

URGENT MODIFICATION REPORT for Modification Proposal P201 'Energy Imbalance Tolerance Band'

Prepared by: ELEXON¹ on behalf of the BSC Panel

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This document has been distributed in accordance with Section F2.1.10 of the Balancing and Settlement Code.²

Proposed Modification P201 seeks to introduce a tolerance band for the application of Imbalance Charges to Supplier Consumption Energy Accounts. Where a Supplier was short on its Consumption Energy Account and the System was short, the Party would be charged a Tolerance Price for the first 20 MWh of imbalance (rather than the Main Price). The Tolerance Price would be the Market Price adjusted to include a premium (plus 10 percent).

Alternative Modification P201 removes the restriction to Suppliers; in addition the Tolerance Band would be reduced to 10 MWh.

BSC PANEL'S RECOMMENDATIONS

Having considered and taken into due account the contents of the P201 draft Urgent Modification Report, the BSC Panel recommends:

- **that Proposed Modification P201 should not be made;**
- **that Alternative Modification P201 should not be made;**
- **an Implementation Date for the Proposed or Alternative Modification P201 of 2 November 2006 if an Authority decision is received on or before 7 September 2006, or 28 June 2007 if the Authority decision is received after 7 September 2006 but before 19th December 2006; and**
- **the proposed text for modifying the Code, as set out in the Modification Report.**

¹ ELEXON Ltd fulfils the role of the Balancing and Settlement Code Company ('BSCCo').

² The current version of the Code can be found at <http://www.elexon.co.uk/bscrelateddocs/BSC/default.aspx>

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SUMMARY OF IMPACTED PARTIES AND DOCUMENTS

As far as the Modification Group has been able to assess, the following parties/documents would be impacted by P201. Please note that this table represents a summary of the full impact assessment results contained in Appendix 3.

Parties	Sections of the BSC	Code Subsidiary Documents
Distribution System Operators <input type="checkbox"/>	A <input checked="" type="checkbox"/>	BSC Procedures <input checked="" type="checkbox"/>
Generators <input checked="" type="checkbox"/>	B <input type="checkbox"/>	Codes of Practice <input type="checkbox"/>
Interconnectors <input checked="" type="checkbox"/>	C <input type="checkbox"/>	BSC Service Descriptions <input checked="" type="checkbox"/>
Licence Exemptable Generators <input checked="" type="checkbox"/>	D <input type="checkbox"/>	Party Service Lines <input type="checkbox"/>
Non-Physical Traders <input checked="" type="checkbox"/>	E <input type="checkbox"/>	Data Catalogues <input checked="" type="checkbox"/>
Suppliers <input checked="" type="checkbox"/>	F <input type="checkbox"/>	Communication Requirements Documents <input type="checkbox"/>
Transmission Company <input checked="" type="checkbox"/>	G <input type="checkbox"/>	Reporting Catalogue <input checked="" type="checkbox"/>
Party Agents	H <input type="checkbox"/>	Core Industry Documents
Data Aggregators <input type="checkbox"/>	I <input type="checkbox"/>	Ancillary Services Agreement <input type="checkbox"/>
Data Collectors <input type="checkbox"/>	J <input type="checkbox"/>	British Grid Systems Agreement <input type="checkbox"/>
Meter Administrators <input type="checkbox"/>	K <input type="checkbox"/>	Data Transfer Services Agreement <input type="checkbox"/>
Meter Operator Agents <input type="checkbox"/>	L <input type="checkbox"/>	Distribution Codes <input type="checkbox"/>
ECVNA <input type="checkbox"/>	M <input type="checkbox"/>	Distribution Connection Agreements <input type="checkbox"/>
MVRNA <input type="checkbox"/>	N <input type="checkbox"/>	Distribution Use of System Agreements <input type="checkbox"/>
BSC Agents	O <input type="checkbox"/>	Grid Code <input type="checkbox"/>
SAA <input checked="" type="checkbox"/>	P <input type="checkbox"/>	Master Registration Agreement <input type="checkbox"/>
FAA <input type="checkbox"/>	Q <input type="checkbox"/>	Supplemental Agreements <input type="checkbox"/>
BMRA <input checked="" type="checkbox"/>	R <input type="checkbox"/>	Use of Interconnector Agreement <input type="checkbox"/>
ECVAA <input type="checkbox"/>	S <input type="checkbox"/>	BSCCo
CDCA <input type="checkbox"/>	T <input checked="" type="checkbox"/>	Internal Working Procedures <input checked="" type="checkbox"/>
TAA <input type="checkbox"/>	U <input type="checkbox"/>	BSC Panel/Panel Committees
CRA <input checked="" type="checkbox"/>	V <input checked="" type="checkbox"/>	Working Practices <input checked="" type="checkbox"/>
SVAA <input type="checkbox"/>	W <input type="checkbox"/>	Other
Teleswitch Agent <input type="checkbox"/>	X <input checked="" type="checkbox"/>	Market Index Data Provider <input type="checkbox"/>
BSC Auditor <input type="checkbox"/>		Market Index Definition Statement <input type="checkbox"/>
Profile Administrator <input type="checkbox"/>		System Operator-Transmission Owner Code <input type="checkbox"/>
Certification Agent <input type="checkbox"/>		Transmission Licence <input type="checkbox"/>
Other Agents		
Supplier Meter Registration Agent <input type="checkbox"/>		
Unmetered Supplies Operator <input type="checkbox"/>		
Data Transfer Service Provider <input type="checkbox"/>		

1 EXECUTIVE SUMMARY

The key conclusions of the P201 Modification Group ('the Group') taken into account by the Panel in formulating its recommendation contained in this report are outlined below.

The Group:

- **AGREED** that exposure to Imbalance Prices is a significant issue affecting Small Suppliers;
- **IDENTIFIED** a number of concerns regarding the introduction of the proposed Tolerance Band for Imbalance Prices;
- **CONSIDERED** analysis of the traded market and the effect of the proposed Tolerance Band on Imbalance Cashflows;
- **IDENTIFIED** an Alternative Modification which would remove the restriction to Suppliers and reduce the size of the Tolerance Band;
- **AGREED** reporting requirements and changes to the Non-Delivery rules to support P201;
- **IDENTIFIED** a workaround which could support implementation prior to the Winter 06/07 period;
- **AGREED** by **MAJORITY** that neither Proposed nor Alternative Modification P201 would better facilitate achievement of the Applicable BSC Objectives;
- **AGREED** a recommended Implementation Date for Proposed an Alternative Modification P201 of 2 November 2006 if an Authority decision is received on or before 7 September 2006, or 28 June 2007 if the Authority decision is received after 7 September 2006 but before 19th December 2006; and
- **AGREED** the Proposed text for modifying the Code.

A description of the P201 solution is provided in Section 2. A summary of the Group's views regarding the merits of the Proposed Modification and potential Alternative Modifications can be found in Section 3. Views of Panel members are provided in Section 6. A copy of the Group's full Terms of Reference can be found in Appendix 10.

2 DESCRIPTION OF MODIFICATION

This section outlines the solution for the Proposed Modification and Alternative Modification, as developed by the Group during the Modification Procedures.

2.1 Proposed Modification

P201 seeks to introduce a tolerance band for the application of Imbalance Charges to qualifying Supplier Consumption Energy Accounts. Where a Supplier was short³ on its Consumption Energy Account and the System was short, the Party would be charged a Tolerance Price for the first 20 MWh of imbalance (rather than the Main Price). The Tolerance Price would be the Market Price adjusted to include a premium (plus 10 percent). This approach is intended to provide relief against the Main Price, whilst retaining an incentive for Parties to contract ahead of Gate Closure for energy where it is available in the market.

Main Price: Under the current baseline, the Main Price is applied to imbalance positions in the same direction as the overall imbalance on the System (i.e. to short positions where the market was short and to long positions when the market was long). The Main Price is derived from the balancing actions taken by the Transmission Company in order to address the overall imbalance on the System. For example, where the overall System was short, System Buy Price (SBP) would be the Main Price and would be derived from the

³ The term short is used to refer to a negative imbalance volume on an Energy Account. For example, where a Supplier has contracted for insufficient energy to meet its Customers' demand or where a generator has not meet the level of output indicated by its contractual position.

buy actions (including Offers) taken by the System Operator. Conversely, where the overall System was long, System Sell Price (SSP) would be the Main Price and would be derived from the sell actions (including Bids) taken by the System Operator. The Main Price is intended to provide an incentive on Parties to contract ahead of Gate Closure to balance their own positions where it is more efficient to do so than rely on the System Operator as residual balancer.

Market Price: The Market Price is derived from trades undertaken on power exchanges utilising information provided by Market Index Data Providers (currently there is one provider, APX). The Market Price is intended to represent the price at which energy was being bought and sold in the market immediately prior to Gate Closure. Under the current baseline, the Market Price is applied to imbalances in the opposite direction to the overall imbalance on the System (i.e. to short positions where the market was long and to long positions when the market was short). The principle behind this approach is that Parties with imbalance positions in the opposite direction to the overall System imbalance are inadvertently reducing the balancing actions required by the System Operator. Therefore, Parties with imbalance positions in the opposite direction to the System should remain neutral to Imbalance Charges. The Market Price is considered neutral as it reflects the price at which the Party could have bought or sold energy via a power exchange prior to Gate Closure.

Tolerance Price: P201 would create a "Tolerance Price" equal to the Market Price adjusted to include a premium (plus 10 percent but capped to the Main Price). The Tolerance Price is intended to provide relief against the Main Price, whilst retaining an incentive for Parties to contract for energy available to them ahead of Gate Closure. Because the Tolerance Price would typically be lower than the Main Price, Parties would pay less for being short than they would under the Main Price. Since the Tolerance Price is higher than the Market Price, Parties would be financially better off purchasing energy available to them in the market prior to Gate Closure than relying on the imbalance mechanism. Therefore, an incentive to contract for energy ahead of Gate Closure would be retained.

Example: The following example illustrates how P201 would apply to a Party's Imbalance Charges:

Party Consumption Account Imbalance Position: IMBV = -25 MWh (i.e. consumed 25MWh more energy than contracted for)

The market was short, hence SBP is the Main Price = £35 / MWh

SSP = Reverse/Market Price = £25 / MWh

Tolerance Price = Market Price + 10% = £27.5 / MWh

Under the current baseline the Party would pay a charge on its Consumption Account of:

$$\text{IMBV} * \text{SBP} = \underline{\underline{\text{£875}}}$$

Under P201, the Party would pay a charge of on its Consumption Account of:

$$(\text{20MWh} * \text{Tolerance Price}) + (\text{5MWh} * \text{SBP}) = \underline{\underline{\text{£725}}}$$

If the Party had been able to cover its imbalance position ahead of Gate Closure at the Market Price it would have paid:

$$\text{IMBV} * \text{Market Price} = \underline{\underline{\text{£625}}}$$

In the example, imbalance charges under P201 are lower than they would be under the current baseline, illustrating how a level of relief is provided against the Main Price. However, the imbalance charges incurred are higher than the cost to the Party of covering its imbalance position purchasing energy within the market (i.e. at the Market Price) prior to Gate Closure were it available.

Scope

P201 is attempting to address the specific scenario whereby a Supplier is unable to purchase sufficient energy within the market to cover its position due to limited market liquidity. Hence, the Proposed Modification applies in limited circumstances. The Proposed Modification would apply as follows:

- A maximum of one qualifying Party would be allowed per Trading Party Group;
- The Trading Party Group must contain at least one registered Supplier;
- Where the Energy Account is a Consumption Energy Account;
- Where the Energy Account was short (i.e. Energy Account Imbalance Volume < 0) and the System was short overall (i.e. Net Imbalance Volume (NIV) > 0); and
- To the first 20 MWh of imbalance only.

The impact of P201 on imbalance charges is illustrated in the table below:

		System Net Imbalance Volume	
		Long	Short
Party Imbalance Position	Long	UNCHANGED Paid SSP (Main Price)	UNCHANGED Paid SSP (Market Price)
	Short	UNCHANGED Pay SBP (Market Price)	UNCHANGED All Production Accounts and Non-Supplier Consumption Accounts, Pay SBP (Main Price) <hr/> CHANGED <u>First 20MWh of Imbalance on Supplier Consumption Accounts, Pay Tolerance Price (Market Price +10%)</u> Remaining Imbalance Volume unchanged i.e. Pay SBP (Main Price)

Under P201, changes would be made to the Non-Delivery rules to ensure it would not possible to benefit via non-delivery of a Bid/Offer Acceptance relative to the current baseline. This would be achieved by removing a proportion of the imbalance charge benefit (i.e. the difference between the main imbalance price and the tolerance price) where non-delivered volumes had been identified. This would involve the introduction of an additional account level Non-Delivery Charge.

Under P201 the following reporting requirements would be introduced:

- BSCCo would maintain and report (via the BSC Website) a record of Trading Party Groups and nominated qualifying Parties;
- The Tolerance Price would not be published on the BMRA; however BSCCo would be required to publish the price as part of the "Best View" pricing data available via the BSC Website. The Tolerance Price would also be included in the Settlement Report (SAA-I014); and
- Tolerance and Non-Tolerance band imbalance charging would be differentiated within the Settlement Report (SAA-I014). The Settlement Report would also identify which Parties qualified for the Tolerance Band, the Tolerance Band Volume and the Tolerance Price Differential at a Settlement Period level.

