Modification Proposal	MP No: 100 *(mandatory by BSCCo)*

Title of Modification Proposal *(mandatory by proposer)***:**

Extension of Demand-side Trading Units in order to increase the competitiveness of the market for embedded benefits

Submission Date *(mandatory by proposer)***:** 2 September 2002

Description of Proposed Modification *(mandatory by proposer)***:**

Realisation of embedded benefit is currently constrained to certain BSC participants based on their contractual status rather than on the appropriate physical characteristics of the avoided use of system. In order to free up embedded benefit so that it can be traded efficiently and competitively (but without requiring new contractual relations between NGC and embedded generators) the following changes are proposed:

1. A single Trading Unit to be formed for each GSP Group
2. For this Trading Unit, no Lead Party is necessary
3. All Supplier BM Units and any BM Unit formed of Exemptible Generating Plant to be deemed to have applied for and been granted such Trading Unit status.
4. The exception to point 3 is any Exempt Export BM Unit whose Lead Party notifies that it wishes to be formed into a separate Trading Unit either as a Sole Trading Unit or else as part of another Trading Unit in the same GSP Group.

A BM Unit comprising Exemptible Generation (as either a single generator or as several generators) may apply to the Panel for a status allowing that BM Unit to meter share with either Production Accounts or Consumption Accounts, regardless of whether the BM Unit is registered in CVA or SVA.

Description of Issue or Defect that Modification Proposal Seeks to Address *(mandatory by proposer)***:**

Under the current trading arrangements, Licence Exemptible Generation (LEG) faces barriers to achieving a reasonable return on its generation. A description of those barriers is contained in Modification Proposal P95. One area where LEGs are at a competitive disadvantage is in their inability to sell their embedded benefits in a sufficiently broad market. Currently their ability to earn a fair share of their embedded benefits is hindered by their weak bargaining position with the relatively few suppliers with sufficient demand under the relevant GSP Group. The weakness of their bargaining position is compounded by the barriers associated with the absence of a fair and cost reflective settlement system for LEGs which is addressed by Modification Proposal P95. In its decision on Modification P7, Ofgem stated: "*The rationale behind permitting access to embedded benefits is based on the fact that embedded generation is deemed to net off local demand and does not utilise the transmission system.*" This rationale is valid regardless of the contractual relationship of the embedded generation because it is a physical phenomenon. Therefore, logically, all embedded benefit should be allowable based on the full level of avoided use of the transmission system.

Although helpful, Modification P7 has provided only a limited benefit to Exemptible Generators who are not trading with or affiliated with a company with a substantial supply portfolio in the appropriate GSP Group. The sole reason for forming a Class 5 Trading Unit (as defined under Annex K-2 of the Code) is so that BM Units within that Trading Unit will be eligible for embedded benefits and so, unless the larger supplier can negotiate a share of those embedded benefits they will not participate in such a Trading Unit. There is no other economic or contractual reason for a larger supplier to participate in Trading Units with smaller suppliers (that would allow such smaller supplier or else a demand-side Consolidator to establish sufficient demand to fully earn the potential embedded benefits).

Therefore, the current trading arrangements unduly impede LEGs in realising the value of their embedded benefits.

The current trading arrangements also unduly constrain the competitiveness of smaller suppliers and demand-side Consolidators since the current rules may often prevent them from establishing sufficient demand under the relevant GSP Group to be effective competitors to purchase the available embedded benefits in the market.

Even where embedded benefits are fully payable on behalf of an embedded generator, it may not be in the economic interest of that generator (due to potential relative TNUoS charges in certain zones as well as to potential RCRC payments) to trade as a Consumption BMU, therefore it seems appropriate to retain the flexibility currently allowed under the Code for the relevant generator to choose whether to trade as a Production BMU or a Consumption BMU.

