balancing with all other actions having been taken for system balancing. Intra half hour actions could be taken for system and energy purposes in a settlement period on both sides of the market yet energy trades on the shorter stack will be ignored. This is fine if a large majority of actions on the smaller stack are for system balancing, if however, there are a substantial volume of energy actions included in the smaller stack then these need to be reflected in cashout prices (as highlighted by Ofgem in many of its modification decisions letters). The degree to which reverse actions are being taken for energy needs requires further investigation. Without this it is not possible to determine whether P78 gives a better separation of balancing actions.
2.	In your opinion, is Modification Proposal P78 valuing actions more correctly, if so, why and if not, why not? (Section 1.5)	No. P78 will dampen prices due to the inclusion of the net volume of NGC's forward trades. The main price will be less reflective than at present of the actions taken by the SO in the Balancing Mechanism. The reverse price will not be reflective of BM actions at all. The mod proposes tagging from the larger stack the total volume of trades on the smaller stack. Where actions have been taken on both sides of the market to create reserve (a cost that Ofgem in its P8 decision considered should be signalled through energy imbalance prices), those that cause this reserve to be called upon should pay for it.

Q	Question	Response (Please provide rationale where possible)
		Whilst P78 retains the dual cashout mechanism, it will better reward parties that are out of balance in the opposite direction to the market than the current mechanism. If parties are able to correctly predict the overall market direction in advance of gate closure and are out of balance in the opposite direction, dependent on the derivation of the 'market price' they will indifferent as to whether they contract to balance.
3.	In your opinion, how does Modification Proposal P78 change the relative reward for notified and instructed actions and how do you believe this to impact on the Transmission Company's balancing of the system, and do you believe this is appropriate? (Section 1.6 defines notified and instructed action)	Because the reverse price will be more attractive than under the current mechanism, the reward for notified actions in the opposite direction to the market will improve. The BM was intended to be the market of last resort. It is not appropriate that Parties that are out of balance in the opposite direction to the market receive/pay the same price as those that have balanced their positions prior to gate closure.
4.	In your opinion, does Modification Proposal P78 more correctly target the cost of energy balancing actions to those causing the imbalance over the current baseline? (Section 1.6)	No for the reasons given in Q2.
5.	In your opinion, how does Modification Proposal P78 change the perceived risk of Bid - Offer submission, how would it change the level of participation seen in the Balancing Mechanism under the current baseline and how do you believe it would affect system balancing? (Section 1.7)	The risks of trading close to gate will have been reduced prior to the implementation of this mod as gate closure will have reduced to one hour and CP 755 will have been implemented. Grid Code obligations provide incentives to adhere to FPN after gate closure and NGC has stated at many of its operational forums that the degree of self balancing has reduced. Setting aside post gate FPN deviations, Parties are able to hold reserve for legitimate self balancing whilst still being able to offer into the BM. This modification will not therefore increase the level of Bid-Offer submission as generators are able to both hold reserve and participate in the BM. In fact, if players choose not to hold reserve, then BM volumes may effectively reduce (see next question) If within gate closure self balancing is seen as a major concern, the

Q	Question	Response (Please provide rationale where possible)
		introduction of an information imbalance charge would discourage post gate closure deviation from FPN.
6.	In your opinion, how do you believe Modification Proposal P78 would affect the level of part loading seen under the current arrangements and in what way do you believe it would be more or less efficient for participants and for the system as a whole? (Section 1.8)	With respect to part loading at gate closure, the answer depends on taking a view on the probability of an offer being accepted and the differential between PXP and offer price and also the correlation between PXP and SBP. Therefore modelling should be undertaken in order to properly answer this question although see answer to Q19. Furthermore, parties will part load if it is economically efficient for them to do so. Parties choose to part load for may reasons. Currently, the market is generally long, the occasions when offers need to be accepted are far less than for bids. In a less long market, more offers will be accepted, more generators may therefore choose to part load to take advantage of increased probability of acceptance in the BM. However if there is more competition, the probability of acceptance will change little. The level of part loading is therefore unlikely to change. Since parties are each incentivised to balance their own positions, in a long market generators will choose to part load their marginal BM Unit as selling the additional output would be at a price below the marginal cost of the purchaser's plant. It would not be in generator's interests to sell at this price because it would affect prices further out on the curve. Therefore, even though such part loading is environmentally inefficient, it is unsurprising. Alternatively, if spot prices increase, and this is coupled with an increase in within day liquidity, plant may be more fully loaded as generators might prefer the certainty of PX sales compared to the uncertainty of BM sales. The degree of part loading will therefore change little under P74.
7.	In your opinion, does Modification Proposal P78 change the incentives to deviate from FPN over the current baseline, if so, how and why? (Section	No. Grid Code obligations have generally provided sufficient incentives to