2.2 Alternative Modification

The Alternative Modification would remove the restriction to Trading Party Groups containing Suppliers. In addition, the Tolerance Band would be reduced to 10MWh. Hence, the Alternative Modification would apply in the following circumstances:

- A maximum of one qualifying Party would be allowed per Trading Party Group;
- One of either the Consumption **OR** Production Energy Account of the qualifying Party could be nominated by the Party;
- Where the Energy Account was short (i.e. Energy Account Imbalance Volume < 0) and the System was short overall (i.e. Net Imbalance Volume (NIV) > 0); and
- To the first 10 MWh of imbalance only.

2.3 Interaction with P202

Modification Proposal P202 – “Energy Imbalance Incentive Band” (P202) seeks to address the same perceived defect as P201. P202 differs from P201 in that it expands the scope of the Tolerance Band to apply when both the market and the qualifying Party were long. P202 and P201 were considered in parallel, however the assessment of P202 is provided in a separate report.

3 AREAS RAISED BY THE TERMS OF REFERENCE

The following areas were considered by the Modification Group during the Urgent Modification Procedures for P201:

- Evidence of a Defect
 - Tools for an Imbalance Avoidance Strategy
 - Liquidity in Short-Term Traded Market
- Use of a Tolerance Band to mitigate the Defect:
 - Impact on Parties’ Incentive to Balance
 - Impact on System Operator Balancing Actions and Costs
 - Application across Parties
- Application of Proposed Tolerance Band:
 - Identification of Qualifying Parties
 - Size of Tolerance Band
 - Changes to the Tolerance Band
 - Tolerance Price
 - Credit Cover
 - Non-Delivery Charge
- Consequences of the Tolerance Band
 - Imbalance Cashflows
 - Liquidity of the Short Term Traded Market
- Relevant Previous Modifications
- Implementation Approach

These issues are considered in more detail in the remainder of this section.

3.1 Evidence of a Defect

The perceived defect identified by P201 centres on the view that small Suppliers face excessively high transaction costs in their imbalance avoidance strategies compared to large and/or vertically integrated Suppliers.

3.1.1 The Various Tools of an Imbalance Avoidance Strategy

All Suppliers have a number of options to adjust their position in order to balance their portfolio and meet their customer's demand. If they are to some degree vertically integrated, they can deploy their own-generation. Alternatively, they can strike a bilateral contract with one or more Generators. In addition, they can trade on the power exchange; these offer a range of products from a single half hour through to weekly products on 'Spot' or 'Prompt' Markets, which relate to immediate or near immediate delivery, through to products for months, quarters and seasons on 'Forwards' Markets. If Suppliers are unable or unwilling to deploy these options to balance, the System Operator will balance on their behalf. As a result, Suppliers will face Imbalance Charges which are related to the prices of those actions which the System Operator has taken in order to balance energy on the System.

P201 centres on the argument that small Suppliers are, effectively, unable to access the full range of options detailed above. Typically, they do not have own-generation to deploy as part of an imbalance strategy and face difficulties contracting with generators for the small volumes that such Suppliers require. Accordingly, small Suppliers are particularly reliant on Spot Markets where prices tend to be higher and more variable than those associated with deploying own-generation or entering bilateral contracts, and also tend towards Imbalance Prices.

The Proposer noted that the ability of a small Party to trade is determined by the products available in the market. Larger players have access to a wider range of products including their own generation, but also the options⁴ market. The options market is not available to smaller players as standard lot size is 50MW with the occasional trade being 25MW.

3.1.2 Degree of Liquidity in the Spot Market

P201 asserts that there are also a number of specific problems facing small Suppliers in utilising the Spot Market option effectively. First, the minimum quantity of electricity offered on the Spot Market for a particular period is often greater than the Supplier's total requirements; that is, there is insufficient 'granularity' in the traded market. Second, at times, there are simply no trades offered on the traded market that the Supplier can take advantage of. At other times, the trades which are available are prohibitively expensive, or that products are not available which match the profile of electricity required over a period ('shape' products). The Proposer argued that liquidity often dries up completely at times of system stress (when Imbalance Prices are at their highest), which means that it is impossible for a small Supplier to balance its position in the traded market. In these circumstances, the traded market is said to be illiquid.

The application of the Tolerance Band seeks to lower the charge associated with the first 20MWh of Imbalance, in circumstances where the System is short and the Supplier is short, to reflect the fact that it is not possible for a small Supplier to purchase energy to trade out of that imbalance position (at economic cost).

Overall, the Proposer argues that, because larger companies often have larger volumes to trade, and can deploy their own generation, issues of liquidity on the Spot Market mean that small Suppliers are exposed to Imbalance Prices to a greater extent. The Proposer stressed that it was the relative cost of access to the various tools faced by small Suppliers that made such tools uneconomic and so effectively unavailable.

⁴ An option is the right, but not the obligation, to buy (for a call option) or sell (for a put option) a specific amount of a given stock, commodity, currency, index, or debt, at a specified price (the strike price) during a specified period of time.

The Group did acknowledge that small Suppliers would not be likely to have access to own-generation. However, some Group members identified that small Suppliers do not have to rely on traded markets and could instead enter bilateral contracts with Generators. They did acknowledge that this option could be more costly, but that this could be caused by the credit position of small players, and the market's perception of the differing risks of dealing with differing players, rather than representing unwillingness on the part of Generators to contract for small volumes.

The Group expressed mixed views regarding evidence of a defect with respect to market liquidity on the short-term traded market. Some members of the Group pointed to evidence that products are offered in small lot sizes. The Group noted that the minimum trade lot is 1MW on the APX markets and one Group member estimated that 30% of trades on that market were less than 5MW, and 40% of trades were in the 1-20MW range. In addition, doubt was expressed that at times of system stress liquidity does dry up completely. Evidence was also cited that shape products were also available on the traded market.

Some members of the Group agreed that whilst there was some evidence of there being a defect in the market with respect to the viability of small Suppliers, it was not related to liquidity of the traded market. However, the Group did conclude that further analysis was required before they could reach a definite conclusion on whether very small volumes could be traded reliably, economically and under conditions of market stress (see Section 3.1.3). Some members of the Group felt that the results of this analysis should also inform the design of any Tolerance Band.

3.1.3 Analysis of Trading in the Spot Market

Appendix 4 provides data illustrating the volumes traded through the APX Power Exchange for a range of Settlement Periods. There were mixed views amongst the Group regarding the conclusions which would be drawn from the results. Some Group members concluded that the analysis showed that there were small volumes available to be traded for the periods in question and that such volumes were traded, down to levels of 1MW. Moreover, whilst in some cases the prices of the offers remaining at the end of the period were higher than the resulting Imbalance Price; in other cases they were somewhat lower, suggesting that evidence existed to demonstrate liquidity at competitive prices.

Other Group members felt that it was not possible to form any general conclusions from the analysis with respect to market liquidity in the Spot Market for a number of reasons. First, the analysis does not show a complete picture of the trend in the price of each offer over the entire period it was available; it is possible therefore that the prices were very high for much of the time they were available and only lowered immediately prior to the relevant period. Moreover, the Spot Market prices reported are significantly higher than the Market Index Price, suggesting that whilst the market may be liquid it is not liquid at competitive prices. Therefore, it is not possible to claim that the offers which were available on the Spot Market were of a 'reasonable' price. Second, the concerns of the Proposer relate particularly to times of System stress, and in their view, although the periods considered included peak SBP and SSP as well as extreme Net Imbalance Volumes, many of the periods considered in the initial analysis did not cover periods of System stress. Finally, the analysis showed that a large part of the matching of trades was undertaken in the final minutes before the relevant period, which would not suggest liquidity in the market in general. One member of the Group disagreed with this latter point, and pointed to a number of trades which had been matched 4-8 hours prior to the relevant period. In addition, some Group members raised the point that different parties would have differing interpretations of whether an offer price was reasonable.

The Group agreed that further analysis should be undertaken which would contain a greater number of sample periods when the System was under stress; in addition, a view of the trend of offer prices over the period they were made available would be included (this data is also included in Appendix 4). The Proposer re-iterated their view that analysis of historic data would not provide a full picture and that consideration of a number of carefully constructed scenarios which could be considered likely as a result of the implementation of the P194 baseline should be considered when assessing the likely impact on small suppliers (see Appendix 6).

This led many Group members to conclude that costs and risks were high for small Suppliers, and possibly relatively high compared to large, particularly vertically integrated Suppliers. There was some discussion whether Suppliers were leaving the market due to high market prices rather than high imbalance prices. This led to a further discussion regarding whether the barriers to the entry of small Suppliers into the market are too high, and whether the market is unhealthy.

Some Group members questioned whether the defect identified in the proposals is a market defect rather than a BSC defect. However, a number of members of the Group argued that because the BSC affects the competitive market the defect could be considered to be a BSC defect.

3.1.4 Modification Group's Conclusion

The Modification Group agreed that there was evidence of there being an issue in the market with respect to the viability of small Suppliers. However, the majority of Modification Group members were of the view that the issue is a market defect rather than a BSC defect. A number of Modification Group members also questioned whether the perceived issue relating to the ability to trade small volumes was supported by the analysis indicating that energy can be traded in volumes of 0.5 MWh via the APX Power Exchange.

3.2 Use of a Tolerance Band to Mitigate the Defect

The Group considered the appropriateness of introducing a Tolerance Band to address the perceived defect.

3.2.1 Incentive to Balance

Concern was expressed that use of a Tolerance Band would not be consistent with the fundamental principle of the Balancing Mechanism that the costs of balancing should be reflected on participants with imbalance positions. This principle aims to ensure that imbalance prices reflect the costs of rectifying imbalance, such that market participants are able to respond to the economic signals they provide. The Proposer agreed that the very intention of the Tolerance Band would be to provide some protection from Imbalance Prices, but only for a limited volume of imbalance, in order to address the fact that small Suppliers are, by their nature, unable to access the full range of tools available to larger Suppliers in managing their imbalance strategy.

Related to this, the Group identified a number of possible consequences of the introduction of a Tolerance Band with respect to Suppliers' attitudes towards balancing. The Proposer argued that the incentive to balance would be retained because the Tolerance Price paid for imbalances within the Tolerance Band would be greater than the Market Price, which would be the price that could be achieved if attempts were made to trade out imbalances. Suppliers would, therefore, be likely to continue to trade out their imbalances. In addition, some Group members held the view that large Suppliers would be unaffected by the Tolerance Band due to its relatively small size; again, they would continue to attempt to balance.

However, other members of the Group held the view that any reduction in Imbalance Charges would inevitably reduce the incentive for Suppliers to balance by some degree. They acknowledged that an incentive to balance would remain for the 20MWh band, but concluded that this would be a weaker incentive than exists at present. Moreover, summing the Tolerance Band volume for all Suppliers would represent a significant proportion of total imbalance volume which would weaken the incentive to balance for a large proportion of the total imbalance volume. In addition, for an individual Supplier, some members of the Group considered the proposed 20MWh band to be significant for an individual, even large, Supplier and that this may have some impact on the imbalance strategy of the larger Suppliers. Indeed a number of Group members felt certain that this would happen, potentially causing imbalances to drift towards the Tolerance Band volume.

Some Group members acknowledged that the size of the premium on top of the Market Price may be a determining factor in whether the remaining incentive would be an appropriate incentive for Suppliers to continue to invest time and resources to balancing in the same way as at present. The Group speculated as to whether the proposed 10% would be sufficient, particularly when actions to continue to trade out

imbalances have cost implications, which could be reduced to some degree should Suppliers be content to accept the Tolerance Price. It was agreed, however, that there was no means of determining actual Supplier behaviour ex ante.

Views of Respondents to Urgent Modification Consultation

Q	Consultation question	Yes	No
1.	Do you believe P201 will influence participants behaviour (if yes state how)?	12	3

Those participants expressing the view that P201 would influence participant behaviour raised the following points:

- By reducing the cost of imbalance, P201 would affect risk management actions and reduce the effort made by participants to balance their positions. Larger imbalances will be tolerated by Suppliers and overall imbalance volume would increase;
- By reducing the cost of imbalance within the Tolerance Band, participants would become less active in trading to avoid imbalance exposure, reducing liquidity in short-term traded markets and reducing the availability of products below the tolerance band level;
- P201 would lead to re-structuring of businesses and increase entry of small, unaffiliated supply businesses due to the competitive advantage provided by the Tolerance Band;
- Since P201 applies only on the buy side, participants would over-contract to a lesser extent (i.e. P201 would reduce tendency to go 'long'); and
- By providing some relief from imbalance charges for small imbalance volumes the risk of imbalance would be reduced, this would lead to greater liquidity as the risks of not being able to trade out a position precisely are reduced.

Those participants expressing the view that P201 will not influence participant behaviour believed participants would still be incentivised to avoid imbalance exposure due to the 10% differential from the market price. Hence, Parties would continue to make the same efforts to avoid imbalance exposure and there would be no-overall impact on behaviour.

The Groups' conclusions can be found in Section 3.2.4.