However, given the concentration of supply in the current market, there still remains a limited option for LEGs in the number of counter-parties available in the market, which leads to a weak bargaining position. This is exacerbated by the fact that, for many smaller generators, the characteristics of their output profile and residual error is better correlated with the characteristics of other generators than with demand such that they would more naturally seek to consolidate within an appropriate generation portfolio than in a supply portfolio. This is not possible at present if the generator is to retain embedded benefits. There seems no reason why this class of plant cannot have the opportunity of meter sharing with similar generators in a Production Account while still retaining their embedded benefits. While recognising that in a two-price cash-out regime, allowing general meter sharing between Production and Consumption Accounts would deliver considerable market power to vertically integrated participants, a limited meter sharing arrangement restricted to just generators would not cause the potential market distortion. This meter sharing is a recognition of the existing right to choose whether to be Production or Consumption while not prejudicing the rights to embedded benefits. This would allow the generator to sell firm energy contracts to suppliers, whilst retaining embedded benefits.

Impact on Code *(optional by proposer)***:**

Section K

Impact on Core Industry Documents *(optional by proposer)***:**

Impact on BSC Systems and Other Relevant Systems and Processes Used by Parties *(optional by proposer)***:**

Impact on other Configurable Items *(optional by proposer)***:**

Modification Proposal	**MP No.** *(Mandatory byBSCCO)*

Justification for Proposed Modification with Reference to Applicable BSC objectives *(Mandatory by proposer)*

The Applicable BSC Objectives are set out in paragraph 3 of Condition 7A of the Transmission Licence, as follows:

(a) The efficient discharge by the Transmission Company of the obligations imposed under the Transmission Licence;

Not applicable

(b) The efficient, economic and co-ordinated operation by the Transmission Company of the Transmission System;

Not applicable

(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;

The modification promotes competition in the generation and supply of electricity, in that:

(i) it removes the barrier in the current rules, whereby LEGs can realise the value of the embedded benefits associated with their generating output only by trading with licensed suppliers with sufficient consumer demand under the generators' GSP group, is a barrier to LEGs realising the proper value of their generating output;

(ii) it removes the weakened bargaining position of LEGs caused by them only being able to sell embedded benefits to such local suppliers in that there will only be a limited number of suppliers with sufficient consumer demand under the generator's GSP group who are willing to acquire such embedded benefits;

(iii) the effect of this modification is to enable LEGs to reach agreement with any meter registrant to acquire the embedded benefits, thus enabling LEGs to sell their embedded benefits into a national market rather than only within the market existing under the GSP group. This encourages competition for the sale of embedded benefits, enabling LEGs to realise their value without existing market constraints;

(iv) the barrier to LEGs selling their embedded benefits into a wider market is one of a range of barriers faced by LEGs. The effect of this barrier has been, with the others, to contribute to disproportionate and damaging effects which NETA has had upon LEGs. This has resulted in withdrawals from the LEG sector and extreme financial consequences for that sector which threaten its continued participation in the generation market. It is not in the interests of competition that the LEG sector, which is up to an estimated 8% of the generation market in England and Wales, should be excluded from access to the whole market;

(v) although this modification proposes a change which would distinguish LEGs from other generators, it does not discriminate against other generators, and

(vi) the modification has the effect of introducing a change to the BSC which assists in causing it to be *consistent with:*

(A) *the duty of Member States under Articles 3(g), 10 and 81 of the EC Treaty not to take any measures which could jeopardise the effectiveness of the rules of competition;*

(B) the requirements of Directive 96/92 (the Electricity Directive) that Member States "ensure that electricity undertakings are operated in accordance with the principles of this Directive, with a view to achieving a competitive market in electricity ..."; and

(C) the duties of the Secretary of State and Ofgem pursuant to Section 3A of the Electricity Act 1989.

The modification is also consistent with the compliance by NGC of its duties as to competition.

(d) Promoting efficiency in the implementation and administration of the balancing and settlement arrangements.

By reducing the number of Trading Units on the demand side to only those necessary to ensure the sole function of such Trading Units is fulfilled, the Balancing and Settlement Arrangements are implemented and administered more efficiently.

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Attachments: NO

If Yes, Title and No. of Pages of Each Attachment: