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25 November 2005

BSC Signatories, National Grid Electricity Transmission plc and Other Interested Parties

Our Ref: MP No P195

Dear Colleague,

Modification to the Balancing and Settlement Code ("BSC") – Decision in relation to Modification Proposal P195: "Neutrality for CCGT BMUs switching between gas and distillate"

The Gas and Electricity Markets Authority[1] (the "Authority") has carefully considered the issues raised, and the responses received, in respect of Proposed Modification P195 - "Neutrality for CCGT BMUs switching between gas and distillate".

The BSC Panel (the "Panel") recommended to the Authority that Proposed Modification P195 should not be made. In the event that the Authority determines that the Proposed Modification P195 should be made, the Panel recommended an Implementation Date of two Working Days following an Authority decision.

Having considered the final Modification Report[2] in respect of Proposed Modification P195, the Panel's recommendation and having regard to the Applicable BSC Objectives[3] the Authority has decided not to direct a modification to the BSC in line with Proposed Modification P195.

[1] Ofgem is the Office of the Authority. The terms "Ofgem" and "the Authority" are used interchangeably in this letter.

[2] ELEXON document reference P195MR, Version No2.0, dated 28/10/05.

[3] The Applicable BSC Objectives, as contained in Standard Condition C3 (3) of National Grid Electricity Transmission plc's Transmission Licence, are:

a) the efficient discharge by the licensee of the obligations imposed upon it by this licence;
b) the efficient, economic and co-ordinated operation of the GB transmission system;
c) promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity; and

This letter explains the background and sets out the Authority's reasons for its decision.

Background

This section sets out the background to the modification proposal in four key areas, namely:

- National Grid's outlook for the gas market in the forthcoming winter;
- the cash out arrangements in the electricity market;
- the commercial interruption arrangements in the gas market; and
- the emergency arrangements in the gas market.

National Grid's (NG) Winter Outlook Report (WOR) 2005-2006

The purpose of NG's WOR is to inform the market of any potential operational issues in relation to the supply and demand of gas and electricity in GB for the winter ahead, particularly in the event of a severe weather conditions (1 in 50 severe winter). This year NG conducted a consultation exercise designed to help the industry and provide feedback for NG to support the production of the WOR 2005-2006. NG published its WOR in October of this year.

Against supply scenarios developed through consultation with the industry and a single base case comprising assumptions regarding beach gas availability, generation availability importation flows and gas storage, the WOR 2005-2006 (amongst other things) outlines potential requirements for demand side response in the gas market. The report concludes that modest Demand Side Participation would be required in an average winter, and substantial Demand Side Participation would be required in a 1 in 50 winter. In an average winter, NG expects 0.1 bcm of demand side response, all of which is expected to be provided by CCGTs. In a 1 in 50 winter, NG expects 3.7 bcm of demand side response with CCGTs to provide 1.8 bcm of demand side response.

Cash out arrangements

Under the electricity cash out rules of the BSC, a Party is in a position of imbalance if its notified contract volume does not match its metered volume, i.e. the Party is producing (or consuming) electricity which has not been sold (or bought) and is therefore not covered by contracts. Imbalance settlement, or 'cash out', is designed so that any electricity produced (or consumed) that is not covered by contracts is paid (or charged) for at a cost reflective price. The arrangements are designed to pass through the costs that National Grid Electricity Transmission plc ("NGET"), as Electricity System Operator (SO), has incurred in buying and selling electricity to match generation and demand to those Parties that are in imbalance, i.e. those Parties on behalf of which NGET has taken electricity energy balancing actions.

d) promoting efficiency in the implementation and administration of the balancing and settlement arrangements;

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A dual cash-out mechanism exists, in which there are two Energy Imbalance Prices, or 'cash out prices': the System Buy Price ("SBP") and the System Sell Price ("SSP"). Parties that are short are generally charged the SBP for their imbalance volumes and Parties that are long generally receive SSP for their imbalance volumes

The cash out arrangements are crucial in sending appropriate price signals and creating the necessary commercial incentives on companies to maintain security of supply. For suppliers, the potential to be exposed to high cash out prices during periods of peak demand provides an incentive to contract with generators in advance to meet their customers' peak demand. For generators, the potential to be exposed to high cash out prices following, for example, a mechanical failure, during periods when margins are tight provides an incentive to maintain plant and to contract with other peaking plant to provide cover for mechanical failures.