3.2.2 System Operator Balancing Actions and Costs

The Group identified that any change to the incentive on Suppliers to balance their positions which led to a change in the behaviour of Parties would have an impact on the frequency and cost of the Balancing Actions which the System Operator will be required to undertake, all other things equal. Specifically, if the incentive to balance becomes weaker the System Operator would be likely to increase the volume of Balancing Actions undertaken, the cost of which would be recovered from all Parties via Balancing Services Use of System Charges (BSUoS).

The Modification Group noted that the Transmission Company analysis (Appendix 3) indicated the nature and estimated the likely magnitude of any impact on System Operator costs. It was considered that potential System Operator costs incurred by P201 will fall into two categories, extra reserve and extra energy balancing costs to resolve additional imbalance in real time. Rough estimates, based on a number of broad assumptions, were provided in the Transmission Company analysis.

3.2.3 Consistent Application of the Tolerance Band

There was some discussion as to whether P201 positively discriminated in favour of small Suppliers, which would suggest cross-subsidisation. The Proposer confirmed that under P201, all Suppliers would benefit from

the application of the Tolerance Band and expressed the view there would be no discrimination as all Suppliers would face lower Imbalance Charges.

The Group discussed whether P201 could be considered discriminatory because it would apply to Suppliers only. The Group noted that if Generators, having contracted to supply, are unable to generate then they will have to adjust their positions in the same way as Suppliers do. The Group considered, therefore, whether it would be appropriate, and feasible, to apply P201 to Generators and Traders in addition to Suppliers.

The Proposer explained that there was never any intention to discriminate against Generators and Traders and the proposals were focused on Suppliers because the Proposer is a Supplier. Moreover, the Proposer felt that differences between the Licensing regime for Suppliers and Generators, in particular the fact that small generators can choose whether to accede to the Code whereas Suppliers cannot, meant that small Generators are effectively able to choose whether to expose themselves to the Balancing Mechanism, whereas Suppliers cannot.

One Modification Group member suggested that the fact small Generators do not have to accede to the Code does not mean they are sheltered from imbalance exposure. Small Generators have to contract their output with a Party which is acceded to the Code; this Party will be exposed to any imbalance risk associated with the small Generator and will factor this into its contract with the small Generator. Effectively this means small Generators are still exposed to the effects of imbalance charges. This Modification Group member suggested the fact small Generators are not required to accede to the Code is not sufficient to justify restricting the tolerance band to Suppliers.

Another Modification Group member indicated that the restriction to Suppliers could not be justified if considered in the context of a Supplier which allocated its volumes through a pure Trading Party. The Trading Party would be exposed to the imbalance risk of the Supplier, whilst a similar Supplier which did not function via a Trading Party would be protected by the Tolerance Band.

Overall the majority of the Group agreed that a restriction to Suppliers was a negative aspect of the proposal and considered that a potential Alternative Modification applying the Tolerance Band to all Parties should be considered (see Section 3.5).

3.2.4 Conclusions – Use of a Tolerance band to address the Defect

The majority of Group members did not support the principle of the Tolerance Band, considering it would reduce the incentive to balance. In addition, the majority of Group members were of the view that a Tolerance Band would deviate from the principle that imbalance charges reflect costs incurred by the Transmission Company to address the overall System imbalance. The minority of Modification Group members considered that the 10% uplift in the Tolerance Price relative to the Market Price would be sufficient to insure participants would avoid imbalance exposure wherever possible, whilst recognising that there are limits on the extent to which any Party (and particularly a Supplier) can balance its position.

The Group concluded that there were a number of drawbacks with respect to the proposed Tolerance Band mechanism and speculated about whether an alternative mechanism could be formulated to meet the concerns identified by the Proposer. Whilst no alternative mechanism within the scope of P201 was identified, it was agreed that revision of the qualification rules and changes to the tolerance band should be considered as part of any Alternative Modification (see Section 3.5).

3.3 Application of Proposed Tolerance Band

The principle elements of the proposed Tolerance Band mechanism include defined qualification criteria, a Tolerance Band threshold volume and application of an uplift on the market price to retain the incentive to balance. The Modification Group discussed these elements of the proposal as set out in the remainder of section 3.3.

3.3.1 Identification of Qualifying Parties

The Group recognised that it would be important to consider carefully the qualification criteria for application of the Tolerance Band. It was identified that there exists potential for all Suppliers to take advantage of P201 to avoid imbalance charges by structuring their businesses into a sufficient number of small businesses to take advantage of the application of multiple tolerance bands. Notwithstanding this, the Group felt that it was important to protect a company's right to structure its business legitimately into a number of discrete businesses. Therefore, it would not be feasible to insist that only a single supply business should be formed for each set of related Suppliers.

The Group agreed that a company group concept should be developed, and that all related companies would be allocated to a single Company Group, which would be able to nominate only one qualifying consumption Energy Account to which the Tolerance Band would be applied. This prompted some discussion regarding the appropriate definition of a Company Group and the Group suggested that the definition of 'Trading Party Group' which is employed to group BSC Parties for the purposes of allocating votes in BSC Panel elections could be used. The BSC states that a Trading Party Group is a group comprised of a Trading Party and every Affiliate of that Trading Party. The BSC defines "Affiliate" as: any holding company of that Party, any subsidiary of that Party or any subsidiary of a holding company of that Party, (within the meaning of sections 736, 736A and 736B of the Companies Act 1985).

There was some discussion regarding whether to apply the qualification criteria automatically within central systems or implement a registration process. Some Group members favoured an automated process where possible as this would be more robust, and there was recognition that a registration process may prove difficult to monitor. It was acknowledged, however, that there is no relationship within central systems between Parties and their Company Group at present, and to incorporate one would be likely to be expensive. It was agreed that further consideration should be given to whether these requirements could be incorporated into existing registration processes. In any event, the Group agreed that it would be important to ensure that Suppliers were able to determine to which of the Consumption Energy Accounts within its portfolio the Tolerance Band would apply. Therefore, it was agreed that a registration process would be required to support the allocation of the Tolerance Band within a Trading Party Group.

During discussion of data analysis to determine the impact of the Tolerance Band on Imbalance Cashflows it emerged that some Suppliers allocate their metered energy volumes to the Consumption Energy Account of a Trading Party ID rather than their Supplier Party ID. Therefore, it was agreed by the Group that the Supplier should be permitted to nominate a non-Supplier consumption energy account for application of the tolerance band providing that there is at least one Supplier within that Trading Party Group.

Having considered the qualification criteria at length the Group agreed the following rules would apply under Proposed Modification P201:

- The Tolerance Band would apply to a maximum of one Party within a group of related companies;
- A group of related companies would be defined using the BSC definition of Trading Party Group, which is a group comprising a Trading Party and every Affiliate of that Trading Party, where that Affiliate is defined as any Holding Company or Subsidiary of that Party or any Subsidiary of a Holding Company of that Party;
- The Trading Party Group must contain at least one registered Supplier; and
- The Tolerance Band would be applied to the Consumption Energy Account of any one of the Parties within the Trading Party Group (as nominated by the parent company).

Views of Respondents to Urgent Modification Consultation

Consultation question	Yes	No
Do you agree with the qualification criteria agreed by the Modification Group?	10	4

The main points raised by those respondents not in support of the qualification criteria agreed by the Group were:

- Despite limiting the allocation within groups of affiliated companies, the proposed qualification rules will not prevent creation of new, unaffiliated but related supply companies to take advantage of the Tolerance Band;
- Every Party should be eligible, the Code should not be concerned with how companies legitimately structure their businesses; and
- Comments relevant to the criteria under the potential Alternative Modifications were also raised as considered in Section 3.5

Having considered the consultation responses, the Modification Group agreed that the qualification rules provided an appropriate mechanism to restrict allocation to Suppliers as required by the Proposed Modification, whilst reducing the potential for manipulation by limiting the allocation within groups of affiliated companies. Some members of the Group retained concern that P201 would lead to the creation of multiple small Supply businesses, set up to take advantage of the tolerance band. However it was acknowledged that this could not be addressed via the P201 solution since it was inherent in the introduction of a tolerance band and could not be prevented via a Code requirement.

3.3.2 Size of Tolerance Band

It was noted by the Modification Group that the 20MWh formed part of the Proposed Modification and any variation to this size could only be progressed as part of an Alternative Modification.

The Proposer stated that the choice of 20MWh for the Tolerance Band was based on a number of factors. First, to provide some equality with the treatment of small Generators (i.e. a capacity of less than 50MW) who can choose whether to participate or not to participate in the BSC. In addition, experience has shown that it is a level below which small Suppliers have found it impossible to obtain bilateral contracts for generation in longer term markets. Finally, the Proposer considers that it is a level below which it is not possible to obtain trades on the market at times of System stress.

There was some discussion about the criteria which should be used to set an appropriate level for the Tolerance Band. Some Group members felt that the availability of trades on the Spot Market should be used to set the Tolerance Band. As detailed in Section 3.2, some Group members felt that there was considerable evidence to show that trades were available in much smaller lots than this, which would suggest that a lower figure be more appropriate, potentially 1 MWh or 5MWh. Other Group members, who believed that the Tolerance Band would reduce the incentive on Suppliers to balance which would change Supplier behaviour, agreed with the view that the Tolerance Band should be a smaller amount because it would minimise the degree to which the System Operator would be required to take additional balancing actions.

In addition, some members of the Group identified that if the Tolerance Band reflected virtually all the volume supplied by a Supplier this could effectively reduce any incentive on the small Supplier to balance, which would be undesirable. They considered, therefore, that analysis was required regarding the size of Suppliers and their portfolios, and this should be considered as a factor in determining the appropriate size of any Tolerance Band (see Annex 5).

Another Group member suggested that given that the Tolerance Band was being proposed as a mechanism to compensate for the fact that small Suppliers did not have access to the full range of options to balance their position which are available to larger Suppliers, it should be related to the average imbalance volume of

small Suppliers. Following a similar argument, another Group member proposed that the Tolerance Band be set at a level above which Suppliers would be able to access the full range of tools to balance their positions.

Another Group member suggested that in order to preserve a sharp incentive to balance, it may be more appropriate to implement the Tolerance Band only where the total imbalance volume was less than or equal to the band. This would mean that any Party with imbalances over 20MWh - or whatever the band turned out to be, would be charged the full imbalance price on the entire volume.

Given the wide ranging debate and views of the group on this issue, the Group agreed that industry views should be canvassed regarding the appropriate level of the Tolerance Band.

Views of Respondents to Urgent Modification Consultation

Consultation question	Yes	No
Do you believe the proposed Tolerance Band of 20MWh is appropriate?	7	8

Those respondents in support of the proposed 20MWh Tolerance Band expressed the following arguments:

- A 20 MWh volume would be aligned with the granularity of long-term contracts available to small Suppliers;
- The proposed volume is broadly aligned with the threshold at which small Generators are required to accede to the Code;
- The volume is consistent with the granularity of short-term trades available at time of System stress; and
- The proposed 20 MWh Tolerance Band is aligned with the volatility of Supplier demand due to weather conditions and hence the accuracy to which a Supplier can reasonably balance its position.

Those respondents not in support of the proposed 20MWh Tolerance Band expressed the following arguments:

- Justification for the Tolerance Band should be based on the volume of energy available in the short term markets. Data from the APX power exchange indicated that energy can be purchased in units of 0.5 MWh. Hence, 20MWh is too large since it significantly exceeds the granularity of available trades on short-term market;
- The 20MWh figure is arbitrary and no analysis had been provided to justify it;
- Average imbalance volumes are lower than 20MWh for small Suppliers, therefore the volume should be smaller; and
- A flat MWh figure discriminates in favour of small Suppliers and the threshold should be based on a percentage.

Having considered the consultation responses, the availability of trades on the APX Power Exchange (Appendix 4) and analysis of qualifying volumes (Appendix 5), the majority of the Modification Group Members were of the view that a Tolerance Band of 20MWh was too large. It was considered by several Group members that a figure of more than 0.5MWh could not be justified given the granularity of trades available in the spot market. Some members of the Group were also concerned that the overall volume of imbalance potentially qualifying under a 20MWh tolerance band would be a significant proportion of the total imbalance on the System. The minority of Modification Group members considered that a 20MWh Tolerance Band was justified based on the typical range of products available to small Suppliers. These Group members also considered that the overall volumes exposed to the Tolerance Band was not a significant issue since Parties would still be encouraged to minimise imbalance exposure via the 10% differential relative to the market price. The Group discussed possible different Tolerance Band values to be progressed under an Alternative Modification as set out in Section 3.5.1.

3.3.3 Changes to the Tolerance Band

The Group discussed the means by which the Tolerance Band would be implemented within the baseline; specifically, whether it should be hard wired into the Code as a fixed parameter which could only be changed by a further Modification, or whether it should be subject to a periodic review. The Group noted that it would be simpler to stipulate the value in the Code and, also, that it would be subject to a high degree of scrutiny. The Group weighed this up against the view that enshrining the value in the BSC would imply a lengthy and difficult process should the value of the Tolerance Band need to change. It was felt that a change might be required in accordance with experience of application of the Tolerance Band. The Group agreed that a review process would be more appropriate. Under the proposed process, the size of the Tolerance Band could be subject to regular review and, if necessary, changes would be proposed by the BSC Panel, subject to approval by the Authority.

