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MODIFICATION REPORT
MODIFICATION PROPOSAL P25 –
Commissioning Status in NETA

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

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1 SUMMARY AND RECOMMENDATIONS

1.1 Recommendation

On the basis of the analysis, consultation and assessment undertaken in respect of this Modification Proposal during the Assessment Phase, and the resultant findings of this report, the BSC Panel recommends to the Authority that:

- (i) The Proposed Modification, as defined by the Modification Group in the Definition Report, be rejected; and
- (ii) The Alternative Modification, as developed by the Modification Group and defined in the Assessment Report, be rejected.

1.2 Background

Modification Proposal P25 was submitted by BP Gas & Marketing on 25 June 2001, proposing the BSC be modified such that plant which could be deemed to be commissioning would be provided with relief from energy imbalance charges. It was argued by the Proposer that the inevitably larger exposure to imbalance prices of BM Units comprising commissioning plant constituted a barrier to entry. Reducing or removing this exposure, it was argued, would thus reduce this barrier to entry, and hence promote competition in the generation of electricity.

An Initial Written Assessment was considered by the BSC Panel on 12 July, which directed that the Proposal should proceed through the Definition phase. A Definition Report was considered by the Panel on 23 August 2001 and the Proposal subsequently proceeded to the Assessment phase for report to the Panel on 18 October 2001.

During the Assessment Phase, the Modification Group developed an Alternative Modification. This achieved the same effects as the Proposed Modification, with only minor differences, but minimised the impact on settlements systems. Consequently, the Modification Group recommended that the Proposed Modification should be rejected in favour of the Alternative Modification. The Modification Group was unable, however, to reach an unambiguous conclusion as to whether this Alternative Modification better facilitated the achievement of the Applicable BSC Objectives. Furthermore, the Modification Group considered that it was unlikely to reach such a view, and accordingly recommended to the Panel that the Modification should not be returned to the Modification Group for further assessment and, instead, proceed to the Report Phase.

The Assessment Report was considered by the BSC Panel on 18 October 2001. The Panel accepted the recommendations of the Modification Group that the Proposed Modification should proceed to the Report Phase and that the Panel should recommend that the Proposed Modification should be rejected. The Panel noted the split views of the Modifications Group and further agreed to recommend to the Authority that the Alternative Modification should also be rejected.

1.3 Rationale for Recommendations

The Panel agreed with the Modifications Group recommendation that the Proposed Modification should be rejected. This was on the ground that the Alternative Modification would better facilitate the achievement of the fourth Applicable BSC Objective, as it would be cheaper and quicker to implement.

Furthermore, the Panel agreed to recommend, that the Alternative Modification be rejected. The Panel noted that the Modification Group had been unable to reach a unanimous conclusion regarding the

Alternative Modification, and decided to recommend that it should be rejected on the grounds that the relief from energy imbalance charges provided by the Alternative Modification constituted a cross-subsidy to one class of BSC Parties at the expense of other BSC Parties. The Panel considered that such a cross-subsidy would be discriminatory, and that hence the Alternative Modification (and by implication the Proposed Modification also) would not promote *“effective competition in the generation and supply of electricity, and (so far as consistent therewith) ... such competition in the sale and purchase of electricity”*.

2 INTRODUCTION

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

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

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

3 PURPOSE AND SCOPE OF THE REPORT

BSC Section F sets out the procedures for progressing proposals to amend the BSC (known as ‘Modification Proposals’). These include procedures for proposing, consulting on, developing, evaluating and reporting to the Authority on potential modifications.

The BSC Panel is charged with supervising and implementing the modification procedures. ELEXON provides the secretariat and other advice, support and resource required by the Panel for this purpose. In addition, if a modification to the Code is approved or directed by the Authority, ELEXON is responsible for overseeing the implementation of that amendment (including any consequential changes to systems, procedures and documentation).

A Modification Report must be prepared and submitted to the Authority in respect of each proposed modification and must contain:

- (a) The recommendation of the Panel as to whether or not the Proposed Modification or any Alternative Modification should be made;
- (b) The proposed Implementation Date for implementation of the Proposed Modification or any Alternative Modification;
- (c) The matters set out in Annex F-1 of the BSC. This will usually be in the form of the relevant Assessment Report where the Proposal has been submitted to a Modification Group prior to the Report Phase;
- (d) An explanation of the Panel’s rationale should the Panel form a different view of any matters contained in the Modification Group Report; and
- (e) A summary of the representations made by Parties and interested third parties during the consultation undertaken in respect of the Proposed Modification and any Alternative Modification.

4 DESCRIPTION OF PROPOSED MODIFICATION

P25, as proposed by BP Gas & Marketing, and as defined by the P25 Modification Group, proposed the introduction into the Balancing & Settlement Code of a Commissioning Status for BM Units, thereby known as “Commissioning BM Units”. This status would be accorded in respect of BM Units satisfying certain qualifying criteria. Commissioning Status would last a year or less in the event that certain “Commissioning Status Exit Criteria” were met. In respect of each Commissioning BM Unit, Trading Parties would nominate that up to 90 Settlement Days be treated as “Commissioning Settlement Days”. On Commissioning Settlement Days, any shortfall (or surplus) against the FPN (as modified by any Accepted Offer or Bid) would be priced at a “Market Price”, derived from prices in publicly-traded markets, rather than the relevant energy imbalance price.