Q	Question	Response (Please provide rationale where possible)
	1.9)	adhere to FPN. If Grid Code obligations and the additional risk of getting the market direction wrong are found to be insufficient, an information imbalance charge should be introduced.
8.	In your opinion, (noting the forthcoming implementation of Modification P12 to reduce Gate Closure to one hour), does Modification Proposal P78 increase the incentive on parties to change Physical Notifications shortly before Gate Closure and do you believe this to be a good or bad thing? (Sections 1.9, 1.11, 1.12, 1.13)	Parties may change their FPNs shortly before gate closure either to match a change in contract position or because they are trying to second guess market direction and create an imbalance position in the opposite direction to the market. The former must not be discouraged otherwise it defeats the purpose of P12 and also of the improvements to the notification process to improve within day liquidity. Any restriction on changes to FPN close to gate closure would discriminate against flexible plant who will be trading closer to real time and also discourage investment in systems that allow trading close to gate closure. The ability of players to change PNs close to gate closure is therefore a good thing. For P78, creating an imbalance position in the opposite direction to the market would only result in saving on the transaction costs of trading. This would be a small benefit compared to the risk and cost of incorrectly predicting market direction. P78 is therefore unlikely to encourage speculation over market direction.
9.	In your opinion, to what extent will Modification Proposal P78 address the issue of asymmetric risk? (Section 1.10)	Asymmetric risk will not go away where the cashout pricing mechanism is based on offers and bids as it is easier and less costly for generators to reduce output than increase output. P78 will however markedly reduce the buy-sell spread and the incentives to balance although the system will remain long. Therefore, the Mod is likely to help to mitigate the effects of asymmetric risk but not eliminate it.
10.	In your opinion, do you believe that Modification Proposal P78 will change the incentives on parties to balance their individual (contractual) trading positions before Gate Closure, if so, how and why? (Sections 1.12	Since P78 reduces the buy- sell spread, it will reduce incentives to balance. NGC will have to take more pre gate closure actions to create reserve capability in both directions. However, since the system will tend

Q	Question	Response (Please provide rationale where possible)
	and 1.13)	to be long, the net volume of NGC's forward trades will usually be added onto the sell stack. This will ensure that the main price based will almost always be based on bids. As is recognised in the Modification Proposal, it is in NGC's interest to have a long system as it benefits their incentive scheme.
11.	In your opinion, do you believe that Modification Proposal P78 will change the incentives for parties as a whole (i.e. in total, even if not balanced on an individual basis) to balance the market as a whole before Gate Closure, if so, how and why? (Section 1.11)	No - due to the asymmetry of generator bids and offers.
12.	In your opinion, does Modification Proposal P78 lead Parties to anticipate the 'direction' of the market, and therefore the Energy Imbalance Price. Could this lead to volume volatility and consequential price instability in the market? (Sections 1.12 and 1.13)	No - see answer to Q8.
13.	What effect do you think Modification Proposal P78 will have on liquidity and prices in the forwards and spot markets, the interrelation of forwards and spot markets with Energy Imbalance Prices and also the level of Energy Imbalance Prices themselves? (Sections 1.14, 1.15 and 1.16)	P78 will reduce the magnitude of exposure when the main price is SBP as far more of the higher prices trades will be tagged than under the current mechanism. The buy-sell spread will reduce due to the increased amount of tagging. This will result in less liquidity in the short term markets as the price exposure will be far less onerous. This is likely to reduce the efficiency of these markets and so maintain discontinuity between spot markets and the energy imbalance prices.
14.	Do you believe that the implementation of Modification Proposal P78 will encourage the development of risk management products and new types of contracts, and what effect do you think this will have on competition and the efficiency of the forwards and spot markets? (Sections 1.17, 1.18, 1.19 and 1.20)	No - this questions is more applicable to P74.
15.	In your opinion what would be the impact on the risk profile of different categories of party (as listed in section 1.21) from the implementation of	

Q	Question	Response (Please provide rationale where possible)
	Modification Proposal P78? (Section 1.21)	
16.	Do you believe that Modification Proposal P78 better facilitates achievement of the Applicable BSC Objectives, if so, which one(s) and why?	The proposer considers that the modification will promote effective competition in the generation and supply of electricity by improving the stability and cost reflectivity of imbalance cashout prices. P78 removes the link to the cost of energy acceptances on the smaller stack since they will all be tagged. The proposal therefore fails to meet its objective. Since P78 will reduce market length, reduce the buy sell spread and make Parties more inclined to go short than at present, the volume of reserve required from the BM and hence BSUoS will increase. This transfers economic purchasing from Parties up until gate closure to the Transmission Company via its forward trading and actions in the BM thus reducing the efficient and economic operation by the Transmission Company of the Transmission system.
17.	Do you believe that an Alternative Modification Proposal better facilitates achievement of the Applicable BSC Objectives than Modification Proposal P78, if so, what is it? (Section 1.23)	
18.	Are there any other issues not identified in the supporting document which you believe should be considered during the assessment of Modification Proposal P78.	Key to this modification is setting the market price. There seems little point in discussing whether the mod better separates out system from energy trades, encourages balancing etc until a market price can be agreed. The price must be transparent, not gameable, not predictable in advance of gate closure and also representative of the cost of short term energy. These are conflicting objectives and progress of other aspects of this modification should be halted until a suitable market price can be established. The assessment also needs to consider the reallocation of the beer fund

Q	Question	Response (Please provide rationale where possible)
		to establish who will benefit from P78. The assessment also needs to consider the incentives on NGC. Whilst these issues might be considered to be outside of the vires of the group, I note that in its determination on Mod P3, Ofgem considered that 'NGC would have faced distorted incentives relating to its balancing services purchasing strategy if variations in energy imbalance prices were related to whether it had contracted forward, rather than to fundamental market conditions' . Since NGC's forward purchases will have a large effect on determining the direction of the main price, the group does therefore need to consider what impact P78 will have on NGC's incentive scheme.
19.	Do you believe that further analysis / modelling is required over that currently identified by the PIMG (in the supporting document), and if so, what specific form should this take?	Any analysis arising from the modelling that is reported in future consultations should be very heavily caveated and should list the assumptions made in order to simplify the modelling. There is a danger that without a detailed explanation of any limitations, respondees to the next consultation will choose the Modification that produces outcomes that meet their cashout pricing expectations without any further exploration of the implications of the changes.

