

## P205 TRANSMISSION COMPANY ANALYSIS AND IMPACT ASSESSMENT – RESPONSE PRO-FORMA

In accordance with paragraph F 2.8 of the Code, please respond to the following questions concerning P205 (including the rationale for each response):

Q	Question	Response
1	Please outline any impact of the Proposed Modification (and, if applicable, any Alternative Modification) on the ability of the Transmission Company to discharge its obligations efficiently under the Transmission Licence and on its ability to operate an efficient, economical and co-ordinated transmission system.	<p>There is no firm obligation on BSC parties to contract sufficiently to cover their energy position prior to Gate Closure. The incentive to resolve their position in the forward market is solely determined by the difference between likely exposure from imbalance prices and the cost of buying that energy forward. It is therefore imperative that, particularly at times of system stress, the incentives on all participants to cover their energy position are appropriate.</p> <p>Deriving a volume weighted average price from the entire NIV does not always form a good proxy for the marginal cost of balancing energy as was endorsed by the approval of P194. The PAR of 500MWh proposed under P205 would effectively return the imbalance price methodology to an average weighted price in over 80% of all periods. As such there is the potential that the cash out price would not reflect the marginal cost of resolving NIV in the majority of settlement periods.</p> <p>This predominantly average pricing methodology would reintroduce those very perversities that P194 sought to remove. The P205 prices would predominantly clear at the average cost of resolving energy imbalance (NIV) whilst the forward market clears at close to the marginal cost of energy traded. Given the observed price spread of offer submissions, the System Operator would be likely to take a quantity of acceptances to resolve energy imbalance in a short market at a price greater than SBP as calculated under P205. Within a market environment, it is expected that participants will seek to minimise their costs. Therefore if the cost of purchasing energy from the marginal unit in the forward market is greater than</p>

		<p>the exposure to imbalance costs a participant will forgo that opportunity and take the cheaper option of having their imbalance cashed out at SBP. Therefore P205 would reintroduce an inappropriate cap on the forward energy price equivalent to the expected level of the average imbalance price for the majority of settlement periods.</p> <p>This distortion, existing in the pre P194 methodology and reintroduced by P205, would be detrimental to the Transmission Company in its ability to discharge its obligations under the Transmission License in that it would lead the market to operate in a less efficient, economic manner.</p>
2	Please outline the views and rationale of the Transmission Company as to whether the Proposed Modification (and, if applicable, any Alternative Modification) would better facilitate achievement of the Applicable BSC Objectives.	<p>This BSC modification will have a detrimental impact on BSC objective b in that it will diminish the incentive to balance.</p> <p>The proposer of BSC modification P205 has intimated that the current market arrangements allow “embedded and renewable generators to sell to suppliers on a partial spill basis. i.e they do not schedule their output”. It is of concern to us that the basis for this proposal is that certain sections of the market should be able to continue to spill their output with relative financial impunity and should, in doing so, not be exposed to the marginal costs incurred by the industry through the System Operators actions to resolve that imbalance.</p> <p>This modification will reduce the liquidity in the spot markets as the incentive to balance is diminished. We do not believe that this can be beneficial in promoting competition in the purchase and sale of electricity. Certainly from this perspective this modification is detrimental to objective c.</p>
3	Please outline the impact of the Proposed Modification (and, if applicable, any Alternative Modification) on the computer systems and processes of the	This modification will alter the IO14 flow content. As such we will need to take account of this change in our IS systems. However

	Transmission Company, including details of any changes to such systems and processes that would be required as a result of the implementation of the Proposed Modification (and, if applicable, any Alternative Modification)	this is work currently being carried out in relation to P194. As such the introduction of P205 or P194 will necessitate the same changes to our IS systems.
4	Please outline any potential issues relating to the security of supply arising from the Proposed Modification (and, if applicable, any Alternative Modification).	<p>We believe that the incentive for participants to cover their contractual positions will be diminished. This will lead to greater uncertainty of sufficient capacity being available. This will increase the risk to security of supply.</p> <p>The diminished incentive to balance will reduce liquidity in the forward markets and obscure the ability of the market price to accurately reflect the marginal cost of energy.</p> <p>This, in turn, will diminish the ability of the forward market to signal emerging supply shortages. The forward price curve is a significant factor in the economic consideration in the investment in new capacity. As such the more accurately it reflects the likely forward cost of energy the more efficiently the market is able to respond to future demand/supply positions. Adequate capacity to meet future demand requirements is the core requirement of meeting long term security of supply. P205 will dilute this signal to the market and the incentive to provide adequate capacity will be impacted accordingly.</p>
5	Please provide an estimate of the development, capital and operating costs (broken down in reasonable detail) which the Transmission Company anticipates that it would incur in, and as a result of, implementing the Proposed Modification (and, if applicable, any Alternative Modification).	The costs of implementing this modification are the same costs as implementing P194. Therefore the impact on National Grid from either modification is the cost of altering any systems that utilise the IO14 flow in there business process. The estimated cost of such a change on the IO14 flow is approximately £60 to £100K
6	Please provide details of any consequential changes to Core Industry Documents and/or the System Operator Transmission Owner Code that would be required as a result of the implementation of the Proposed Modification (and, if applicable, any Alternative Modification).	No consequential changes to core industry documents
7	Any other comments on the Proposed Modification (and Alternative Modification if applicable).	We would like to highlight that in our view all the reasons we noted in our support of P194 are just as valid now as they when

	<p>proposed. P194 ensured that parties would have a clearer incentive to balance. Hence, in our view the approval of P194 was both welcomed and appropriate.</p> <p>We would also like to highlight the following points</p> <ul style="list-style-type: none"><li>• P194 was approved in March 2006, following an extensive consultation process that included a Regulatory Impact Assessment. Following this extremely thorough process, Ofgem has also given a commitment to review how P194 is working in practice six months after its implementation which will give a further opportunity for review in the light of actual experience.</li><li>• Hence, we do not believe that it is appropriate for an Urgent modification that seeks to undo P194 to succeed prior to the thoroughly assessed P194 having been given the opportunity to work in practice, particularly given that P205 has raised no significant issues that were not already raised in P194.</li><li>• We would also highlight specifically that when Modification P194 was submitted the proposer of that modification, in providing analysis to the working group, explicitly asked if parties would like to see the material impact of other PAR values. Extensive analysis of the imbalance price, as calculated using a PAR 500 methodology, was provided. Despite this evidence no respondent to the consultation advocated the proposal of PAR 500 as an alternative proposal.</li><li>• We also have reservations that this modification is proposing a change to the BSC in regard to a rule change</li></ul>
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		that has yet to be implemented. In effect this sets a precedent that, despite a ruling by the regulatory authority, any approved modification proposal with a sufficient implementation lead time can be challenged before it is even introduced.
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Please send your response by 17:00 on Wednesday 20 August 2006 to [modifications@elexon.co.uk](mailto:modifications@elexon.co.uk). Any queries regarding the analysis should be addressed to Tom Bowcutt on 0207380 4309 or email address [thomas.bowcutt@elexon.co.uk](mailto:thomas.bowcutt@elexon.co.uk).