3.3.4 Tolerance Price

The Proposer chose to define the Tolerance Price as a 10% premium on the Market Price as a means of relating the Tolerance Price to the Market Price but adding what was considered to be a sufficient uplift to retain an incentive on Suppliers to balance their positions. The Proposer acknowledged that the chosen figure had not been made on the basis of a detailed cost assessment and that they were content for the Group to propose an alternative uplift figure if this was considered to be more appropriate.

The Group reinforced the need for an appropriate premium price in order to retain the incentive to balance. The Group discussed the reasoning behind the premium value of 10%; some members of the Group felt that the premium should be substantially higher than the 10% in order to ensure that the incentive to balance was maintained. Some Group members speculated that there could be significant resource and time savings to be had by not trading out an imbalance position, which could make it worthwhile paying the 10% premium. This would effectively reduce the premium by the value of these savings. The Proposer argued that any incentive above the Market Price would ensure that Suppliers maintained their efforts to balance and that if the premium were significantly higher than Market Price, it would not provide the protection to small Suppliers that the proposal intended. Other members of the Group felt that without a higher premium the behaviour of larger Suppliers would change in response to the reduced incentive to balance.

There are some combinations of circumstances, however, when the principle of relating the Tolerance Price to Market Price can not apply. One example is the case when there is no short term Spot Market. That is, when the volume of trades on the Spot Market is less than 25 MWh (i.e. where there is no market data and the reverse/market price defaults to the main price). There was some discussion about what should apply in such circumstances. Some Group members suggested that the Tolerance Price should default to the Main Price, which would mean that in these circumstances Suppliers would not benefit from reduced exposure to Imbalance Prices. Another suggestion was that some form of discount to the Main Price would be appropriate, for example, a percentage discount. The Group noted that where no market data is available, there would be no spread between SSP and SBP. Accordingly, the Group agreed that it would be appropriate for the Tolerance Price to default to the Main Price in this circumstance.

The Group discussed whether a different approach to the calculation of the Tolerance Price might be more appropriate. For example, one member suggested the possibility of using a £/MW rate applied relative to Market Price, rather than the 10% premium. Some Group members considered, however, that re-stating the value of the Tolerance Band and considering different approaches to the calculation of the Tolerance Price would make little difference to their view of the appropriateness of a Tolerance Band. This view is based on a view that, at its heart, the principle of the Tolerance Band is inconsistent with the principle of allocating the costs of balancing to those out of balance. Therefore, for these Group members, it is the principle of applying a Tolerance Band, rather than the detail of its calculation to which they object.

The Group agreed that the 10% differential relative to the Market Price should be subject to a review process whereby, changes could be proposed by the BSC Panel if necessary and subject to approval by the Authority.

Views of Respondents to Urgent Modification Consultation

Consultation question	Yes	No
Do you believe the Tolerance Price based on the Market price with a premium of 10% is appropriate?	7	8

Those respondents in support of the proposed Tolerance Price expressed the following arguments:

- The 10% differential relative to the market price will preserve the incentive to balance;
- The proposed approach strikes an appropriate balance between maintaining an incentive to balance and addressing the perceived defect; and
- The 10% is significantly greater than the transaction costs of trading out an imbalance position; hence it is sufficient to maintain the incentive to balance where it is possible to do so.

Those respondents not in support of the proposed Tolerance Price expressed the following arguments:

- No premium should be applied and the Tolerance Price should be the market price;
- The 10% differential relative to the market price is an arbitrary figure not based on analysis;
- 10% is insufficient to preserve an incentive to balance;
- Only the main imbalance price provides an appropriate incentive to balance; and
- The differential is not sufficient to offset the costs which would be saved due to not trading.

The majority of Modification Group members did not support the principle of a Tolerance Price since it would not be reflective of the costs incurred by the System Operator to balance the System. It was also noted that the 10% uplift on the Market Price was an arbitrary figure. However, it was recognised that the proposed approach provided a solution to the perceived defect by providing relief against the main imbalance price which retaining an, all be it reduced, incentive to avoid imbalance exposure where possible. Hence, alternative approaches to the derivation of the Tolerance Price were not considered further.

3.3.5 Credit Cover

The Group discussed whether there would be any changes to the levels of Credit Cover required by Suppliers. Although P201 potentially impacts liabilities of Parties under the BSC, no changes to the Credit Cover arrangements are proposed. Actual Energy Indebtedness, based on Trading Charges, would reflect the P201 Trading Charges without any revision of the current rules (since Interim Information Run imbalance charges, used to calculate Actual Energy Indebtedness, would utilise the new Tolerance Price). The Group considered that, because this would be an automatic adjustment there would be no changes required.

3.3.6 Non-Delivery Charge

The Group discussed the possibility that the application of the proposed Tolerance Band may require a change to the calculation of Non-Delivery Charges. The Group identified that in certain circumstances, if P201 were implemented without a change to Non-Delivery Charges, a Party could profit by non-delivery to a greater extent than is possible at present. This occurs since imbalance exposure in the Tolerance Band may be lower than that assumed in the non-delivery calculation (since the Non-Delivery calculation assumes imbalance exposure at either SBP or SSP, whereas the Party may actually be exposed to the Tolerance Price).

The Group recognised that currently the Supply side does not tend to deliver Bids or Offers; therefore it was suggested that it would not be necessary to amend the Non-Delivery rules under the Proposed Modification.

However, it was agreed that a change to the Non-Delivery Charges should be considered further for the potential Alternative Modification which extended application of the Tolerance Band to Production Energy Accounts. Further analysis was conducted and considered by the Group as set out in Appendix 7.

On consideration of the consultation responses, analysis of the Non-Delivery rules under P201 and the results of impact assessment, the Modification Group agreed that changes should be made to the Non-Delivery rules under both the Proposed and Alternative Modifications.

The Group agreed an approach which would attempt to identify the volume by which a Party benefits within the Tolerance Band as a consequence of non-delivery and remove any benefit from the differential between the Main Price and Tolerance Price for this volume (see Approach 2 in Appendix 7). The P201 Non-Delivery rules will ensure that it is not possible to benefit via non-delivery of a Bid/Offer Acceptance relative to the current baseline. This would be achieved by removing a proportion of the imbalance charge benefit (i.e. the difference between the Main Price and the Tolerance Price) via the introduction of an additional account level Non-Delivery Charge. It was recognised that, in some cases the proposed approach would result in an over recovery, such that participants will be at a net disadvantage from Non-Delivery. However, any overcharge will be limited to the imbalance charge benefit provided to the Party via the Tolerance Band. As such, a Party would never be in a worse position overall than under the current baseline. Recognising that over and under recovery can occur under the existing non-delivery rules, the Group agreed that the proposed rules would provide a suitable mechanism to ensure that there is no increased incentive not to deliver an accepted Bid/ Offer under P201. Full details of the P201 Non-Delivery rules are included in Appendix 7.

3.3.7 Reporting Requirements

The Modification Group considered reporting requirements under P201 and agreed that the following requirements should be introduced:

- BSCCo would maintain and report (via the BSC Website) a record of Trading Party Groups and nominated qualifying Parties;
- The Tolerance Price would not be published on the BMRA; however BSCCo would be required to publish the price as part of the "Best View" pricing data available via the BSC Website. The Tolerance Price would also be included in the Settlement Report (SAA-I014); and
- Tolerance and Non-Tolerance Band imbalance charging would be differentiated within the Settlement Report (SAA-I014). The Settlement Report would also identify which Parties qualified for the Tolerance Band, the Tolerance Band Volume and the Tolerance Price Differential at a Settlement Period level.

Consideration was given to whether an indicative Tolerance Price should be reported on the BMRS and the Modification Group agreed that it would not be necessary to provide Tolerance Price information via the BMRS. Whilst it was acknowledged that the majority of respondents to the industry consultation and impact assessment had suggested that information should be made available via the BMRS, it was recognised that the Tolerance Price could be simply derived from existing information on the BMRS (i.e. it is a fixed multiple of the indicative Reverse Price). It was also noted that including this requirement would increase the implementation costs by approximately £55k.

Consideration was also given to whether Trading Party Groupings should be reported by the CRA. However, it was recognised that this information would ultimately be maintained by BSCCo and, given that the information would be unlikely to change regularly, it would be more cost efficient for BSCCo to publish this information via the BSC Website.

3.4 Consequences of the Tolerance Band

The Modification Group considered the potential impact of the Tolerance Band in terms of imbalance cashflows and market liquidity.

3.4.1 Imbalance Cashflows

The aim of the Tolerance Band is to reduce the Imbalance Charge of the qualifying Parties for a specific volume of imbalance. The Group discussed the degree to which the Tolerance Band would materially affect imbalance cashflows of individual Parties in order to determine the degree to which the P201 would correct the alleged defect. It was agreed that analysis using actual Party data should be undertaken to investigate this issue.

It was recognised that the total benefit to all Parties of the application of the Tolerance Band (i.e. the difference between the Imbalance Charges under the Tolerance Band and what they would have been without the Tolerance Band in place) would be recovered from all Parties through the Residual Cashflow Reallocation Cashflow (RCRC). The Group identified that there was a need for some analysis to determine the likely impact on RCRC of the introduction of the proposed Tolerance Band.

Two types of analysis were undertaken and are contained in Appendix 5 and Appendix 6. Appendix 5 represents an analysis of the impact on participant cash flow and volume of imbalance affected by the Tolerance Band for selected historic Settlement Periods. Appendix 6 illustrates the effect on different sizes of Supplier in a constructed scenario which illustrates a number of circumstances which may be likely over the Winter Period.

Some members of the Group commented that the analysis showed that large Suppliers would benefit significantly from the application of the Tolerance Band. It was also noted that of the total imbalance volume benefiting from the application of the Tolerance Price, a significant majority was accounted for by the imbalance volumes of the large Suppliers. In light of concern from some Group members regarding the overall level of imbalance within the Tolerance Band, there was discussion regarding limiting the proposals to "small" Suppliers (see Section 3.5)

In addition, the Group agreed that the analysis, by expressing the impact on cashflows as £/MWh supplied, showed that the cash flow of small Suppliers would be particularly affected by P194 and the application of a Tolerance Band. Moreover, the analysis showed that there were large differences between large and small Suppliers with respect to the cost/MWh supplied. One Group member re-iterated that this type of scenario was not unlikely, and that a similar effect on Suppliers' cashflows would apply equally when the market was long.

3.4.2 Liquidity of Spot Market

The Group speculated whether P201 would increase or decrease the liquidity of the market, and granularity of the products, or whether it would have no impact. Some members of the Group held the view that liquidity would decrease as there would be little need to develop products at a level of granularity smaller than the Tolerance Band. However, some members of the Group disagreed with this, arguing that liquidity should be maintained because Suppliers would continue to be incentivised to balance their position by the Tolerance Price representing an uplift on the Market Price.

3.5 Development of the Alternative Modification

The Group identified two distinct potential Alternative Modifications which it agreed would benefit from further consideration regarding whether they better achieve the Applicable BSC Objectives than the Proposed Modification. Analysis illustrating which Parties would be likely to qualify under each of the potential Alternative Modifications and the impact on settlement cash-flows over a range of sample Settlement Periods is provided in Appendix 5.

Option 1: Restrict Qualification to “small” Suppliers

This potential Alternative Modification would apply the Tolerance Band in precisely the same format as Proposed Modification P201 but it would apply to ‘small’ Suppliers only.

The rationale behind this potential Alternative Modification was based on the various factors comprising the perceived defect that small Suppliers do not have access to the full range of tools available to large Suppliers (that is, own-generation and the ability to enter into bi-lateral contracts with generators for their required volumes). Accordingly, small Suppliers face relatively high transaction costs in their imbalance avoidance strategies compared with larger Suppliers. The Tolerance Band can be seen, therefore, as a means of offsetting these proportionally higher transaction costs, which are faced by small Suppliers only.

The Group discussed the appropriate definition of ‘small’ Supplier at some length. It was agreed that an appropriate and workable definition would be one related to volume supplied and market share. The Group also recognised that it may be possible for some Suppliers to operate around the threshold of the definition and that an automatic means of determining qualification would be a simpler and more objective approach than a regular assessment of the market. The Group agreed, therefore, that for the purposes of this potential Alternative Modification, a small Supplier would be defined as a Supplier whose credited energy volume in a Settlement Period was less than 750MWh. This implies that the assessment of a “small” Supplier would be undertaken at the Settlement Period level, and that the Tolerance Band would be applied only for Settlement Periods in which the absolute Credited Energy of a Trading Party Group was less than 750MWh.

The benefit of this potential Alternative Modification would be to target the application of the Tolerance Band to the Parties to whom the alleged defect applies, and minimises the total imbalance volume to which the Tolerance Price applies. The perceived drawback of the potential Alternative Modification is that it applies an aspect of the Code arrangements to a sub-set of Parties rather than a distinct type of Party.

Option 2: Expand Qualification to all Participants

This potential Alternative Modification would apply the Tolerance Band in the same format as Proposed Modification P201 but would extend the qualifying criteria for its application to Generators and Traders in addition to Suppliers.