P78_ASS_015 – Innogy plc

Responding on Behalf of (please list all BSC Parties): This response is on behalf of Innogy plc, npower Limited, Innogy Cogen Trading Limited, npower Direct Limited, npower Northern Limited, npower Yorkshire Limited

Responding as which type of Party (see list in section 1.21): BSC Parties

Q	Question	Response (Please provide rationale where possible)
1.	In your opinion, does Modification Proposal P78 give a better separation of balancing actions (i.e. system vs energy) used in setting the Energy Imbalance Price(s), if so, how? (Section 1.1)	P78 applies a new BSC variable, "Net Imbalance Volume" to the bid/offer stack in the direction of imbalance (after taking into account arbitrage and de minimus bid/offers) to effectively identify "energy" balancing

Q	Question	Response (Please provide rationale where possible)
		actions separate from "system" balancing actions. As a result, the volume of energy imbalance actions are defined or deemed to be equivalent to NIV. This is a less arbitrary approach that the existing methodology, as NIV will change each Settlement Period, whereas BRL is a constant. Since the P78 methodology applies to the stack in the direction of system imbalance, the approach is likely to provide results that are more cost-reflective than the current approach.
2.	In your opinion, is Modification Proposal P78 valuing actions more correctly, if so, why and if not, why not? (Section 1.5)	We are assuming that the 'actions' referred to here are Bid Offer Acceptances. P74 does not change the approach towards valuing BOAs taken by the SO when compared with the current methodology.
3.	In your opinion, how does Modification Proposal P78 change the relative reward for notified and instructed actions and how do you believe this to impact on the Transmission Company's balancing of the system, and do you believe this is appropriate? (Section 1.6 defines notified and instructed action)	The use of a market price for the "reverse imbalance" is an arbitrary approach that will incorrectly value the benefit of parties that are out of balance in the reverse direction to the system imbalance. It is noted that NGC argue that the use of such a market price may better reflect the true cost of the reverse imbalance. However, the P78 methodology may result in movements in the market price that reflect the expected out turn of the system (long or short). This feedback and linkage may result in market prices for reverse imbalances that distort the relative value of notified and instructed actions.
4.	In your opinion, does Modification Proposal P78 more correctly target the cost of energy balancing actions to those causing the imbalance over the current baseline? (Section 1.6)	The use of a single price will more accurately reflect the fact that the system can only be out of electricity balance in one direction in any one trading period (i.e. the system can only be either long or short, not both at the same time). A dual cash out process inevitably requires the construction of an "artificial" price for imbalances that are in the opposite direction to system balance (the so-called "reverse" direction). Therefore the use of a dual price system will not more accurately reflect the costs of ensuring energy balance.
5.	In your opinion, how does Modification Proposal P78 change the perceived risk of Bid - Offer submission, how would it change the level of	P78 may encourage parties to anticipate the direction of system imbalance and therefore the relevant price that is applied. However,

Q	Question	Response (Please provide rationale where possible)
	participation seen in the Balancing Mechanism under the current baseline and how do you believe it would affect system balancing? (Section 1.7)	there appears to be limited benefit from this. In addition, the reduction in the value of asymmetric risk by using a market price for reverse imbalance may encourage parties to balance reducing the overall cost of imbalances. P78 will have little or no impact on the risk of bid/offer submission or participation in the balancing mechanism. As noted above, NGC can take other actions to mitigate any perceived impact on bid/offer submissions arising from this modification.
6.	In your opinion, how do you believe Modification Proposal P78 would affect the level of part loading seen under the current arrangements and in what way do you believe it would be more or less efficient for participants and for the system as a whole? (Section 1.8)	To the extent that P78 encourages parties to balance their positions, the modification should reduce the amount of part loaded plant although the decision whether to hold part loaded plant is ultimately a commercial decision taken by individual parties. Changes to the pricing mechanism may or may not have an impact on these commercial decisions.
7.	In your opinion, does Modification Proposal P78 change the incentives to deviate from FPN over the current baseline, if so, how and why? (Section 1.9)	Whilst P78 might change the incentives to deviate from FPN, it does not affect the Grid Code obligation to follow the FPN. Consequently, any deviations from FPN should be treated appropriately.
8.	In your opinion, (noting the forthcoming implementation of Modification P12 to reduce Gate Closure to one hour), does Modification Proposal P78 increase the incentive on parties to change Physical Notifications shortly before Gate Closure and do you believe this to be a good or bad thing? (Sections 1.9, 1.11, 1.12, 1.13)	In so much as P78 increases the ability to trade within day to react in a timely manner to developments within the market, it may increase the incentive on parties to change PNs to better reflect their operating intentions after Gate Closure. . This will allow NGC to balance the system based on those FPNs with greater confidence and at lower cost. It is therefore a “good thing”.
9.	In your opinion, to what extent will Modification Proposal P78 address the issue of asymmetric risk? (Section 1.10)	P74 does not change the asymmetric risk associated with electricity prices, but it will change the cost of accommodating this risk as the imbalance price better reflects the value of the energy. However, this may not be the optimal solution.
10.	In your opinion, do you believe that Modification Proposal P78 will change the incentives on parties to balance their individual (contractual)	P78 is likely to encourage parties to be closer to balance when compared with the existing dual cash out pricing methodology which encourages

Q	Question	Response (Please provide rationale where possible)
	trading positions before Gate Closure, if so, how and why? (Sections 1.12 and 1.13)	parties to be consistently long. The key benefit of P78 is the better removal of system effects from the main imbalance price.
11.	In your opinion, do you believe that Modification Proposal P78 will change the incentives for parties as a whole (i.e. in total, even if not balanced on an individual basis) to balance the market as a whole before Gate Closure, if so, how and why? (Section 1.11)	The current pricing methodology in the BSC uses dual pricing to encourage individual parties to balance and thereby ensure that the system is in balance. However, this has not proven to be the case. Although P78 may weaken the current incentives to a certain extent, it does not fundamentally change this approach.
12.	In your opinion, does Modification Proposal P78 lead Parties to anticipate the 'direction' of the market, and therefore the Energy Imbalance Price. Could this lead to volume volatility and consequential price instability in the market? (Sections 1.12 and 1.13)	Parties may wish to anticipate the direction of system balance and therefore the main price. However, in the absence of perfect information it will be difficult to systematically ensure that parties are on the “right side” of the market (which ever side this is). As a result parties may seek to balance to mitigate exposure on either side of the market.
13.	What effect do you think Modification Proposal P78 will have on liquidity and prices in the forwards and spot markets, the interrelation of forwards and spot markets with Energy Imbalance Prices and also the level of Energy Imbalance Prices themselves? (Sections 1.14, 1.15 and 1.16)	The use of “market price” derived from the forwards and or spot markets for imbalance settlement raises a number of issues, particularly related to the interaction between the forward price and the imbalance price. It is possible that changes in the power exchange price could have consequent effects in the balancing mechanism (and vice versa).
14.	Do you believe that the implementation of Modification Proposal P78 will encourage the development of risk management products and new types of contracts, and what effect do you think this will have on competition and the efficiency of the forwards and spot markets? (Sections 1.17, 1.18, 1.19 and 1.20)	Since P78 retains the dual pricing methodology, it is unlikely that it will encourage the development of new risk management products.
15.	In your opinion what would be the impact on the risk profile of different categories of party (as listed in section 1.21) from the implementation of Modification Proposal P78? (Section 1.21)	To the extent that P78 reduces the significant asymmetry between the SBP and SSP, and volatility in the reverse price, the risk profile of the whole market may be reduced with potential benefits for all parties. However, we do not believe that P78 will change the relative risk profiles between different classes of party.

Q	Question	Response (Please provide rationale where possible)
16.	Do you believe that Modification Proposal P78 better facilitates achievement of the Applicable BSC Objectives, if so, which one(s) and why?	P78 should better facilitate BSC objectives 1.2.1 (b) (ii) and 1.2.1 (b) (iii) for the reasons detailed above, however there are fundamental flaws within the modification through the use of a 'market price'.
17.	Do you believe that an Alternative Modification Proposal better facilitates achievement of the Applicable BSC Objectives than Modification Proposal P78, if so, what is it? (Section 1.23)	Any Alternative will need to address issues raised by the use of a market price.
18.	Are there any other issues not identified in the supporting document which you believe should be considered during the assessment of Modification Proposal P78.	No
19.	Do you believe that further analysis / modelling is required over that currently identified by the PIMG (in the supporting document), and if so, what specific form should this take?	

P78_ASS_016 – RWE Trading Direct

Responding on Behalf of RWE Trading Direct:

Responding as which type of Party: Small Supplier

Q	Question	Response (Please provide rationale where possible)
1.	In your opinion, does Modification Proposal P78 give a better separation of balancing actions (i.e. system vs energy) used in setting the Energy Imbalance Price(s), if so, how? (Section 1.1)	Yes, whilst this modification does not provide the "perfect" answer to the problem of system versus energy, as actions taken for system reasons will often assist in energy balancing these actions may be included in the price setting. Due to the system balancing portion of the action, the action may have been taken out of price order therefore artificially increasing the price. However by looking at the net actions taken this modification will in general use those actions required for energy to set the price whilst excluding any purely balancing actions. As the reverse price should in simplistic terms not have any energy actions a market

Q	Question	Response (Please provide rationale where possible)
		price is a suitable solution.
2.	In your opinion, is Modification Proposal P78 valuing actions more correctly, if so, why and if not, why not? (Section 1.5)	Yes, see previous response
3.	In your opinion, how does Modification Proposal P78 change the relative reward for notified and instructed actions and how do you believe this to impact on the Transmission Company's balancing of the system, and do you believe this is appropriate? (Section 1.6 defines notified and instructed action)	Participants may under P78 feel that taking a position opposite to the market position (i.e. long if the market is expected to be short) will mean greater rewards are possible if the market price calculation means the prices available in the market just before gate closure are below the reverse price. As the market price has yet to be defined this may not be possible depending on the market price definition. The risks involved relative to reward in pre guessing the market will limit the extent of this behaviour and will therefore not cause a significant impact on the Transmission Company.
4.	In your opinion, does Modification Proposal P78 more correctly target the cost of energy balancing actions to those causing the imbalance over the current baseline? (Section 1.6)	No, the distribution of cost to participants is not changed, however the differential in costs faced by large and small participants will be reduced as the price of both SSP and SBP will be nearer the market price.
5.	In your opinion, how does Modification Proposal P78 change the perceived risk of Bid - Offer submission, how would it change the level of participation seen in the Balancing Mechanism under the current baseline and how do you believe it would affect system balancing? (Section 1.7)	P78 should bring the market to a position nearer balance therefore increasing the need for the Transmission Company to accept Offers to increase Generation or reduce Demand so more participants should be encouraged to participate in the Balancing Mechanism especially in the mid to high price range thus reducing the cost of any extreme situations and increasing available plant in the Balancing Mechanism. In addition the reduction in the difference between SSP and SBP and the market price will reduce the cost of failure and therefore the risk thus increasing participation.
6.	In your opinion, how do you believe Modification Proposal P78 would affect the level of part loading seen under the current arrangements and in what way do you believe it would be more or less efficient for participants and for the system as a whole? (Section 1.8)	Unknown