Gas interruptions and the electricity market

Commercial gas interruption

Commercial interruption is the term given to demand side actions taken to reduce gas demand in response to market dynamics. There are three different forms of commercial interruption:

a) in response to high prices for gas, a demand side participant decides to reduce demand. For example, an CCGT may choose to switch to an alternative fuel at times when the cost of gas is higher than its alternative fuel source;
b) pre-contracted response that give shippers rights to interrupt; and
c) Gas Balancing Alerts (GBA) are indicators of when the gas system is likely to experience supply/demand problems. A GBA can act as a contract trigger for those contracts struck between customers and suppliers, if a customer wishes to provide demand side response.

The first two forms of commercial interruption are relevant to this modification proposal.

Emergency gas interruption

In the gas market there are a number of stages in the emergency arrangements. The first three stages are relevant to this modification proposal.

When NG Gas identifies a supply shortfall that cannot be addressed through the normal commercial arrangements, it will ask the National Emergency Co-ordinator (NEC) to declare a Gas Deficit Emergency (GDE). The NEC will then invoke all or part of the following five-step procedure as appropriate:

- **Stage 1 – notice of impending emergency**. This indicates that there is a potential gas emergency, where the information available to the NEC indicates that there is sufficient time and sufficient gas available, for the primary system to be rebalanced without recourse to Stage 2. This would include maximising the use of linepack, storage and interruption of those customers on interruptible transportation contracts.;

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- **Stage 2 – declaration of emergency**. At this stage the commodity market is suspended and the primary transporter is instructed to carry out the measures set out in the emergency arrangements.;

- **Stage 3 – firm load shedding**. The affected transporter makes direct or indirect contact with firm end-users and instructs them to stop or reduce their offtakes of gas. Firm load shedding is divided into three tranches of increasing severity and effect. The three tranches are:

    - very large end-users (VLDMC) (those taking more than 50 million therms per annum (tpa));
    - large end-users (those taking between 25,000 tpa and 50 mtpa); and
    - end-users taking less than 25,000 tpa.

  Firm load shedding will be invoked in the order shown above. It is at Stage 3 that exports of gas through interconnectors can be curtailed;

- **Stage 4 – system isolation**. The available gas will be allocated to secondary systems supplying domestic end-users;

- **Stage 5 – restoration**. Normal arrangements are restored.

The Modification Proposal

SSE submitted Proposed Modification P195 "Neutrality for CCGT BMUs switching between gas and distillate" on 3 October 2005, and a request for urgency was issued to the Authority by the panel on 4 October 2005.

The Authority agreed to grant urgency to the modification proposal on 5 October 2005. Urgent modification group meetings were held on the 6, 11 and 24 October 2005 and a consultation took place. The final urgent modification report was presented to the panel on the 28 October 2005. The urgent modification report was issued to the Authority on the 28 October 2005.

Modification proposal P195 seeks to ensure that a distillate CCGT BM Unit that either trips or fails to meet its intended load levels following a decision to switch from gas to distillate or vice versa at times of system stress on the gas or electricity system, remains neutral in respect of its electricity cash out exposure. The modification proposal would seek to hold a distillate CCGT BM Unit neutral if the following conditions are met:

- the distillate CCGT BM unit trips or fails to meet its intended load levels during the winter period (1 November to 31 March);

- that there is system stress on the electricity or gas systems (one of a set of defined "triggers"[4] set out in the modification proposal); and

[4] Triggers referred to are as follows:

Gas

a) when a distillate CCGT BM Unit receives an instruction which originated from the relevant gas transporter or Network emergency co-ordinator (NEC) to cease or reduce using gas, including in the case of potential or

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- that as a result of the system stress, and acting as a reasonable and prudent operator, the distillate CCGT BM Unit switches from gas to distillate or vice versa.