The Group considered that if the Tolerance Band is to apply to all Suppliers, and not be restricted to small Suppliers in order to correct the specific alleged defect as defined in Potential Alternative Modification 1, then it would be necessary to apply the Tolerance Band to all remaining Participants (i.e. All Suppliers, Generators and Traders) and not just one sub-set of them (i.e. all Suppliers). This is because, the Group noted, that if Generators, having contracted to supply, are unable to generate they would have to adjust their positions in the same way as Suppliers would; the Group agreed, therefore, that different types of Party should not face different Imbalance Prices.

This would imply that within a Trading Party Group, one Party (either Supplier, Generator or Trader) would have the Tolerance Band applied to both¹⁵ its Consumption and Production Accounts.

The benefit of this potential Alternative Modification is that it reduces the potential detrimental effect on competition which may result from the Proposed Modification which applies the Tolerance Band to Suppliers only. The drawback of this potential Alternative Modification is the increased volume of imbalance to which the Tolerance Band would apply, which may affect the incentive for Parties to balance their positions and also reduce the degree to which imbalance charges are levied directly on those Parties causing the imbalance. With this drawback in mind, the Group discussed whether extension of the Tolerance Band to all Parties should be implemented with a narrower Tolerance Band volume, for example, 10MWh rather than the proposed 20MWh. This would reduce the total volume of imbalance which would be subject to the Tolerance Price.

⁵ NB: the Alternative Modification subsequently refined this to be one of either the Consumption or Production Energy Account

Views of Respondents to Urgent Modification Consultation

Consultation question	Yes	No
Do you believe either of the potential Alternative Modifications P201 better facilitates achievement of the Applicable BSC Objectives when compared to the current baseline?	6	9
Do you believe either of the potential Alternative Modifications P201 better facilitates the achievement of Applicable BSC Objectives when compared to the Proposed Modification?	9	6

Alternative Option 1:

The main argument expressed by respondents in support of potential Alternative Option 1 was that a restriction to “small” Suppliers would focus on the specific group to which the perceived defect applies and would be more appropriate.

The main arguments expressed by respondents not in support of potential Alternative Option 1 were:

- Any restriction to “small” Suppliers only increases the discrimination which is already present in the Proposed Modification;
- It is inappropriate to address differences in competitive conditions facing participants via the Code; and
- A “small” supplier threshold may act to restrict the growth of Suppliers.

Alternative Option 2:

The main argument expressed by respondents in support of potential Alternative Option 2 was that removing the restriction to Suppliers reduces the level of discrimination under P201.

The main arguments expressed by respondents not in support of potential Alternative Option 2 were:

- Expanding the scope of the qualification criteria would increase the total volume of imbalance falling within the Tolerance Band and would significantly reduce the incentive to balance overall. This would cause an increase in balancing actions and System Operator costs; and
- Expansion to generation is not required since small generators already receive protection by being exempt from acceding to the Code.

Consultation respondents also indicated that the definition of qualification criteria for either potential Alternative Modification should be developed further if progressed.

3.5.1 Alternative Modification

Having considered the analysis conducted and the results of industry consultation, the Modification Group agreed an Alternative Modification which removed the restriction to Trading Party Groups containing Suppliers. In addition, it was agreed that the Tolerance Band would be reduced to 10MWh and should only be applied to one of either the Consumption or Production account of a qualifying Party. Hence, the Alternative Modification would apply in the following circumstances:

- A maximum of one qualifying Party would be allowed per Trading Party Group;
- One of either the Consumption **OR** Production Energy Account could be nominated by the qualifying Party;
- Where the Energy Account was short (i.e. Energy Account Imbalance Volume < 0) and the System was short overall (i.e. Net Imbalance Volume (NIV) > 0); and
- To the first 10 MWh of imbalance only.

The Modification Group agreed that removing the restriction to Suppliers would help to address the perceived detrimental affect of the Proposed Modification in terms of providing preferential treatment to certain categories of participants.

The Modification Group was conscious that expanding the Tolerance Band to all participants would increase the potential volume of energy exposed to the Tolerance Band. The Group noted that several Parties and the Transmission Company had expressed concern relating to the total volume of energy potentially exposed to the Tolerance Band. Hence, the Group agreed that, under the Alternative Modification, the Tolerance Band should be reduced to 10MWh. Whilst some Modification Group members considered a Tolerance Band of more than 0.5 MWh could not be justified on the basis of the volume of trades available via the power exchange, it was recognised that this would not address the issue raised by the Proposer and would not be efficient given the implementation cost.

Overall the Group agreed that the Alternative Modification would go some way to address concerns related to providing a competitive advantage to certain participant types, whilst at the same time not increasing the total volume of imbalance exposed to the Tolerance Band relative to the Proposed Modification.

3.6 Relevant Previous Modifications

The Modification Group considered background provided by a number of previous proposals in both the gas and electricity markets.

3.6.1 Electricity Proposed Modification P26: Market-Driven Trading Neutrality Band

A similar proposal to introduce a Tolerance Band for Imbalance Charges was submitted in 2001 and subsequently rejected by the Authority (P26: Market-Driven Trading Neutrality Band). Although the size of the Tolerance Band is the same under P201 as P26, they differ in that under P26, the imbalance price which would have applied to the Tolerance Band was equivalent to the Market Price whereas under P201 the Tolerance Price represents a 10% uplift on the Market Price. In addition, under P26, all BSC Parties would benefit from a Tolerance Band, whereas Proposed Modification P201 limits the Tolerance Band to Suppliers.

The various reasons cited by the Authority for rejecting P26 were considered by the Group and are contained in the following table. Alongside each is a summary of the Group's views regarding the degree to which they may be relevant to P201 and P202:

Reason for Rejection of P26 Proposal	Group View
Imbalance Charges should be targeted to those out of balance	Applies to P201
Imbalance Charges should reflect costs faced by NGC of balancing actions - anything else is effectively an undesirable cross-subsidy	Applies to P201
No evidence of insufficient liquidity and granularity of traded products, to prevent small suppliers from balancing economically	There were differences in opinion amongst members of the Group regarding the conclusions that could be drawn from analysis undertaken in this area. Some felt the analysis demonstrated sufficient liquidity, others that no conclusions could be drawn.
The development of consolidation and aggregation services should assist small suppliers	There has been little activity in consolidation and aggregation services.
Reduces the incentive on parties to balance which is likely to increased the costs to the SO of balancing	This argument applies to a lesser degree with respect to P201 and P202 as the Tolerance Price is defined as an uplift on Market Price, rather than the Market Price itself as under P26. However, there is still a reduction in any incentive relative to the existing baseline.

3.6.2 Gas Modification Proposal 0415: Phased Reduction in Shipper Tolerances

A Tolerance Band for a level of Imbalance Volume to prevent Shippers being cashed out at System Marginal Price was a feature of the Gas Trading Arrangements until this Modification Proposal was implemented following its approval by Ofgem in 2000. A progressive reduction of the Tolerance Band was undertaken between 1999 and 2001 and, although a small tolerance for imbalance volumes for Non-Daily Metered (NDM) customers was retained for some time, this has also now been removed.

Although the significant differences in the electricity and gas industries mean that a direct comparison cannot be made between P201 and the circumstances of and reasons for the removal of the gas Tolerance Band the views of the Authority regarding this Modification will nevertheless be relevant. The various reasons for the Authority's approval of this modification are summarised below:

- Shipper use of tolerances, and their average imbalance volumes increased over time, (prior to the removal of the tolerances);
- There was evidence that Shippers were using their imbalance tolerances for commercial purposes to avoid trading out imbalances;
- The tolerance regime and the cash out regime in place prior to 2000 was encouraging Shippers to take imbalance positions;
- The consequences of this were i) to increase the Balancing Actions which Transco were required to undertake and, ii) to discourage trading and reduce liquidity in the traded market; and
- The removal of tolerances would sharpen the incentives for Shippers to balance their positions.

Some members of the Modification Group highlighted that the removal of Shipper Tolerances was contingent on participants having the ability to minimise imbalance exposure via access to line pack⁶ services (i.e. that tolerances were originally provided in recognition of the limited tools available to a participants to avoid imbalance exposure).

3.7 Implementation Approach

The rationale for the proposal is to mitigate exposure to imbalance charges which are likely to be at their highest over the winter period, particularly in light of implementation of Approved Modification P194. The Proposer expressed concerns that if the proposal was not implemented, there would be a risk of small Suppliers going out of business, as happened over the winter 05/06 period. The Group noted that implementation of the changes required to central systems would imply a lead time of around six months, suggesting an Implementation Date during February 2007.

The Proposer expressed concerns that this approach would present extreme risks to the ability of small Suppliers to withstand the expected high prices over the winter 06/07; they pointed to the experience of the winter 05/06 period when five small Suppliers left the market and identified that implementation of the P194 baseline ahead of the winter 06/07 would increase the risk to remaining small Suppliers. P201 was granted urgent status in order to allow consideration of approaches to support implementation ahead of winter 06/7.

The Group speculated about the degree to which the implementation could be accelerated by increasing resources and implementing parallel running of certain activities. It was agreed that an impact assessment would be required in order to determine the degree to which this would be possible. The Group identified a number of possible implementation options to be considered:

⁶ Line pack: Storage of gas by compression in gas transportation and transmission system

Normal Implementation

This option would fully incorporate the P201 requirements into central systems in normal system release timescales, using the standard project approach and resources. This option would provide the best balance of project cost and risk of error during implementation. However, given the process and timescales for consideration of the Proposals and decision-making by the Authority, this approach would not provide for implementation before winter 06/07.

Accelerated Implementation

This option would fully incorporate the P201 requirements into central systems in an accelerated timescale compared to normal implementation. This would be achieved by deploying additional resources and scheduling activities in parallel where possible. Additional costs would be incurred relative to implementation in normal timescales due to the use of additional resource and project management effort. Moreover, it is possible that there may be an increased risk of error occurring during implementation.

Implementation via Workaround

This option would implement the legal text of the P201 baseline in time for winter 06/07 but no changes to central systems would be made in this timescale. Instead a workaround would be implemented, and operated by the BSC Agent, ELEXON or an alternative service provider.

Implementation in Reconciliation

This option would implement the legal text of the P201 baseline in time for the approved Implementation Date (i.e. ahead of winter 06/07) but no changes would be made to central systems in this timescale. Incorporation of the P201 baseline into central systems would be undertaken in normal release timescales but would be effective from the Implementation Date. Implementation of the legal baseline could be undertaken in approximately 5 working days. However, this option would not allay the Proposer's concerns regarding the risk posed by the P194 baseline on the survival of small Suppliers over the winter 06/07 period (since charges over the winter period would be generated in accordance with the pre-P201 baseline). This approach could also give rise to issues as invoices would be issued which were not calculated in accordance with the prevailing legal baseline, which could allow Parties to challenge charges over the interim period.

3.7.1 Results of Implementation Approach Consultation

The previously identified options were issued to obtain initial views from industry on possible implementation approaches. Thirteen responses were received to the Implementation Approach Consultation in respect of the P201. The key points to emerge from the responses were:

- A significant number of respondents felt that 'Normal Implementation' was the only feasible option based on their assessment of the relative costs and risks associated with the workaround options;
- Many respondents identified that the availability of accurate reporting of Trading Charges was a crucial issue in determining their preferred implementation option;
- There was limited support for the implementation in Reconciliation based on concerns regarding the practical operation and legality of such an approach;
- Many respondents expressed some support for the various workaround options but qualified their responses by indicating that more detailed information regarding the relative costs, benefits, risks and issues of each of the options would be required before they could confirm their preferred approach;
- The views of the Auditor should be canvassed to determine the appropriateness of the various workaround options; and
- A number of respondents suggested that a delay to the implementation of P194 should be considered.

3.7.2 Results of Initial High Level Impact Assessment

An initial High Level Impact Assessment of each of the implementation options identified above provided more detailed information regarding the approaches adopted and costs of each of the options.

Normal Implementation

The total cost associated with the Normal Implementation option was initially estimated at approximately £550,000 (of which £300,000 is associated with change-specific costs and approximately £250,000 is associated with release costs, and includes changes to both BSC Agent and BSCCo systems and processes). This option had an estimated lead time of 25 weeks.

Accelerated Implementation

Initial impact assessment did not identify an accelerated implementation approach that would allow for implementation ahead of winter 06/07 at an acceptable level of cost or risk. Hence this approach was not considered further.

Implementation via Workaround

Initial impact assessment indicated that the cost, lead times and functionality of workarounds operated by either by Elexon or an Alternative Service Provider would not compare favourably to the BSC Agent Workaround. Primarily this was a consequence of additional development required to recreate the imbalance charge calculation and meet the reporting requirements.

Implementation in Reconciliation

Given the fact this approach does not address the concerns of some participants ahead of winter this approach was not investigated further.

After considering each of these approaches, the Group agreed that a more detailed impact assessment should focus on the Workaround operated by the BSC Agent in addition to the Normal Implementation option. The Group agreed that this particular workaround was favoured as it provided a more cost-effective and timely solution appearing, in particular, to meet the Group's requirements for accurate and easily accessible reporting. In addition it was recognised that this approach would allow P201 charges to be reflected in the Credit Cover process, which would not be possible under the other approaches considered.