Q	Question	Response (Please provide rationale where possible)
7.	In your opinion, does Modification Proposal P78 change the incentives to deviate from FPN over the current baseline, if so, how and why? (Section 1.9)	The only additional incentive to deviate from FPN is in order to take advantage of the reverse price after Gate Closure so as to increase a participants certainty of which price will be the reverse price, but as this would violate the grid code sufficient deterrents should already be in place.
8.	In your opinion, (noting the forthcoming implementation of Modification P12 to reduce Gate Closure to one hour), does Modification Proposal P78 increase the incentive on parties to change Physical Notifications shortly before Gate Closure and do you believe this to be a good or bad thing? (Sections 1.9, 1.11, 1.12, 1.13)	The need to predict the reverse price in order to determine a participants strategy may encourage parties to increase trading in the period before gate closure, however as the cost of being short (in a short market) is still higher than the cost of being long participants may be reluctant to try to guess the direction of the market and if this is not predictable then significant changes in strategy just prior to Gate Closure are unlikely.
9.	In your opinion, to what extent will Modification Proposal P78 address the issue of asymmetric risk? (Section 1.10)	Asymmetric risk is not eliminated just reduced.
10.	In your opinion, do you believe that Modification Proposal P78 will change the incentives on parties to balance their individual (contractual) trading positions before Gate Closure, if so, how and why? (Sections 1.12 and 1.13)	Yes, parties will be incentivised to be more in balance, as the risk associated with being short will be reduced, however the incentive to forecast accurately will still be significant.
11.	In your opinion, do you believe that Modification Proposal P78 will change the incentives for parties as a whole (i.e. in total, even if not balanced on an individual basis) to balance the market as a whole before Gate Closure, if so, how and why? (Section 1.11)	Under P78 parties will be likely to be less long and therefore the market as whole will also be less long.
12.	In your opinion, does Modification Proposal P78 lead Parties to anticipate the 'direction' of the market, and therefore the Energy Imbalance Price. Could this lead to volume volatility and consequential price instability in the market? (Sections 1.12 and 1.13)	See response to question 1
13.	What effect do you think Modification Proposal P78 will have on liquidity and prices in the forwards and spot markets, the interrelation of forwards	As parties are likely to try to trade nearer to balanced then liquidity in the short term markets should be increased, as participants will be more

Q	Question	Response (Please provide rationale where possible)
	and spot markets with Energy Imbalance Prices and also the level of Energy Imbalance Prices themselves? (Sections 1.14, 1.15 and 1.16)	sensitive to changes in expected demand levels.
14.	Do you believe that the implementation of Modification Proposal P78 will encourage the development of risk management products and new types of contracts, and what effect do you think this will have on competition and the efficiency of the forwards and spot markets? (Sections 1.17, 1.18, 1.19 and 1.20)	Unknown
15.	In your opinion what would be the impact on the risk profile of different categories of party (as listed in section 1.21) from the implementation of Modification Proposal P78? (Section 1.21)	As RWE TDL probably fits into the category of small supplier we would expect our risk profile to reduce as SSP and SBP are closer to the market price. Despite Customer not being a category we would expect their costs to be reduced due to the reduction in risk their supplier will have to accept on their behalf.
16.	Do you believe that Modification Proposal P78 better facilitates achievement of the Applicable BSC Objectives, if so, which one(s) and why?	Yes 3b, by encouraging an overall market position, which is closer to balance the extent of the actions taken by NGC, should be reduced, thus improving the efficiency of the system. 3c, by encouraging additional short term trading P78 should promote competition.
17.	Do you believe that an Alternative Modification Proposal better facilitates achievement of the Applicable BSC Objectives than Modification Proposal P78, if so, what is it? (Section 1.23)	Some minor adjustments to the calculation of the NIV under P78 may improve the modification
18.	Are there any other issues not identified in the supporting document which you believe should be considered during the assessment of Modification Proposal P78.	No, however the detail of the market price has yet to be defined and this will have significant impacts on the modification.

Q	Question	Response (Please provide rationale where possible)
19.	Do you believe that further analysis / modelling is required over that currently identified by the PIMG (in the supporting document), and if so, what specific form should this take?	Yes, modelling may not provide all the answers but may provide some useful insights into the way P78 may affect the market. The form of the modelling should be discussed at the relevant Modifications Group with assistance from experts in this specific field.

P78_ASS_017 – AEP Energy Services

Responding on Behalf of (please list all BSC Parties): AEP Energy Services Ltd and AEP Energy Services UK Generation Ltd

Responding as which type of Party (see list in section 1.21): Trading Party

Q	Question	Response (Please provide rationale where possible)
1.	In your opinion, does Modification Proposal P78 give a better separation of balancing actions (i.e. system vs energy) used in setting the Energy Imbalance Price(s), if so, how? (Section 1.1)	Yes. The proposal would provide a better separation. The use of the net imbalance volume to separate actions taken for energy balancing purposes from those taken for system balancing purposes should significantly improve on the tagging mechanism which has been shown not to remove actions that clearly relate to system balancing, on occasion. The use of a market-derived 'reverse price' should prevent some of the problems associated with transmission constraint costs feeding into imbalance cash out. The proposal should also lead to a significant reduction in the use of default rules to set either the system sell or system buy price.
2.	In your opinion, is Modification Proposal P78 valuing actions more correctly, if so, why and if not, why not? (Section 1.5)	Yes as the modification will lead to more cost-reflective cash out prices.
3.	In your opinion, how does Modification Proposal P78 change the relative reward for notified and instructed actions and how do you believe this to impact on the Transmission Company's balancing of the system, and do you believe this is appropriate? (Section 1.6 defines notified and instructed action)	Do not see any benefit to the assessment of the modification from introducing this distinction. As long as System Operator can rely on accurate FPNs it should balance the system based only on FPN data and demand forecasts. The modification should maintain commercial incentives to balance through introducing more cost-reflective cash-out