If the above three conditions are met, and the distillate CCGT BM Unit trips off or fails to meet its intended load levels, with the result that the market participant becomes out of balance, the modification proposal states that the market participant should be held neutral to cash out exposure for up to four hours.

The modification proposal suggests that any generator that wishes to make a claim would submit it to the Panel[5] for adjudication as to whether the claim is valid and warranted. To deter frivolous claims, it is proposed that the claimants would have to pay a non-refundable £10,000 claim processing fee.

Under this modification proposal distillate CCGTs would be neutral to cash out prices in the event of the exercise of commercial interruption when a trigger event occurs, as well as interruption as a consequence of an Emergency Instruction.

The proposer of the modification argued that the modification proposal would be beneficial as it will ensure that distillate CCGT generating plant do not declare themselves unavailable at times of system stress, particularly where there is a gas shortage, due to the risks involved in the process of switching fuels. The proposer also believed that if this modification proposal was not implemented, distillate CCGT generating plant may submit very high Bid and Offer prices to reflect the risks associated with switching fuels which would distort energy imbalance prices.

Potential Alternative Modifications

During the modification process, the group considered four potential Alternative Modification Proposals, but agreed not to develop any of these options further as it was considered that none would better facilitate achievement of the Applicable BSC Objectives when compared to the modification proposal or the current baseline.

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actual Network gas supply emergencies or local gas supply emergencies(in accordance with the UNC (G1.20, G6.7 or Q3.1).

b) where a distillate CCGT BM Unit receives an instruction from a non-affiliated shipper to cease or reduce using gas. NB this instruction could be made for commercial reasons.

c) where the CCGT BM Unit receives a notice informing of the cessation or revocation of the instruction referred to in a or b.

Electricity

d) that a GB (electricity) Transmission system warning (as listed in OC7.4.8.4, and detailed in OC7.4.8.5-7.4.8.10 of the grid code (Reference 5)) is issued.

e) when a distillate CCGT BM Unit receives an Emergency Instruction (as detailed in BC2.9 of the Grid Code) from the GB (electricity) System Operator.

f) where a notice or instruction relating to the end of Transmission System Warning or Emergency Instruction is issued or the time period relating to the end of Transmission System Warning or Emergency Instruction passes.

[5] Noting that the Panel might choose to delegate authority for this function to a Panel Committee, which could include the Trading Disputes Committee, or request external expertise.

Respondents' views

This following section outlines the views expressed by the respondents. It is intended to summarise the principal themes of the respondents' views, full details of these can be found at Elexon's website.[6]

15 responses were received in relation to the Proposed Modification P195. Two supported the modification proposal and 13 were opposed to it.

Respondents supporting the modification proposal

Commercial incentives

Two respondents, including the Proposer, considered that the modification proposal would better facilitate Applicable Objective (b). The Proposer was of the view that implementation of the modification proposal would remove any current potential commercial disincentives for distillate CCGT generating plant to respond to system stress trigger events by switching fuels. The Proposer considered that such a disincentive could arise if the prevailing price did not adequately compensate for the action(s) taken in response to the system stress "trigger" events. The Proposer noted that implementation of the proposal would ensure that distillate CCGT generating plant would remain cost neutral when responding to system stress "trigger" events.

The Proposer also considered that by removing the potential commercial disincentives for distillate CCGT generating plant to respond to system stress trigger events by switching fuels, by holding them neutral to cash out exposure in this situation, the proposal would ensure that the plants were incentivised to provide capability at times of system stress. The Proposer considered that this was important given the need for generation by CCGTs at times of system stress identified in NG's WOR.