The Modification Proposed also proposed a change to Residual Cashflow Reallocation Cashflow (RCRC). It was suggested that Credit Energy Volume associated with Commissioning BM Units on Commissioning Settlement Days should not count towards the pro-rating of RCRC. This was on the grounds that it is inappropriate that Commissioning BM Units, being immune from exposure to energy imbalance charges, should attract payments arising from the exposure of others.

The Alternative Modification was proposed with the objective of minimising the impact on settlements systems, particularly recognising that the provisions of the Modification would apply to a small number of BM Units, each for a limited duration. Accordingly, the Alternative Modification achieved the required changes in Trading Charges by calculating and effecting changes in the Account Bilateral Contract Volumes of the affected BSC Parties in the affected Settlement Periods. Other differences between the Alternative Modification and the Proposed Modification were that: the change in the allocation of RCRC implicit in the Proposed Modification were, as a necessary simplification, not included in the Alternative Modification; and, at the behest of the Proposer, the retrospective application back to the Go-Live Date, which was a feature of the Modification Proposal, was not included.

5 HISTORY OF PROPOSED MODIFICATION

Modification Proposal P25 was submitted by BP Gas & Marketing 2001 on 25 June 2001. The Proposer requested that the Modification Proposal be treated as an Urgent Modification Proposal. However, ELEXON did not consider that there was any risk of disruption or severe malfunction that could be prevented by the Proposed Modification, if made, and that consequently it was not appropriate to recommend to the Panel that the Modification Proposal should be treated as an Urgent Modification Proposal.

An Initial Written Assessment was considered by the BSC Panel on 12 July, which directed that the Proposal should proceed through the Definition phase. A Definition Report was considered by the Panel on 23 August 2001 and the Proposal subsequently proceeded to the Assessment phase for report to the Panel 18 October 2001.

During the Assessment Phase, the Modification Group considered by correspondence a Requirements Specification that detailed an alternative requirement, which minimised the impact of settlements systems. The Panel had been appraised of the potential for such an alternative when the Definition Report was presented. The Group subsequently met on 5 October 2001 to discuss the assessment against Applicable BSC Objectives of the Proposed Modification, and to decide that the alternative requirement should be presented as an Alternative Modification. The Modification Group was unable, however, to reach an unambiguous decision as to whether this Alternative Modification (or the Proposed Modification) better facilitated the achievement of the Applicable BSC Objectives.

The Assessment Report was considered by the BSC Panel on 18 October 2001. The Panel accepted the recommendations of the Modification Group that the Proposed Modification should proceed to the Report Phase and that the Panel should recommend that the Proposed Modification should be rejected. The Panel noted the split views of the Modifications Group and further agreed to recommend that the Alternative Modification should also be rejected.

The draft Modifications report was sent out for consultation after the Panel meeting. The Modifications report has been updated to reflect the responses received.

6 ASSESSMENT

6.1 Assessment against Applicable BSC Objectives

In the Modification Proposal, the Proposer argued that commissioning plant, by dint of its greater exposure to imbalance prices than commissioned plant, potentially could suffer considerable financial loss due to the extreme nature of those prices. This constituted a barrier to entry. The Proposed Modification, by mitigating such exposure would remove this barrier to entry, and would thereby promote effective competition in the generation of electricity.

In preparing the Assessment Report, the Modification Group did not reach a consensus on whether the Proposed Modification or the Alternative Modification would better meet the Applicable BSC Objectives. Nevertheless, the Group concluded as follows:

- (1) If it is considered that the consequences of exposure to imbalance prices reasonably reflected costs imposed on the System by energy imbalances, then there was no basis for supposing that the Proposed Modification or the Alternative Modification would better meet the Applicable BSC Objectives, specifically the promotion of effective competition in generation.
- (2) If, however, it is considered that the consequences of exposure to imbalance prices *did not* reasonably reflect costs imposed on the System by energy imbalances, then, to the extent that commissioning plant was inevitably more exposed to imbalance prices, there was a barrier to entry.
- (3) If (2) then, then there is a case to argue that the imbalance prices were wrong for *all* imbalances incurred by *all* Trading Parties, and that a proper solution might be to modify the imbalance pricing mechanism.
- (4) However, notwithstanding (3), the assessment should be undertaken against the Balancing & Settlement Code as it is drafted, and not against the Code assuming the adoption of some other, as yet unspecified, Modification.

Views diverged on whether the consequences of exposure to imbalance prices, as presently calculated, were reasonable, with three Group members believing that this was the case, whilst four members disagreed. Thus, in this respect, the Modification Group could not reach an unambiguous conclusion as to whether the Alternative Modification (or the Proposed Modification) would better meet the Applicable BSC Objective of, “*promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity*”.