3.7.3 Scope of BSC Agent Workaround

The specific requirements of the BSC Agent operated workaround are:

- ELEXON will manage the process for identifying and maintaining a record of:
 - The relationship between each Party and its Trading Party Group
 - The Party (maximum one per Trading Party Group) to which the Tolerance Qualifying flag is set to apply;
- These relationships will be reported to CRA on a regular basis and CRA will maintain a record of these (NB: it is possible for the qualification to change over the period of the workaround and it will be necessary to maintain the history of any changes);
- As the SAA software will not have been updated, it will run without fully incorporating P201 Trading Charges. However, as part of the run process, the SAA will perform a semi-automated workaround process to calculate adjusted Trading Charges in line with the P201 baseline. Specifically, the following steps will be incorporated into the workaround:
 - Record the prevailing (i.e. pre-P201 calculated) Trading Charges in order that an audit trail exists;
 - Calculate each element of the Trading Charges under the P201 as appropriate (i.e. $CAEI_{aj}$, $TCEI_j$, TRC_j , $RCRC_{aj}$, $TACP_{aj}$). NB: Revised Non-Delivery charges are not in the scope of the Workaround.

- P201 Trading Charges will be correctly reported to the FAA by SAA (i.e. the Trading Charges as defined above will be included in the SAA-I013);
- P201 Trading Charges will be correctly reported by SAA (SAA-I014) within the existing report structure, such that the existing data items detailing Imbalance charges and the RCRC will reflect P201, but the additional data items specifying details of the application of the Tolerance Band will not be included;
- Trading Charges used in the Credit Cover calculation will reflect P201;
- After each Settlement Run, SAA will report the Tolerance Price for each Settlement Period to ELEXON in a format suitable for publication on the BSC Website;
- Sufficient testing will be conducted to provide assurance that the solution will function correctly; and
- The workaround will operate correctly for Short Days.

This option has an estimated lead time of 8 weeks. The total cost associated with the BSC Agent workaround was estimated to be £56,500 operated until June 2007. This includes changes to, and the operation of, both BSC Agent and BSCCo systems over the relevant period of operation of the workaround. It should be noted that the cost of the workaround would be in addition to the cost of the normal implementation.

3.7.4 Limitations of Workaround

Some members of the Modification Group questioned whether the workaround could be utilised as an enduring solution; in response the BSC Agent impact assessment highlighted the following limitations of the workaround:

- A number of design decisions were included in the workaround, balancing risk against cost, on the basis that this would only be in operation for a short period of time. While the workaround is reasonably robust it includes a level of risk which can only comfortably be controlled over a relatively short period of operation.
- The workaround involves calculating some settlement cashflows twice, once using the P194 baseline and again revised for the P201 baseline. This will have an adverse affect on the performance of the settlement processing although the actual magnitude of this performance degradation can not be fully estimated.
- The workaround does not include all aspects of the full solution, specifically changes to SAA reporting and Non-Delivery charges.
- In the event of an Emergency Instruction being issued whilst the P201 workaround was in operation there would be two manual adjustments to the System Prices and settlement cashflows. The cumulative risk of an error arising from these manual adjustments is still assessed as low; however, given the potential magnitude of such System Prices the impact of any error on Parties could be substantial.
- A significant risk reduction was that the reconciliation runs (at very least the Final Reconciliation run) would be run using the full solution developed according to a normal development cycle. As such any errors in the application of the workaround not previously noticed would be resolved by these reconciliation runs. If the workaround solution was to be run permanently this risk reduction strategy would not exist.
- The workaround would introduce a two phase settlement calculation process. This is considerably more difficult to maintain in the event either that defects are found in the settlement calculation which must be fixed or that a further change to the settlement calculation is approved (for example via another Modification).
- An operational cost would be incurred for each day the workaround is in place.

3.7.5 Views of Respondents to Urgent Modification Consultation

Q	Consultation question	Yes	No
1.	Were P201 to be approved, would you support the implementation approach described in the consultation document preferred by the Modification Group (i.e. BSC Agent operated workaround)?	10	5

The respondents in support of the proposed implementation approach expressed the view that it would be important to ensure P201 could be aligned with the implementation of P194.

Those respondents not in support of the proposed implementation approach expressed concern that there would be a risk of errors in participants Trading Charges and that participant processes for verifying imbalance charges would be adversely impacted for the duration of the workaround. Concern was also expressed that additional implementation costs would be incurred in order to implement and operate the interim workaround.

3.7.6 Agreed Implementation Approach

Having considered the consultation responses and the results of initial and full impact assessment, the Modification Group agreed that implementation for winter 06/07 via a BSC Agent operated workaround, with full system changes being delivered in the June 07 System Release would meet the requirements of the proposal whilst minimising associated risk and impact on participants. In agreeing this approach, the Modification Group recognised that the some participants did not support the workaround on the basis of the impact on their ability to validate Trading Charges for the duration of the workaround and associated risk. However, it was acknowledged that the significant concerns of some participants ahead of winter and the rationale provided for urgent treatment of P201 meant that an approach allowing implementation ahead of winter 06/07 P201 should be progressed.

4 IMPLEMENTATION APPROACH AND COSTS

PROPOSED MODIFICATION IMPLEMENTATION COSTS⁷

		Stand Alone Cost	Incremental Cost	Tolerance
Service Provider⁸ Cost	Change Specific Cost			
	- Full Solution	£243,741	£243,741	+/-5% (£10k)
	- Workaround	£21,497	£21,497	
	Release Cost			
	- Full Solution	£195,869		+/-0%
	- Workaround	£11,432		
	Total Service Provider Cost	£472,539	£265,238	+/-3%
Implementation Cost	External Audit	£0	£0	+/-0%
	Design Clarifications	£12,000	£12,000	+/-100%
	Additional Resource Costs	£0	£0	+/-0%
	Additional Testing and Audit Support Costs	£38,000		+/-20%
Total Demand Led Implementation Cost		£522,539	£277,238	+/- 5%

ELEXON Implementation Resource Cost	Full Solution	336 Man days £73,920	166 Man days £36,520	+/- 5%
	Workaround	32 Man days £7,040	32 Man days £7,040	+/- 5%
Total Implementation Cost		£603,116	£321,026	+/- 5%

PROPOSED MODIFICATION ONGOING SUPPORT AND MAINTENANCE COSTS

	Stand Alone Cost	Incremental Cost	Tolerance
Service Provider Operation Cost	£16,600 ⁹	£16,600	+/- 0 %
Service Provider Maintenance Cost	£ 0	£ 0	+/- 0%
ELEXON Operational Cost	£0	£0	+/- 0%

⁷ An explanation of the cost terms used in this section can be found on the BSC Website at the following link:

http://www.elexon.co.uk/documents/Change_and_Implementation/Modifications_Process_-_Related_Documents/Clarification_of_Costs_in_Modification_Procedure_Reports.pdf

⁸ BSC Agent and non-BSC Agent Service Provider and software costs.

⁹ NB: this is a one off charge for operation of the workaround to June 07

a) BSC Agent Impact

The BSC Agent cost estimates outlined above reflect both the full system changes and the implementation and operation of the interim workaround. The activities associated with these two strands are detailed below:

Full Implementation:

The BSC Agent costs identified reflect the following activities in relation to the full solution:

- Introduction of new variables/parameters into BSC Agent Systems;
- Changes to Central Registration Agent (CRA) and Settlement Administration Agent (SAA) software and documentation to amend the Imbalance Charge calculation;
- Changes to SAA reporting and the Interface Definition documentation to detail the impact of the Tolerance Band within the Settlement Report (SAA-I014);
- Unit, Module, System, Change Specific, Regression (partial), Operational Acceptance and Participant testing; and
- Project Management Overhead.

The required BSC Agent lead time is 6 months.

Workaround Operated by BSC Agent:

The BSC Agent costs identified above reflect the following activities in relation to the workaround:

- Development of semi-automated scripts, running of post-Settlement Run for P201 effective Settlement Dates, to reprocess the Calculate Energy Imbalance Cashflow data and its dependant data;
- Updating existing database data with the recalculated values so that subsequent runs of the SAA-I014 and SAA-I013 contain the P201 compliant data;
- Unit, Module and Deployment/Back out testing. End to end testing will be carried out using Live like data;
- Operation of workaround for interim period; and
- Project Management Overhead.

The required BSC Agent lead time is 8 weeks.

b) BSC Party and Party Agent Impact

BSC Parties would be impacted by changes to the Trading Charge calculation (in order to update their charge verification processes) and changes to the Settlement Report (SAA-I014). Party impact assessment indicated that these changes would cost between £50-200k per Party and require lead times from 4-9 months. Parties would also be required to participate in a pre implementation process undertaken by BSCCo to allocate all relevant Party IDs into relevant Trading Groups and to determine which Party within each Trading Group has the Tolerance Band applied to it.

The design of the workaround has sought to ensure that there will be no material change to the format and content of reporting provided to BSC Parties for the duration of the workaround. However, a number of participants highlighted concerns with the operation of the workaround both in terms of the associated risk and the adverse impact on the ability of participants to verify Trading Charges for the duration of the workaround.

c) Transmission Company Impact

The Transmission Company would be impacted via changes to the Settlement Report (SAA-I014).

d) BSCCo Impact

The BSCCo costs identified reflect the following activities:

- Development of SAA and CRA document changes to support the full solution;
- Workaround implementation and testing support;
- Changes to the Trading Operations Market Analysis System (TOMAS) and Extra Settlement Determination (ESD) calculator (NB: the estimate of this cost is in the demand led service provider costs);
- Audit activities;
- Managing the process of identifying and recording Qualifying Parties for the Tolerance Band;
- Reporting the Qualifying Parties for the Tolerance Band to the BSC Agent ; and
- Publishing Qualifying Parties and Tolerance Price data on BSC Website.

4.1 Alternative Modification

The costs and impacts of the Alternative Modification are aligned with those of the Proposed Modification outlined previously. However, there would be an additional Service Provider change specific cost of approximately £5k for implementation of the full solution.

5 MODIFICATION GROUP'S RECOMMENDATIONS TO THE PANEL

This section summarises the discussion of issues and recommendations of the Modification Group to the BSC Panel.

5.1 Assessment of Proposed Modification Against Applicable BSC Objectives

This section outlines the views of consultation respondents and the Modification Group regarding the merits of Proposed Modification P201 when assessed against the Applicable BSC Objectives.

5.1.1 Views of Respondents to Assessment Procedure Consultation

Q	Consultation question	Yes	No
1.	Do you believe Proposed Modification P201 better facilitates the achievement of the Applicable BSC Objectives?	6	9

The majority view of respondents to the Urgent Modification Consultation was that the Proposed Modification would not better facilitate the achievement of the Applicable BSC Objectives.

The main points expressed by respondents in support of P201 were:

- Imbalance exposure is a significant issue for market entrants. By providing relief against the main imbalance price, P201 will act to remove a potential barrier to entry and thereby promote competition;
- P201 addresses discrimination which exists against non-vertically integrated players which means small Suppliers can only balance at higher cost. By reducing this cost differential P201 will be beneficial for competition;
- The application of a premium on Market Price means the incentive to balance is preserved. Hence, P201 will have negligible impact on the extent to which participants attempt to avoid imbalance exposure and will not adversely affect efficient operation of the Transmission System; and

- P201 may lead to a reduction in the overall imbalance on the System, since participants may reduce the extent to which they take long positions to avoid exposure to SBP. This may lead to more efficient operation of the Transmission System.

The main points expressed by respondents not in support of P201 were:

- Whilst P201 identifies genuine issues faced by small Suppliers the perceived defect is reflective of wider market conditions rather than being an issue which should be addressed via the Code;
- Based on the data provided, there is no evidence for lack of granularity in short-term traded market;
- P201 will deviate from the principle that imbalance charges are reflective of the costs incurred by the System Operator to address participants' imbalance positions. This will result in inappropriate targeting of the cost of imbalance which would be detrimental for competition;
- By applying to Suppliers only, the Proposed Modification would discriminate against generators and traders, and distort competition in the market. The resulting cross subsidy would be detrimental for competition;
- An Imbalance Price which is less than the Main Price will not provide an appropriate incentive to balance and will cause an increase in System Operator balancing activities and costs. This would be detrimental for the efficient operation of Transmission System;
- By reducing the incentive for participants to trade out imbalance volumes below the Tolerance Band, P201 will reduce liquidity in short-term market and limit development of products of a size smaller than the Tolerance Band. This would be detrimental to competition; and
- The introduction of a Tolerance Band will make the Code more complex and will incur significant implementation costs. This will be detrimental to overall efficiency of the arrangements.

5.1.2 Modification Group's Assessment

The majority view of the Modification Group was that the Proposed Modification would have a detrimental impact on achievement of Applicable BSC Objectives (b), (c) and (d) when compared to the current Code baseline, for the following reasons:

Applicable BSC Objective B – 'the efficient, economic and co-ordinated operation by the Transmission Company of the Transmission System'

Arguments identified in support of Proposed Modification P201:

P201 retains an incentive for Suppliers to balance because the Tolerance Price includes a premium on the Market Price to ensure that it is higher than the short-term traded energy price. Hence, to the extent that it is possible to do so, participants will continue to contract ahead of Gate Closure to avoid imbalance exposure. As such, there would be no increase in the balancing requirements of the Transmission Company or adverse impact on the efficient operation of the Transmission System.

P201 reduces the incentive for Suppliers to take a long(er) position to avoid System Buy Price, thereby reducing the overall level of balancing required by the Transmission Company, benefiting the efficient operation of the Transmission System.