Security of supply

One respondent, representing large gas consumers, considered that implementation of the proposal would assist in providing appropriate incentives for all gas consumers able to do so to provide demand side response, particularly when gas supplies for the coming winter were recognised to be tight.

Impact on BM prices

The Proposer considered that the modification proposal would better facilitate Applicable Objective (c). The Proposer was of the view that the proposed changes would remove any potential distortion of BM prices brought about by distillate CCGT operators attempting to factor the cash out risk of responding to a system stress trigger event, into their prices. The Proposer considered that because system stress trigger events were not within the control of distillate CCGT BM Units, it was inappropriate for parties responding to such events to be exposed to financial losses as a result of complying with the instruction. By removing the potential for such losses, implementation of the modification proposal would promote effective competition in the generation and supply of electricity.

[6] Respondents views can be found on the Elexon website www.elexon.co.uk

Respondents against the modification proposal

Balancing roles

NGET, as SO, considered that if the modification proposal were to be implemented, the fundamental market principle of self-balancing, and incentives on the market to balance, would be undermined. NGET, therefore, did not consider that the Proposed Modification P195 better facilitated the achievement of Applicable Objective (a) and (b).

Commercial incentives to maintain plant

The majority of respondents (which included parties with distillate CCGT generation plant) who did not support the implementation of the modification proposal were of the view that the modification proposal would encourage the inefficient maintenance and operation of distillate CCGT generating plants. These respondents considered the modification proposal would remove or weaken the incentive on distillate CCGT operators to improve and maintain the switching mechanisms of the plants, making their potential failure more likely. These respondents, therefore, did not consider that the modification proposal would better facilitate the achievement of Applicable Objective (b). Some respondents considered that if this modification proposal were implemented there was a possibility that the current duty on generators' to ensure their plants can run in a safe and efficient manner would not be fulfilled.

Several respondents also considered that in periods following plant failure, the incentive to recover quickly would be dampened due to the neutrality period.

Commercial incentives to switch to distillate

A number of respondents were of the opinion that the electricity cash out arrangements and market rules already provided sufficient incentive for distillate CCGT to switch to distillate in the event of a gas interruption. One respondent noted that cash out prices provided the incentives for generators to generate to its contracted position. If a generator does not generate and has not been able to procure a contract from elsewhere to cover the shortfall, as would be likely during a period of shortage, then it will be exposed to the full cost of its subsequent imbalance. These respondents considered that minimising generators' exposure through the adjustment proposed in the modification proposal would reduce this incentive, as the CCGT BM Unit would be held neutral in respect of cash out prices for any shortfall. The respondents argued that this could have issues relating to security of electricity supply at times of system stress.

Furthermore, a number of respondents considered that the incentives on distillate CCGTs to generate, resulting from the cash out arrangements, were sufficient despite the risk of tripping. These respondents stated that generating, even at the risk of a trip, would have the potential to reduce the cash out exposure of the generator. These respondents therefore did not consider that there was a need to neutralise cash out prices to place an incentive on distillate CCGTs to switch fuels.

Commercial incentives to balance

A number of respondents did not consider that the modification proposal would better facilitate the achievement of Applicable Objective (b) as implementation would be likely to lead to less efficient electricity energy balancing by distillate CCGT BM Units, and hence could result in additional security of supply issues. These respondents were of the view that under the proposals distillate CCGT BM Units would be encouraged to start up or switch fuel even if their reliability was low. These respondents were concerned that this could lead to increased tripping by distillate CCGT BM Units at times of system stress, which would result in less efficient operation of the system as the SO would need to take potentially more expensive Offers following such a trip. Some respondents were concerned that such operation by the distillate CCGT BM Units could also result in issues associated with security of electricity supply.

One respondent was concerned that if the modification proposal was implemented there would be an incentive on distillate CCGT operators to leave testing their switching capability until times of system stress, which again would have implications for the efficient operation of the system should the switch cause the plant to trip.