Q	Question	Response (Please provide rationale where possible)
		pricing and should not adversely effect the Transmission Company's balancing of the system.
4.	In your opinion, does Modification Proposal P78 more correctly target the cost of energy balancing actions to those causing the imbalance over the current baseline? (Section 1.6)	Yes. The current baseline can, on occasions, lead to inappropriate and non-cost reflective cash out prices through the failure of the tagging mechanism to work as intended and/or the use of default pricing rules. This modification addresses both of these issues.
5.	In your opinion, how does Modification Proposal P78 change the perceived risk of Bid - Offer submission, how would it change the level of participation seen in the Balancing Mechanism under the current baseline and how do you believe it would affect system balancing? (Section 1.7)	By reducing the risk of inappropriate cash-out prices, the modification should reduce the perceived risk and should encourage participation in the balancing mechanism.
6.	In your opinion, how do you believe Modification Proposal P78 would affect the level of part loading seen under the current arrangements and in what way do you believe it would be more or less efficient for participants and for the system as a whole? (Section 1.8)	Not a relevant consideration in assessing the modification. The imbalance price should reflect the costs of imbalances on both sides of the market. Market participants are then best placed to respond to this dynamic price signal and judge whether part-loading is an appropriate commercial response.
7.	In your opinion, does Modification Proposal P78 change the incentives to deviate from FPN over the current baseline, if so, how and why? (Section 1.9)	No. Adequate arrangements are already in place through the Grid Code to ensure accurate FPN submission. NGC has not reported significant problems to date and Ofgem has powers to fine where breaches take place.
8.	In your opinion, (noting the forthcoming implementation of Modification P12 to reduce Gate Closure to one hour), does Modification Proposal P78 increase the incentive on parties to change Physical Notifications shortly before Gate Closure and do you believe this to be a good or bad thing? (Sections 1.9, 1.11, 1.12, 1.13)	No. Parties changing Physical Notifications shortly before Gate Closure could be 'good' or 'bad' depending on the circumstances. If changes in PNs are the result of Parties seeking to trade out imbalances within day and more accurately reflect actual metered generation and demand in the relevant settlement period then this would reduce the role and costs of the Transmission Company's system balancing actions. This would be a 'good' thing. If changes in PNs reflected the attempts of Parties to go long or short into imbalance and the cash-out price was not cost-reflective and was less costly than trading out the imbalance then this

Q	Question	Response (Please provide rationale where possible)
		would be a 'bad' thing. By leading to more cost-reflective cash-out prices, the modification should lead to changes in PNs only in the former case.
9.	In your opinion, to what extent will Modification Proposal P78 address the issue of asymmetric risk? (Section 1.10)	The question implies that any asymmetry is problematic. If the asymmetry is cost reflective (and there are good reasons why it might be given the relative costs associated with flexing up and down) then it should not be addressed. Any asymmetry under this modification should be cost reflective.
10.	In your opinion, do you believe that Modification Proposal P78 will change the incentives on parties to balance their individual (contractual) trading positions before Gate Closure, if so, how and why? (Sections 1.12 and 1.13)	Yes but it should not significantly weaken incentives as energy imbalance prices should better reflect the costs to NGC of participants' imbalances
11.	In your opinion, do you believe that Modification Proposal P78 will change the incentives for parties as a whole (i.e. in total, even if not balanced on an individual basis) to balance the market as a whole before Gate Closure, if so, how and why? (Section 1.11)	Yes as the market as whole will simply be the aggregate of individual actions (see previous answer).
12.	In your opinion, does Modification Proposal P78 lead Parties to anticipate the 'direction' of the market, and therefore the Energy Imbalance Price. Could this lead to volume volatility and consequential price instability in the market? (Sections 1.12 and 1.13)	All participants are likely, to some extent, to try and anticipate the direction of the market and the energy imbalance price. Any decision to go long or short based on this expectation is not problematic as long as imbalance cash out prices reflect the costs that participants impose in being out of balance. Any resulting volume and price instability would, by definition, be efficient as it would represent the markets view on the relative costs associated with trading out imbalances relative to the costs imposed in not balancing.
13.	What effect do you think Modification Proposal P78 will have on liquidity and prices in the forwards and spot markets, the interrelation of forwards and spot markets with Energy Imbalance Prices and also the level of Energy Imbalance Prices themselves? (Sections 1.14, 1.15 and 1.16)	The modification should not significantly weaken incentives to balance and therefore should continue to encourage forward trading, thereby encouraging liquidity in prompt and forward markets. Other things being equal, the modification would lower imbalance prices by preventing the

Q	Question	Response (Please provide rationale where possible)
		application of the default rules and/or problems with the tagging mechanism leading to artificially high imbalance prices that do not reflect costs.
14.	Do you believe that the implementation of Modification Proposal P78 will encourage the development of risk management products and new types of contracts, and what effect do you think this will have on competition and the efficiency of the forwards and spot markets? (Sections 1.17, 1.18, 1.19 and 1.20)	Yes, by making energy imbalance prices better reflect costs, parties will be more willing to forecast prices and develop risk managements products and contract types. This will increase competition and efficiency in all markets.
15.	In your opinion what would be the impact on the risk profile of different categories of party (as listed in section 1.21) from the implementation of Modification Proposal P78? (Section 1.21)	The proposal should ultimately benefit all parties by producing more cost-reflective cash-out prices.
16.	Do you believe that Modification Proposal P78 better facilitates achievement of the Applicable BSC Objectives, if so, which one(s) and why?	Yes. The proposal should better facilitate competition in generation and supply by removing any cross subsidies caused by artificially high cash out prices under default rules and/or when system balancing costs are not tagged out.
17.	Do you believe that an Alternative Modification Proposal better facilitates achievement of the Applicable BSC Objectives than Modification Proposal P78, if so, what is it? (Section 1.23)	Further consideration needs to be given to ensuring that system balancing costs are fully removed from energy imbalance. System balancing costs could still feed into imbalance prices where NGC seeks to correct a net imbalance and resolve a transmission constraint simultaneously.
18.	Are there any other issues not identified in the supporting document which you believe should be considered during the assessment of Modification Proposal P78.	See answer to question 17
19.	Do you believe that further analysis / modelling is required over that currently identified by the PIMG (in the supporting document), and if so, what specific form should this take?	None required.