Arguments not in support of Proposed Modification P201:

P201 would lower the imbalance charges associated with a significant volume of individual Supplier imbalance and total potential System imbalance, reducing the incentive to balance. Under P201 Parties would take advantage of the Tolerance Band and reduce the extent to which they trade ahead of Gate Closure to avoid imbalance exposure. This would increase the number of balancing actions required by the Transmission Company. Hence, P201 would adversely impact the efficient, economic and co-ordinated operation by the Transmission Company of the Transmission System.

Applicable BSC Objective C – ‘promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity’

Arguments identified in support of Proposed Modification P201:

P201 provides an environment to facilitate the development of small supply businesses which supports the promotion of competition in the sale and purchase of electricity. This is because contracts for the volumes required by small Suppliers are not available at a cost which enables small suppliers to compete effectively. Therefore, small Suppliers can only achieve balance at a disproportionate cost which represents a barrier to market entry. Removing this barrier by introducing a Tolerance Band to mitigate the higher costs therefore promotes competition.

Arguments not in support of Proposed Modification P201:

The Tolerance Price would not appropriately target the costs of balancing the System at Parties with imbalance positions. Inappropriate targeting of costs in this manner would not promote effective competition.

The proposal provides a financial benefit to a certain category of Party (i.e. Suppliers) at the expense of others, which does not promote effective competition.

P201 will dampen the signals provided by Energy Imbalance Prices to the forward markets by reducing the incentive for Parties to trade ahead of Gate Closure. P201 will also reduce liquidity in the market by discouraging the availability of products at lot sizes below the size of the Tolerance Band. This will adversely impact competition.

There is no evidence of illiquidity in the short term traded markets to suggest that small Suppliers are unable to take advantage of tools to manage their imbalance strategy, as such there is no evidence that the proposals will increase competition in the supply of electricity.

Applicable BSC Objective D – Promoting efficiency in the implementation and administration of the balancing and settlement arrangements

Arguments not in support of Proposed Modification P201:

There changes required to central systems and the introduction of new or amended processes required to implement the P201 are significant and expensive. This would be increased were the proposal implemented ahead of winter 06/07 using an interim workaround. The proposal also increases the complexity of the balancing and settlement arrangements. Therefore, P201 would have an adverse impact on efficiency in the implementation of the balancing and settlement arrangements.

5.2 Assessment of Alternative Modification Against Applicable BSC Objectives

The majority of Modification Group members agreed that the Alternative Modification would better facilitate the Applicable BSC Objectives as compared to the Proposed Modification. These members of the Modification Group were of the view that removing the restriction to Suppliers would reduce the detrimental affect of the Proposed Modification in terms of providing a financial benefit to i.e. Suppliers at the expense of others. This would better achieve the promotion of effective competition, and thereby achievement of Applicable BSC Objective c), relative to the Proposed Modification.

The majority view of the Modification Group was that the Alternative Modification would have a detrimental impact on the achievement of Applicable BSC Objectives (b), (c) and (d) when compared to the current Code baseline, for the same reasons as set out for the Proposed Modification. Whilst it was recognised that the removal of the restriction to Suppliers and reduction of the Tolerance Band would be beneficial relative to the Proposed Modification, this was not sufficient to completely remove the concerns of the majority of Modification Group members associated with the proposed introduction of an imbalance Tolerance Band.

5.3 Interaction with P202

Modification Proposal P202 – “Energy Imbalance Incentive Band” (P202) seeks to address the same perceived defect as P201. P202 differs from P201 in that it expands the scope of the Tolerance Band to apply when both the market and the qualifying Party were long. The Modification Group considered the differences and relative merits of the two proposals.

The majority of Modification Group members were of the view that P201 would better facilitate the Applicable BSC Objectives as compared to the P202. It was considered that, since P201 was limited to the situation where both the Party and the System was short, P201 would minimise the volume of energy exposed to the Tolerance Band and would limit any adverse impact on the achievement of the Applicable BSC Objectives. Some Modification Group members indicated a preference for P202 since it maintained symmetry in the imbalance arrangements. It was argued that applying the Tolerance Band to both long and short position was less likely to affect participants’ behaviour.

The Modification Group noted that, were P202 approved, P201 would not be required.

5.4 Implementation Date

The Modification Group agreed the following recommended implementation approach for P201:

- An Implementation Date for Proposed an Alternative Modification P201 of 2 November 2006 if an Authority decision is received on or before 7 September 2006, or 28 June 2007 if the Authority decision is received after 7 September 2006 but on or before 19th December 2006.

If an Authority decision on or before 7 September 2006, the workaround solution would be utilised from the 2 November until the full solution is implemented in the scheduled BSC System Release on the 28 June 2007. If an Authority decision is received after 7 September 2006 but before 19th December 2006 the full solution would be implemented in the 28 June 07.

The Modification Group recognised that the some participants did not support the workaround on the basis of the impact on their ability to validate Trading Charges for the duration of the workaround and associated risk. However, it was acknowledged that the significant concerns of some participants ahead of winter 06/07 and the rationale provided for urgent treatment of P202 meant that an Implementation Date ahead of winter 06/07 should be recommended.

If approved, P201 would apply to Settlement Runs and Volume Allocation Runs carried out in relation to Settlement Days on or after the Implementation Date. Settlement Runs and Volume Allocation Runs carried out in relation to Settlement Days before the Implementation Date would not be affected by P201.

Participants would be required to identify Trading Party Groups and nominate qualifying Parties as part of the registration process prior to implementation. Parties would not qualify for the Tolerance Band until they have completed this process.

5.5 Legal Text

Initial draft legal text was issued as part of the Urgent Modification Consultation and no comments were received.

The Modification Group reviewed the legal text via correspondence and agreed (responses received from four Modification Group members) that it delivers the solution developed by the Group.

6 RATIONALE FOR PANEL'S RECOMMENDATIONS TO THE AUTHORITY

6.1 Panel's Consideration of the draft Urgent Modification Report

The Panel considered the P201 draft Urgent Modification Report at its meeting on 10 August 2005. This section summarises the Panel's discussions in formulating its final recommendations.

6.1.1 Perceived Defect

The Panel considered the perceived defect highlighted in the proposal and the extent to which this was an issue related to the Code, a more general issue with the wider market structure or an inherent feature of any market.

The Panel agreed it is difficult for Parties to enter the market, that small Suppliers tend to face higher exposure to imbalance prices and that the cost of managing imbalance exposure will be proportionally higher when trading smaller volumes.

Some Panel members were of the opinion that market arrangements, in particular the imbalance charging arrangements, currently favour large vertically integrated Parties. As such, small Parties are disadvantaged by the Code arrangements. It was suggested that, whilst it was outside of the remit of the Panel to consider wider market issues, it is appropriate to consider mitigating issues created by the market structure via revision of the Code as suggested by P201. Another Panel member suggested that the existing Code rules exacerbate the impact of wider market issues and it is appropriate to address this via a Modification Proposal.

One Panel member considered that the APX data (Appendix 4) supported the view that volumes are not available to small Parties at time of system stress. Another Panel member noted that there has been limited development of suitable products that allow small Suppliers to efficiently manage imbalance exposure.

Another Panel member expressed the view that larger participants will always have a natural advantage in any market, since the cost of trading small volumes of any commodity will always be proportionally higher. It would be inappropriate to introduce a mechanism to protect small Parties at the expense of others.

One Panel member noted that small Parties' ability to manage imbalance exposure is limited, since they are unlikely to have access to their own generation and, on the basis of the views expressed by the Proposer, are limited by the volumes of energy typically traded in the options market. However, the analysis provided by APX (Appendix 4) illustrates that small volumes of energy are available in the short term market and, whilst the price may not be considered favourable by small Suppliers, this did not support the suggestion that it is not possible to purchase energy in small volumes. It was also noted that the view expressed by the Authority in approving P194 was that liquidity in the market would increase post implementation.

6.1.2 Appropriateness of Tolerance Band

The Panel considered whether the proposed Tolerance Band was an appropriate mechanism to address the perceived defect identified by the proposal.

The majority of Panel members supported the concerns expressed by the Modification Group in relation to the proposed introduction of a Tolerance Band. In particular, that the use of a Tolerance band would not be consistent with the principle that the cost of resolving imbalance should be reflected on Parties with imbalance positions. It was considered that the Tolerance Band would reduce the incentive to balance. There was also a suggestion that the proposal was likely to exacerbate the issue it sought to address, since it may reduce the extent participants attempt to trade out their imbalance positions and therefore reduce liquidity. One Panel member considered the Tolerance Band would be open to manipulation (in terms of amending trading strategy to take advantage of the protected volume) and that it was likely to affect the behaviour of participants beyond those it was designed to benefit.

Those Panel members who supported the principle of a Tolerance Band were of the view that an incentive to balance would be retained via the uplift relative to the Market Price. The view was expressed that the Tolerance Band would reduce barriers to market entry that exist at present and support the development of competition. It was noted by one Panel member that the Gas market had previously provided a level of support to participants via an imbalance tolerance mechanism. Removal of tolerance mechanism in the gas market had only been performed over an extended period based on the development of products allowing participants to effectively manage imbalance exposure; equivalent tools do not exist in the electricity market. One Panel member considered that there are several reasons why existing imbalance prices do not appropriately target the cost of balancing at participants (for example inaccuracies in the tagging mechanisms). Given the accepted approximate nature of the existing pricing mechanism, a Tolerance Band which retained an incentive to balance would be an appropriate solution to the perceived defect. One Panel member also suggested that the Tolerance Band would reduce the extent to which Parties adopt long positions to avoid exposure to SBP and therefore lead to a more balanced market and to more efficient operation of the Transmission System.

6.1.3 Applicable BSC Objectives: Proposed Modification

The majority view of Panel members was that the Proposed Modification would not better facilitate achievement of the Applicable BSC Objectives when compared to the current Code baseline, for the following reasons:

Applicable BSC Objective a)

The Panel agreed that the Proposed Modification would have no impact on Applicable BSC Objective (a).

Applicable BSC Objective b)

The Panel noted the arguments identified by the Modification Group in relation to Applicable BSC Objective b).

The majority of Panel Members supported the argument that P201 would lower the imbalance charges associated with a significant volume of individual Supplier imbalance and total potential System imbalance, reducing the incentive to balance. Parties may take advantage of the Tolerance Band and reduce the extent to which they trade ahead of Gate Closure to avoid imbalance exposure. This would increase the volume of balancing actions required by the Transmission Company. Hence, P201 would adversely impact the efficient, economic and co-ordinated operation by the Transmission Company of the Transmission System.

The minority of Panel members considered that P202 would retain an incentive for Suppliers to balance due to the premium relative to Market Price. Hence, to the extent that it is possible to do so, participants will continue to contract ahead of Gate Closure to avoid imbalance exposure. As such, there would be no increase in the balancing requirements of the Transmission Company or adverse impact on the efficient operation of the Transmission System.

One Panel member suggested that P201 would reduce the incentive for Suppliers to take a long(er) position to avoid the System Buy Price, thereby reducing the overall level of balancing required by the Transmission Company, benefiting the efficient operation of the Transmission System.

Applicable BSC Objective c)

The Panel noted the arguments identified by the Modification Group in relation to Applicable BSC Objective c).

The majority of Panel Members supported the argument that the Tolerance Price would not appropriately target the costs of balancing the System at Parties with imbalance positions and that inappropriate targeting of costs in this manner would not promote effective competition.

The majority of Panel members also expressed the view that the proposal provides a financial benefit to a certain category of Party (i.e. Suppliers) at the expense of others, which does not promote effective competition.

Some Panel members considered that P201 would reduce liquidity in the market by discouraging the availability of products at lot sizes below the size of the Tolerance Band, adversely impacting competition.

Some Panel members also supported the view that, on the basis of the data provided by APX (Appendix 4), there is no evidence of illiquidity in the short term traded markets to suggest that small Suppliers are unable to manage their imbalance positions, as such there is no evidence that the proposals will increase competition in the supply of electricity.

The minority of Panel members supported the view that P201 provides an environment to facilitate the development of small supply businesses which supports the promotion of competition in the sale and purchase of electricity. This is because contracts for the volumes required are not available at a cost which would enable small Suppliers to compete effectively. Therefore, small Suppliers can only achieve balance at a disproportionate cost which represents a barrier to entry. Removing this barrier by introducing a Tolerance Band to mitigate the higher costs therefore promotes competition.

One Panel member suggested that, since Suppliers are particularly affected by the perceived defect, it is appropriate to restrict application of the Tolerance Band as proposed. There is nothing to prevent rules which appropriately differentiate between categories of participants. Therefore, the proposed restriction to Suppliers should not be seen as providing a financial benefit to a certain category of Party at the expense of others, instead it constitutes removal of an existing inappropriate benefit to participants at the expense of Suppliers. As such, restricting the proposal to Suppliers would promote effective competition.

Applicable BSC Objective d)

The Panel noted the arguments identified by the Modification Group in relation to Applicable BSC Objective d).

The majority of Panel members supported the view expressed by the Modification Group that P201 would have an adverse impact on efficiency in the implementation of the balancing and settlement arrangements. However, the impact on objective d) was not a primary consideration in the Panel's assessment of P201.