Furthermore, one respondent was concerned that, in the event of a system trip, generators would be disincentivised by their neutrality to cash out prices from contracting out of their contractual position for the period of neutrality and would not be incentivised quickly to return the plant to service. The respondent was concerned that this would result in increased balancing costs being incurred by the SO. Another respondent considered the proposal would reduce the incentives on CCGTs to contract forward for period of system stress.

One respondent was concerned that, if implemented, this modification proposal could lead to gaming opportunities if CCGTs, in the class of distillate CCGTs covered by the proposal, entered into contracts with gas shippers to instigate commercial interruption at times of high pricing within the power market. The respondent stated that such contracts could protect the CCGT from a trip risk in this situation and potentially provide the CCGT with a means to increase cash out prices to influence the forward market.

Potential for discrimination

The majority of respondents, including NGET, who did not support the implementation of the modification proposal considered that the modification proposal would not better facilitate the achievement of Applicable BSC Objective (c), as implementation of the modification proposal would result in discriminatory treatment in favour of one type of generating technology (i.e. the class of distillate CCGT BM Units covered by the modification proposal).

The majority of respondents considered that it was inappropriate for CCGTs to be provided with a cross-subsidy (through neutrality of cash out prices) from generators with fuel types other than the class of distillate CCGTs specified in the modification proposal. A number of these respondents noted that these CCGTs had chosen to have interruptible fuel contracts for commercial advantage and therefore that it would be inappropriate for the risks associated with these contracts to be mitigated and, in practice, spread across other classes of generators. A number of respondents considered that there was no rationale for treating CCGT generating

plants differently from any other plants capable of some form of fuel switching, as the ability to switch was not exclusive to CCGT generating plants.

Several respondents were of the view that the modification proposal would potentially distort the operation of the market at times when the market signals encouraged generation to run. These respondents considered that a generator should not be allowed to benefit from the market price whilst being held free of cash out exposure in the event that it fails to meet its contracted position. One respondent considered that CCGT generating plants with distillate capability would be placed in an advantageous market position given the limitations on the class of generators that can benefit from the modification proposal and the costs that the proposal would enable them to avoid in relation both to investment in reliable plant capable of switching fuels; and from not having to sign a firm gas contract. It was further noted that there is currently no evidence that such generators are unduly disadvantaged by the operation of the market at present.

One respondent considered that, at times of system stress, it was likely that other generating plants would be required to generate as much as possible, which may increase the likelihood of such plants tripping, which would leave them fully exposed to the cash out price.

One respondent considered that the implementation of the modification proposal would introduce an element of discrimination against all participants in the market, at times when imbalance charges arise during periods where cash out neutrality would apply. This respondent considered that parties other than the failing plant would pay for the plant trip/failure.

Claims process

Five respondents commented on the effect of the proposed claims process on the efficiency of the implementation and administration of the Balancing and Settlement Arrangements. One of these respondents considered that, as the exact details of how claims would be made have not been fully detailed, there is much scope for interpretation on a case by case basis and that this could prove costly. The other four respondents considered that the proposed claims process will significantly increase the administrative burden on Elexon and BSC parties and hence lead to substantially higher costs.

Panel's recommendation

The Panel met on 28 October 2005 to consider Proposed Modification P195, the Draft Modification Report, the views of the PSMG and the consultation responses received.

The Panel considered that Proposed Modification P195 would not better facilitate the achievement of any of the Applicable BSC Objectives compared to the existing BSC baseline. It unanimously agreed with the majority Group recommendation that P195 would be detrimental to Applicable BSC Objectives (b), (c) and (d) for the reasons detailed below.

Objective (b):

- Reduced incentives to keep plant reliable. If a CCGT operator was exposed to cash out prices when it had problems switching, the operator would have a greater incentive to ensure that the switch was carried out smoothly;

- CCGT operators should not be encouraged to switch fuels at times of Transmission System stress; and
- It is inefficient to try and address concerns about the operation of the gas market through changes to the electricity market.