P78_ASS_018 – Intergen (UK)

InterGen (UK) is not in a position to conduct a highly detailed assessment of the proposal. However, on behalf of our BSC Parties (CECL, IETS, RPCL, SPAL) we are fully supportive of any measures that make System Prices more cost reflective of the Net Imbalance Volume and mitigate the non cost reflective financial penalties that have been levied upon generators when plant availability has changed unexpectedly.

We are therefore in favour of the implementation of modification Proposal P78.

P78_ASS_019 – Eledor Limited

Responding on Behalf of (please list all BSC Parties): **Eledor Limited**

Responding as which type of Party (see list in section 1.21): **Non Physical Trader (Consolidator)**

Q	Question	Response (Please provide rationale where possible)
1.	In your opinion, does Modification Proposal P78 give a better separation of balancing actions (i.e. system vs energy) used in setting the Energy Imbalance Price(s), if so, how? (Section 1.1)	The proposed mechanism potentially gives a better separation.
2.	In your opinion, is Modification Proposal P78 valuing actions more correctly, if so, why and if not, why not? (Section 1.5)	No. Participants who are long or short are exposed to a price that may vary between the applicable cash out price and a market derived price. The cost of imbalance faced by individual participants is not cost reflective or directly related to the corresponding energy balancing action.
3.	In your opinion, how does Modification Proposal P78 change the relative reward for notified and instructed actions and how do you believe this to impact on the Transmission Company's balancing of the system, and do you believe this is appropriate? (Section 1.6 defines notified and instructed action)	The imbalance charge potentially seen by an individual participant who goes short would vary between SBP (or SSP) and a market derived figure dependent on the Net Imbalance Volume. The exposure to potential punitive dual cashout prices would be reduced, although the price volatility would increase for being out of balance in a particular direction. Participants taking notified actions would be exposed to more favourable imbalance charges. As there is less risk in taking notified actions, it follows that more notified actions may be taken to reduce the potential risk of exposure to SBP. Failure to deliver instructed actions would also

Q	Question	Response (Please provide rationale where possible)
		expose participants to less punitive non delivery charges.
4.	In your opinion, does Modification Proposal P78 more correctly target the cost of energy balancing actions to those causing the imbalance over the current baseline? (Section 1.6)	No. A fundamental principle of NETA has been the incentive to self balance. The cost of imbalance faced by individual participants is not cost reflective or directly related to the corresponding energy balancing action.
5.	In your opinion, how does Modification Proposal P78 change the perceived risk of Bid - Offer submission, how would it change the level of participation seen in the Balancing Mechanism under the current baseline and how do you believe it would affect system balancing? (Section 1.7)	Failure to deliver instructed actions would expose participants to a less punitive non delivery charge. This may reduce some of the risk perceived when submitting bid/offer price ladders and have the duel effect of increasing reducing the margin between SBP and SSP should the volume of accepted bid and offers remain the same.
6.	In your opinion, how do you believe Modification Proposal P78 would affect the level of part loading seen under the current arrangements and in what way do you believe it would be more or less efficient for participants and for the system as a whole? (Section 1.8)	Actions that may be taken to increase load in gate closure without instruction from NGC are limited. The incentives for participants to enter gate closure part loaded depends primarily on the perceived rewards of instructed actions. P78 potentially mitigates the risk of exposure to non delivery charges and hence may encourage more parties to enter the Balancing Mechanism at part load seeking income from instructed actions
7.	In your opinion, does Modification Proposal P78 change the incentives to deviate from FPN over the current baseline, if so, how and why? (Section 1.9)	Generators who believe they may obtain the market derived price (rather than SSP) through increasing the load from FPN (without instruction from NGC) will have a greater incentive over the current position and payment at SSP.
8.	In your opinion, (noting the forthcoming implementation of Modification P12 to reduce Gate Closure to one hour), does Modification Proposal P78 increase the incentive on parties to change Physical Notifications shortly before Gate Closure and do you believe this to be a good or bad thing? (Sections 1.9, 1.11, 1.12, 1.13)	P78 increases the incentive for parties to take notified actions. As the incentive to self balance is less pronounced, the incentive on parties to maintain accurate FPNs is reduced. With gate closure moving to one hour this is undesirable as NGC will have less time to take more actions to correct variance from the FPN position.