There was some debate about whether there could be a potential effect on System Operation as a result of spill from commissioning plant onto the System. Presently Trading Parties are likely to prefer to spill rather than contract in respect of commissioning plant, for fear of the consequences of exposure to System Buy Price. Such spill results potentially in the System being long and the Transmission Company consequentially having to accept more Bids, with a possible effect on System Sell Prices. However, a result of the Proposed Modification would have been that Trading Parties with Credited Energy Volumes from Commissioning BM Units would be more likely to contract rather than spill - thereby receiving something akin to Market Price rather than System Sell Price, without risking exposure to System Buy Price – and hence reduce the amount to which the market would otherwise be long. In any case, NGC had indicated to the Modifications Group that it believed that it could accommodate any spill from commissioning plant - which would occur irrespective of whether the

Alternative Modification or Proposed Modification were adopted - either in the balancing mechanism or by forward contracting.

In view of this effect, the Modification Group agreed that the Alternative Modification (and the Proposed Modification) would result in prices better reflecting the balance of supply and demand, and would, in this respect, better meet the Applicable BSC Objective of, *“promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity”*.

It was recognised that the Proposed Modification did provide some incentive for Commissioning BM Units, which could satisfy the one of the Commissioning Status Exit Criteria¹, not so to do. This could impair, *“the efficient, economic and co-ordinated operation by the Licensee of the Licensee’s Transmission System”*. A counter-view was that it was improbable that plant would be able to commission much in advance of the 90 Commissioning Settlement Days limit, such that this incentive was more a theoretical rather than practical concern.

6.2 BSC Agent Impact Assessment

Assessment by Logica indicated that the Alternative Modification could be developed and implemented at a cost of £134,000, in a period of 11-13 weeks

6.3 BSC Party Impact Assessment

In the request for impact assessment by BSC Parties, only one BSC Party indicated that the Proposed Modification would have any impact on its own systems.

Views of BSC Parties as to whether the Proposed Modification would better facilitate the achievement of the Applicable BSC Objectives were expressed during the initial consultation and to some extent, again, during the Impact Assessment. These views were taken into account by the Modification Group in formulating its conclusions.

Details of the Assessment Phase are contained in the Assessment Report, which may be found on the BSC website at www.elexon.co.uk.

¹ One of the Commissioning Status Exit Criteria in the Modification as defined in the Definition Report was the deviations of BM Unit Metered Volume from FPN (as modified by any accepted Offers and Bids) being less than a specified percentage.

7 RATIONALE FOR PANEL RECOMMENDATIONS

The Panel agreed with the Modifications Group view that the Proposed Modification should be rejected on the grounds that the Alternative Modification would better facilitate the achievement of the Applicable BSC Objectives as it was cheaper and quicker to implement, and hence would better meet *“efficiency in the implementation and administration of the balancing and settlement arrangements”*, whilst being equally effective in other respects.

In deciding to recommend that the Alternative Modification should be rejected, the Panel noted that the Modification Group had been unable to reach a unanimous conclusion regarding the Alternative Modification. The Panel decided to recommend that the Alternative Modification should be rejected on the grounds that the relief from energy imbalance charges provided by the Alternative Modification constituted a cross-subsidy to one class of BSC Parties at the expense of other BSC Parties, concurring with the view expressed by a number of Parties in the initial consultation. The Panel considered that such a cross-subsidy would be discriminatory and would distort competition, and that hence the Alternative Modification (and by implication the Proposed Modification also) would not promote *“effective competition in the generation and supply of electricity, and (so far as consistent therewith) ... such competition in the sale and purchase of electricity”*.

8 LEGAL TEXT TO GIVE EFFECT TO THE PROPOSED MODIFICATION

In view of the recommendation of the Panel to recommend to the Authority that both the Modification and Alternative Modification Proposal should be rejected , the Panel has consulted with the Authority, and the Authority has agreed that proposed text to modify the Code need not be commissioned for inclusion in the Modification Report.

9 SUMMARY OF REPRESENTATIONS

Eight responses were received to the consultation on the draft Modification Report. Seven responses supported the Panel's decision to recommend to the Authority that the Modification should be made, whilst one response disagreed with the decision.

Of the responses supporting the Panel decision, five noted the Panel's conclusion that the Proposed Modification would constitute a cross-subsidy of one set of BSC Parties at the expense of others. One respondent was unhappy with a Modification mitigating imbalance prices when there were other Modifications being considered that would affect these. One respondent argued that a potential materiality of £5m to £10m would be small compared to the costs of constructing a power station, whilst another noted that this would be only one of many costs taken into account when deciding whether to enter the market.

The response disagreeing with the Panel decision, highlighted that the Modifications Group had unanimously concluded that, the decision on whether the Proposed Modification better facilitated the BSC objectives rested on whether the consequences of exposure to imbalance prices did or did not reasonably reflect costs that are imposed on the System by energy imbalances. However, the respondent felt the Panel had not taken its decision on this basis. The respondent also observed that the Panel had cited cross-subsidy and discrimination as the basis for not making the Modification, but that this argument had been considered by the Modifications Group and had been dismissed.

ANNEX 1 – REPRESENTATIONS

See separate attachment.