Objective (c):

- Gas shippers and transporters may choose to have interruptible contracts, and the UNC caters for gas interruptions at an appropriate price. The gas market has a mechanism for Parties to remain neutral for gas interruptions. Introducing neutrality to the electricity side too was felt to be anti-competitive;
- Allowing CCGT BM Units that fail to meet their intended load four Settlement Periods to fix the Plant would decrease incentives on them to use the market to trade out their position;
- CCGT generating plant switching between gas and distillate are no more likely to trip off at times of system stress than other generation types that might be asked to exceed normal levels of generation, leading to discrimination if only the former were held neutral to cash out prices;
- Similarly, there are generating plants capable of switching between fuels other than gas and distillate, but subject to the same risks of tripping. It would be discriminatory if these did not have equivalent treatment; and
- A CCGT BM Unit failing to meet its intended load levels may cause the SO to take additional balancing actions. The cost of these actions would be paid by all Parties, except the CCGT BM Unit, via the cash out prices. Effectively all other Parties in the market would pay for the plant trip/failure.

Objective (d):

- The claims process for P195 was likened to the Past Notification Errors ("PNE") claims process. It was noted that the PNE process was very costly and it was felt that the P195 claims process could carry similar costs. It was suggested that this would be inefficient, as the costs of processing an upheld claim could exceed the claim itself.

Therefore, in the final Modification Report the Panel recommended to the Authority that Proposed Modification P195 should not be made. In the event that the Authority determines that Proposed Modification P195 should be made, the Panel recommended an Implementation Date of two Working Days following an Authority decision.

Ofgem's view

Having carefully considered the final Modification Report, the respondents' views and the Panel's recommendation, Ofgem, having regard to the Applicable BSC Objectives, is of the view that Proposed Modification P195 would not better facilitate achievement of the Applicable BSC Objectives.

In this section we set out the reasons for this decision in the context of the Applicable BSC Objectives.

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Applicable BSC Objective (b) – the efficient, economic and co-ordinated operation of the GB Transmission System"

Proposed Modification P195 recommends that a distillate CCGT BM Unit that either trips or fails to meet its intended load level after switching fuels from gas to distillate or vice versa following an appropriate trigger event on the gas or electricity Systems, in a winter period, remains neutral to cash-out exposure. Ofgem agrees with the unanimous verdict of the Panel and the majority of respondents that this modification proposal would not better facilitate the relevant objective to ensure the efficient, economic and co-ordinated operation of the GB Transmission systems for reasons outlined below.

Ofgem considers that if the modification proposal were implemented distillate CCGT generating plants will have less of an incentive to ensure that they can switch reliably. This lack of incentive to have robust plants would not facilitate the efficient or economic operation of the Transmission System, as it may require the SO to take additional balancing actions in its role as residual balancer in the event that such plants experience problems when switching. Furthermore, as it is most likely that plants would need to switch to alternative fuels at times of system stress, in reducing the incentive on plant operators to switch fuel reliably there is a heightened risk of plants tripping at times of system stress which could ultimately impact on security of supply.

Ofgem considers that there is a risk that the proposal will provide a disincentive for plants that have tripped to return back to production in a timely fashion.

Ofgem agrees with the Panel and the majority of respondents that a plant operator should consider the implications and potential risks of switching when considering whether to switch to alternative fuels. If the plant operator was not going to be exposed to cash out prices for any imbalance associated with switching, then it may risk switching fuels when otherwise it would not, as the costs of plant failure and any associated exposure to cash out prices would be removed, thereby reducing the potential costs of switching. This modification proposal, therefore, risks encouraging plants that are unreliable when switching to switch when they would otherwise not. As a respondent suggested, it could even result in relevant CCGT generating plants testing their switching ability during a neutrality period when they know that they will be held neutral in respect of cash out prices in the event that they trip.