Q	Question	Response (Please provide rationale where possible)
9.	In your opinion, to what extent will Modification Proposal P78 address the issue of asymmetric risk? (Section 1.10)	Short term power requirements have to be met by flexible power generators or demand management mechanisms. Such resources generally have low utilisation and have to recover fixed costs (rent) over a shorter period of running hours. The Bid Offer spread needs to be maintained to remunerate short term flexible resources. Firm prices signals are required to incentivise participants to invest in such resources and maintain their operational viability. P78 potentially gives less incentive to participants to self balance, especially if faced with short term power bid offer spreads shortly before gate closure. This would increase the volume of short term power bid/offer acceptances. This would have the effect of increasing the long and short stack. It does not seem to reflect the issue that actions to increase load at short notice are different from actions to decrease load at short notice.
10.	In your opinion, do you believe that Modification Proposal P78 will change the incentives on parties to balance their individual (contractual) trading positions before Gate Closure, if so, how and why? (Sections 1.12 and 1.13)	The incentives on Parties to self balance before gate closure will be reduced as the exposure to punitive dual cash out prices is reduced. Furthermore, parties (with for instance those with large volumes of excess and flexible generating capacity) will have the capability of manipulating the market position by changing between IPN to FPN positions. This will make NGCs role more challenging upon movement of gate closure to one hour before real time. A variance in IPN to FPN may increase the volume of balancing mechanism activity. This may further incentivise owners of excess flexible generating capacity to manipulate the mechanism and realise enhanced income from balancing mechanism activity.
11.	In your opinion, do you believe that Modification Proposal P78 will change the incentives for parties as a whole (i.e. in total, even if not balanced on an individual basis) to balance the market as a whole before Gate Closure, if so, how and why? (Section 1.11)	Yes. There are less incentives to balance due to the potential cash out prices being less punitive.

Q	Question	Response (Please provide rationale where possible)
12.	In your opinion, does Modification Proposal P78 lead Parties to anticipate the 'direction' of the market, and therefore the Energy Imbalance Price. Could this lead to volume volatility and consequential price instability in the market? (Sections 1.12 and 1.13)	Yes. Parties with the correct profile (i.e. Large volumes of flexible, low utilisation excess generating capacity) may also attempt to manipulate the "direction" of the market, especially at peak periods when the SBP-SSP margin is most pronounced. Plants with load restrictions due to environmental constraints could also be used to manipulate the market in this way.
13.	What effect do you think Modification Proposal P78 will have on liquidity and prices in the forwards and spot markets, the interrelation of forwards and spot markets with Energy Imbalance Prices and also the level of Energy Imbalance Prices themselves? (Sections 1.14, 1.15 and 1.16)	P78 has the effect of reducing the incentives to self balance. Portfolio players and vertically integrated players who currently retain flexible capacity to manage their own delivery and supply risk may be more willing to offer such capacity in the day ahead markets, hence increasing liquidity. This will be due to the lower risk of exposure to the dual cash out prices and potential guaranteed benefits of power revenues in the dayahead market. However, the bid offer spread in the dayahead market will be more distorted than at present. Power sales at short notice prior to gate closure would still need to be fulfilled by flexible plant. This plant could obtain high prices in the Balancing Mechanisms and hence parties would be unwilling to sell volumes from such plant at prices significantly lower than that they may obtain in the Balancing Mechanism. Parties seeking power may choose to take their chances on the direction of the single imbalance charge rather than pay such prices prior to gate closure and enter gate closure in Balanced position. Plants that are able to respond within one hour are the most flexible and generally the most expensive, hence, the overall "system" cost of fulfilling the imbalance will be increased due to a later balancing action being required. Furthermore P78 would make the short term markets more imperfect than the status quo as the price transparency will be more opaque and parties responsible for an imbalance in a direction will not be responsible for the costs of actions to rectify the imbalance.

Q	Question	Response (Please provide rationale where possible)
14.	Do you believe that the implementation of Modification Proposal P78 will encourage the development of risk management products and new types of contracts, and what effect do you think this will have on competition and the efficiency of the forwards and spot markets? (Sections 1.17, 1.18, 1.19 and 1.20)	P78 would actively discourage the development of risk management products and new types of contracts for third parties. It allows portfolio players and vertically integrated players to strengthen their influence over short term power markets, and increases their income from such activity at the overall expense of the system and eventually the customer. They have more perfect information and greater price transparency due to their internal position. Such portfolio players currently are able to enjoy the benefits of internal risk management products. Reducing the perceived margins in providing risk management services such as Consolidation will discourage market entry by Independent Service Providers. Influence of short term power prices allows a party a trading advantage in the forward markets. An imperfect short term market distorts the forward market as parties seek to maximise their income and mitigate risk. As mentioned above P78 makes the short term market more imperfect and makes price transparency more opaque.
15.	In your opinion what would be the impact on the risk profile of different categories of party (as listed in section 1.21) from the implementation of Modification Proposal P78? (Section 1.21)	• small suppliers- Overall increased risk • Large suppliers- Decreased risk • LEGs- Overall increased risk • Unpredictable generators- Overall increased risk • Non portfolio generators- Overall increased risk • Portfolio generators- Decreased risk • Vertically integrated players- Decreased risk • Non Physical Traders- increased risk and consolidation is discouraged • Transmission Company- increased risk
16.	Do you believe that Modification Proposal P78 better facilitates achievement of the Applicable BSC Objectives, if so, which one(s) and why?	No. It has the opposite effect.

Q	Question	Response (Please provide rationale where possible)
17.	Do you believe that an Alternative Modification Proposal better facilitates achievement of the Applicable BSC Objectives than Modification Proposal P78, if so, what is it? (Section 1.23)	No
18.	Are there any other issues not identified in the supporting document which you believe should be considered during the assessment of Modification Proposal P78.	Portfolio Players and vertically integrated players currently have the ability to employ internal Risk Management Strategies both within gate closure and prior to gate closure. In a perfect market independent service providers would be able to deliver services (and benefits) to small and independent players comparable with those naturally realised by portfolio and vertically integrated players. P78 discourages the emergence of such service providers. The use of market reflective prices form the Dayahead Exchanges is reliant on the parties that publish such figures to maintain the process and method of calculation.
19.	Do you believe that further analysis / modelling is required over that currently identified by the PIMG (in the supporting document), and if so, what specific form should this take?	OFGEM is currently endeavouring to encourage players to enter the market as independent consolidators. P78 would actively discourage such market entry.