Recommendation to the Authority

The Panel agreed a majority recommendation to the Authority that:

- **The Proposed Modification should not be made**

6.1.4 Applicable BSC Objectives: Alternative Modification

The majority view of Panel members was that the Alternative Modification would not better facilitate achievement of the Applicable BSC Objectives when compared to the current Code baseline. Whilst it was recognised that the removal of the restriction to Suppliers and reduction of the Tolerance Band would be beneficial relative to the Proposed Modification, this was not sufficient to completely remove the concerns associated with the proposed introduction of an imbalance Tolerance Band.

The majority of Panel members agreed that the Alternative Modification would better facilitate the Applicable BSC Objectives as compared to the Proposed Modification. These Panel members supported the argument that removing the restriction to Suppliers would reduce the detrimental affect of the Proposed Modification in terms of providing a financial benefit to Suppliers at the expense of others. This would better achieve the promotion of effective competition, and thereby achievement of Applicable BSC Objective c), relative to the Proposed Modification. One Panel member suggested that expansion of the Tolerance Band would encourage small generators to accede to the BSC and therefore promote competition.

One Panel member indicated a preference for the Proposed Modification, since it would focus the solution and impact of the proposal to the category of participant particularly affected by the perceived defect.

Recommendation to the Authority

The Panel agreed a majority recommendation to the Authority that:

- **The Alternative Modification Should not be made**

6.1.5 Interaction with P202

The Panel noted the majority view of the Modification Group that P201 would be preferable to P202, since it would limit the overall volume of energy exposed to the Tolerance Price rather than the Main Price. Contrary to the view of the Modification Group, the Panel indicated a relative preference for P202.

It was the view of the Panel that, since P202 would apply symmetrically, it was less likely to affect participant behaviour. As a consequence, any detrimental impact on the efficient operation of the Transmission System would be less under P202 than under P201. It was noted that, were the Tolerance Band considered appropriate, P202 would address the perceived defect to a greater extent.

The Panel agreed that, were P202 approved, P201 would not be required.

6.1.6 Implementation Date

The Panel unanimously agreed the Implementation Date recommended by the Modification Group.

6.1.7 Legal Text

The Panel unanimously agreed the legal text for the Proposed and Alternative Modifications

7 DOCUMENT CONTROL

7.1 Authorities

Version	Date	Author	Reviewer	Reason for Review
0.1	30/07/06	Amanda Greenwood	Tom Bowcutt	For peer review
0.2	02/08/06	Tom Bowcutt	Sarah Jones	For technical review
0.3	03/08/06	Tom Bowcutt	Modification Group	For Review
0.4	07/08/06	Tom Bowcutt	Katie Ann Key	Quality Review
0.5	08/08/06	Change Delivery	BSC Panel	For Panel Decision
1.0	11/08/06	BSC Panel	Ofgem	For Decision

7.2 References

BSC modification documentation is available via the BSC (ELEXON) Website:

<http://www.elexon.co.uk/changeimplementation/ModificationProcess/modificationdocumentation/default.aspx>

Information relating to Gas Modification UNC0415 is available via the Ofgem Website: www.ofgem.gov.uk

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APPENDIX 1: LEGAL TEXT

Draft legal text for the Proposed Modification is attached as a separate document, Attachment 1A (P201UMR_Attachment1A_P201ProposedLegalText).

Draft legal text for the Alternative Modification is attached as a separate document, Attachment 1B (P201UMR_Attachment1B_P201Alternative Legal Text).

APPENDIX 2: URGENT MODIFICATION CONSULTATION RESPONSES

Full copies of the Urgent Modification Consultation responses are attached as a separate document, Attachment 2A (P201UMR_Attachment2A_P201_Responses_v1.0),

Full copies of the Implementation Consultation responses are attached as a separate document, Attachment 2B (P201P202UMR_Attachment2B_ImplementationConsultationResponses).

APPENDIX 3: IMPACT ASSESSMENT RESPONSES

Full copies of the consultation responses are attached as a separate document, Attachment 3. Responses are summarised below:

Results of Impact Assessment

a) Impact on BSC Systems and Processes

BSC System / Process	Impact of Proposed and Alternative Modification
Registration	A new registration process will be required for: <ul style="list-style-type: none"> - Maintaining a record of Trading Party Groups - Identifying eligible Trading Party Groups; and - Allowing participants to nominate and change the qualifying Party within an eligible Trading Party Group,
Settlement	Changes would be required to amend the calculation of Trading Charges. At a high level it is considered that changes would be required to: <ul style="list-style-type: none"> - Identify qualifying Energy Accounts; - Derive the Tolerance Price; and - Calculate Trading Charges in accordance with P201
Reporting	The Settlement Report will be amended to detail application of the tolerance band. BSCCo reporting via the BSC Website will be impacted by the requirement to provide information relating to Party qualification and make best view Tolerance Price information available.
Market Index Data Provision	The provision of Market Index data is not impacted.
Credit Cover	No changes would be made to the calculation of Energy Indebtedness.

b) Impact on BSC Agent Contractual Arrangements

BSC Agent Contract	Potential Impact of Proposed Modification
LogicaCMG (BMRA, CRA, CDCA, SAA, ECVA, TAA, FAA)	No impact beyond changes to Service Descriptions.

c) Impact on BSC Parties and Party Agents

All Parties will be impacted financially by the revised approach to calculation of Trading Charges. Recipients of the Settlement Report (SAA-I014, all sub flows) may be impacted. Parties may also be affected by the workaround.

d) Impact on Transmission Company

The Transmission Company will be impacted as a recipient of the Settlement Report (SAA-I014).

e) Impact on BSCCo

Area of Business	Potential Impact of Proposed Modification
ELEXON Systems	<p>The Trading Operations Market Assurance System (TOMAS) would be impacted.</p> <p>The Extra Settlement Determination System would be impacted by change to the approach for calculating imbalance charges.</p> <p>P114 File Copier, Gatekeeper and LuSTRe and associated documentation will be impacted.</p>
ELEXON Procedures	ELEXON operational procedures would be impacted by changes to the approach for derivation of imbalance charges and the registration process.

f) Impact on Code

Code Section	Potential Impact of Proposed Modification
Section A: Parties & Participation	Introduction of reference to a Trading Party Group and its relationship to the Tolerance Band for the purposes of implementing P201.
T: Settlement and Trading Charges	Changes would be required reflecting the derivation of the Tolerance Price and the calculation of imbalance charges for qualifying Energy Accounts.
V: Reporting	Additional BSCCo Reporting Requirements.
X: Definitions	New definitions required.

g) Impact on Code Subsidiary Documents

Document	Potential Impact of Proposed Modification
Settlement Administration Agent (SAA) Service Description	The SAA Service Description would be impacted
Central Registration Agent (CRA) Service Description	The CRA Service Description would be impacted

Document	Potential Impact of Proposed Modification
CVA Data Catalogue	Changes to reflect additional SAA, CRA and/or BMRA reporting requirements. Interfaces for notification of the tolerance price band may also be required.
Reporting Catalogue	BSCCo Reporting Amended (Parameters Set By the Panel, Party Details, Operational Data)
BSCP065	BSCP065 will be amended to reflect the new process for identification and registration of Trading Party Groups and qualifying Parties.
BSCP038	Minor change to note that a Category A signatory responsibility to nominate Trading Party Group and consumption account

h) Impact on Core Industry Documents and Other Documents

None identified.

i) Impact on Other Configurable Items

Document	Potential Impact of Proposed Modification
SAA User Requirements Specification (URS)	The SAA URS will be impacted
CRA URS	The CRA URS will be impacted
IDD Parts 1+2	Changes to reflect additional SAA reporting requirements. Interfaces for notification of the tolerance price band also required.

j) Impact on BSCCo Memorandum and Articles of Association

None identified.

k) Impact on Governance and Regulatory Framework

None identified.

APPENDIX 4: APX ANALYSIS OF LIQUIDITY IN SHORT TERM MARKET

Attached as separate document – Attachment 4 (P201P202UMR_Attachment4_APXAnalysis).

APPENDIX 5: IMPACT OF TOLERANCE BAND ON IMBALANCE CASHFLOWS

Attached as separate document – Attachment 5 (P201P202UMR_Attachment5_SettlementCashflowImpact).

APPENDIX 6: ANALYSIS OF STRESS SCENARIOS FOR IMBALANCE COSTS

Attached as separate document – Attachment 6 (P201P202UMR_Attachment6_StressScenarios).

APPENDIX 7: ASSESSMENT OF NON-DELIVERY RULES

Attached as separate document – Attachment 7 (P201P202UMR_Attachment7_NonDelivery).

APPENDIX 8: PROCESS FOLLOWED

In granting Urgent Treatment, the Authority indicated that P201 was commercially significant and linked to an imminent date related event. The process followed is outlined in the table below.

Date	Event
26/05/06	P201 Modification Proposal raised by Utilita
02/06/06	P201 IWA presented to the Panel / Panel consider P202 urgency request
01/06/06	P202 Modification Proposal raised by Bizzenergy
12/06/06	Ofgem grants P202 Urgent Status
13/06/06	BSCCo recommends urgent treatment of P201 and Panel consider recommendation
13/06/06	Ofgem grants P201 Urgent Status
14/06/06	First Modification Group meeting held
15/06/06	Implementation Options Consultation document issued
22/06/06	Implementation Options Consultation responses returned
26/06/06	Initial Requirements Specification issued for High level impact assessment
30/06/06	High level impact assessments returned
04/07/06	Second Modification Group meeting held
12/07/06	Urgent Modification Consultation document issued
12/07/06	Requirements Specification issued for detailed level impact assessment
25/07/06	Detailed impact assessment responses returned
25/07/06	Urgent Modification Consultation responses returned
28/07/06	Third Modification Group meeting held
08/08/06	Urgent Modification Report issued to Panel
10/08/06	Urgent Modification Report considered by Panel

Copies of all documents referred to in the table below can be found on the BSC Website at:

<http://www.elexon.co.uk/changeimplementation/ModificationProcess/modificationdocumentation/default.aspx>

APPENDIX 9: MODIFICATION GROUP MEMBERSHIP

Member	Organisation	14/06/06	04/07/06	28/07/06
Thomas Bowcutt	ELEXON (Chairman)	✓	✓	✓
Amanda Greenwood	ELEXON (Lead Analyst)	✓	✓	✓
Bill Bullen	Utilita (Proposer P201)	X	✓	X
Keith Munday	Bizz Energy (Proposer P202)	✓	✓	✓
Bob Brown	P201 Proposer's Representative	✓	✓	✓
Robert Barnett	Campbell Carr	✓	✓	✓
Rob Smith	National Grid	✓	✓	X
David Lewis	EDF Energy	✓	✓	✓
Lisa Waters	Waters Wye	✓	X	X
Richard Jones	RWE Npower	✓	X	X
Ben Sheehy	E.ON UK	✓	✓	✓
Paul Dawson	Barclays Capital	✓	X	✓
Ian Calvert	British Sugar	Part	X	Part
Andy Colley	Scottish and Southern	✓	✓	X
Merel van der Neut Kolfcholen	Centrica	✓	✓	✓
Ian Moss	APX	✓	✓	X

Man Kwong Liu	SAIC	✓	X	✓
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Attendee	Organisation			
Melanie Henry	ELEXON (Lawyer)	✓	✓	✓
Raihana Braimah	Ofgem	X	✓	X
Ben Woodside	Ofgem	✓	X	✓
Dean Riddell	ELEXON	✓	X	X
Mark Gribble	LogicaCMG	✓	✓	X
Phil Broom	Gaz de France	✓	X	X
Loise Allport	British Energy	✓	✓	X
Bill Reed	RWE Npower	X	✓	X
Shafqat Ali	National Grid	X	X	✓

APPENDIX 10: MODIFICATION GROUP TERMS OF REFERENCE

Urgent Modification Procedure

The Modification Group will carry out an Urgent Modification Procedure pursuant to section F2.9 of the Balancing and Settlement Code and in accordance with the urgent procedure and timetable agreed by the Authority.

The Modification Group will produce a draft Urgent Modification Report for consideration at the BSC Panel at its meeting on 10 August 2006.

The Modification Group shall consider and/or include in the draft Urgent Modification Report as appropriate:

- Consideration of the application of the tolerance band including:
 - A specification of the qualification criteria and how these should be applied by central systems
 - An assessment of the appropriateness of the circumstances in which the tolerance band will apply
 - A view on the potential for manipulation
 - A view on the appropriate size of the tolerance band. Including consideration of the capacity of the Manx Interconnector
- An assessment of the principle of the tolerance price and approach to derivation
- An assessment of the appropriateness and impact of the tolerance band
- Consideration of the implementation approach, including identification of any workarounds that would support implementation ahead of winter 06/07
- Consideration of the potential impact on Settlement cashflows
- An assessment of the level of liquidity and the range of trade-able products in the market
- Identification of the benefits provided to participants
- A consideration of the potential influence on participant behaviour
- Any relevant Background provided by previous Modification Proposals. In particular issues raised in the Authority decisions on Rejected Modification Proposal P26 – 'Market-Driven Trading Neutrality Band' and Gas Network Code Modification 0415 'Phased Reduction in Shipper Tolerances'
- A consideration of the interaction with the credit arrangements