Ofgem does not agree with the argument put forward by the Proposer that the modification proposal would encourage plants to be available, when otherwise they would not, to the ultimate benefit of security of electricity supply. It is Ofgem's view, as outlined above, that the modification proposal will undermine the commercial incentives for Parties to balance their positions which could increase the costs of balancing the system via the SO and, ultimately, could prejudice security of supply. Furthermore, if a plant operator were to consider switching fuels as a result of price signals from the gas and electricity markets, the current market arrangements would incentivise the participant to test its switching capability at times when the system is not under stress, and/or to contract for options to make up the potential deficit or keep another plant in its portfolio on standby to counter the risk that the switching plant trips. By removing this incentive for the plant operator to consider options to mitigate switching risk, there is a risk that back up plant is not made available to the electricity SO given the reduced timescale for notice. In turn, this again risks increasing the overall costs incurred by the SO in

meeting the potential shortfall caused by a tripping plant, which is not in the overall interest of operating an economic or efficient Transmission System.

For the reasons outlined above, Ofgem does not consider that the Proposed Modification P195 better facilities relevant Objective (b) – the efficient, economic and co-ordinated operation of the GB 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

Related to the arguments set out above, Ofgem agrees with the Panel, and the majority of respondents, that the modification proposal will not promote effective competition in the generation of electricity. Plant operators that would benefit under the modification proposal would not face exposure to cash out prices for any imbalance experienced during the process of fuel switching and so would have no commercial incentive to trade out these imbalance positions. Ofgem considers that competition will be enhanced if all Parties are exposed to those imbalance exposure risks that they are able to manage by bilaterally contracting for their positions in the market. Therefore, Ofgem considers that removing imbalance exposure reduces the incentives for relevant Parties to balance their positions, which would have a detrimental impact on the development of effective competition in the generation and supply of electricity.

Ofgem agrees with the Panel, and the majority of respondents, that the modification proposal would lead to undue discrimination between different types of plant operators. The modification proposal only considers distillate CCGT generating plants and does not recognise that there are other plants which are capable of switching between fuels that may also be susceptible to tripping during times of system stress. Therefore, Ofgem considers that the modification proposal would unduly discriminate between different Plant types and would not promote effective competition in electricity generation.

Applicable BSC Objective (d) – promoting efficiency in the implementation and administration of the balancing and settlement arrangements

Ofgem notes that Proposed Modification P195 may increase the costs of Settlement on account of the relatively complex claims process. Whilst the modification proposal contains a number of factors designed to militate against this, such as the payment of a claim fee by the claimant, it is nonetheless likely to be a costly process to administer, requiring considerable expert judgement and also potentially extensive involvement of the Panel. For these reasons, Ofgem agrees with the Panel recommendation and considers that the Proposed Modification P195 does not meet Applicable BSC Objective (d).

Summary

Overall, Ofgem considers that Proposed Modification P195 would not better facilitate the achievement of the Applicable BSC Objectives, most notably Applicable BSC Objectives (b), (c) and (d). In particular, Ofgem considers that the modification proposal would weaken the commercial incentives for Parties to maintain reliable plants, which would in turn be expected to be to the detriment of the efficient, economic and co-ordinated operation of the GB Transmission System. Furthermore, Ofgem considers that the modification proposal would, by

removing imbalance exposure linked to gas-distillate switching, weaken the commercial incentives on Parties to balance their positions and mean that the SO's Electricity Balancing costs are not targeted onto all the Parties on whose behalf the SO is taking these actions. Ofgem considers that this would not be in the interests of promoting competition in the generation and supply of electricity. For these principal reasons, Ofgem considers it appropriate to reject the proposal.

If you would like to discuss any aspects of this letter, please contact Helen Connolly on 020 7901 7267 or Ed Carter on 020 7901 7304.

Yours sincerely

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