

# Report Phase Consultation Responses

## P304 'Reduction in PAR from 500MWh to 250MWh'

**ELEXON**

This Report Phase Consultation was issued on 12 September 2014, with responses invited by 30 September 2014.

What stage is this document in the process?

### Consultation Respondents

Respondent	No. of Parties/Non-Parties Represented	Role(s) Represented
GDF SUEZ	14/0	Generator, Supplier
InterGen (UK) Ltd.	3/0	Generator
Good Energy	1/0	Supplier, ECVNA, MVRNA
SmartestEnergy	1/0	Supplier
National Grid	1/0	Transmission Company
VPI Immingham	1/0	Generator
Gazprom Marketing & Trading Retail Ltd	1/0	Supplier
Drax Power Limited	2/0	Generator, Supplier
SSE plc	3/0	Generator, Supplier, Interconnector User
RenewableUK	0/1	Trade Association
Statkraft Markets GmbH	1/0	Generator, Supplier, Interconnector User, ECVNA, MVRNA
ESB	1/0	Generator
Centrica	15/0	Generator, Supplier, Interconnector User, Non Physical Trader
Green Energy UK	1/0	Supplier
ScottishPower	9/0	Generator, Supplier, Non Physical Trader, ECVNA, MVRNA, Supplier Agent
First-Utility	1/0	Supplier
LoCO2 Energy Supply Limited	1/0	Supplier
EDF Energy	10/0	Generator, Supplier, Non Physical Trader, ECVNA, MVRNA

**01** Initial Written Assessment

**02** Definition Procedure

**03** Assessment Procedure

**04** Report Phase

Respondent	No. of Parties/Non-Parties Represented	Role(s) Represented
Utilita	1/0	Supplier
UK Power Reserve Ltd	1/0	Generator, ECVNA, MVRNA

Question 1: Do you agree with the Panel's initial majority view that P304 should be rejected?

## Summary

Yes	No	Neutral/No Comment	Other
11	9	0	0

## Responses

Respondent	Response	Rationale
GDF SUEZ	Yes	<p>Ofgem's concern set out in the EBSCR is that imbalance prices are not creating the correct signals to allow the market to balance, leading to increased risks to future security of supply. P304 is meant to be a 'stepping stone' to the more radical reforms to the cashout arrangements set out in P305.</p> <p>GDF SUEZ believes that P304 will incentivise over contracting to avoid exposure to the more marginal system buy price. It will not create the signals to allow the market to balance, instead the market will be 'long' and longer than it is already. GDF SUEZ therefore sees P304 as a backward step which lacks coherence when set against the concerns set out in the EBSCR.</p> <p>The Proposer has described the Issue or Defect that Modification Proposal Seeks to Address as follows.</p> <p>"The existing cash-out arrangements, which have the effect of dampening cash-out price signals, do not provide sufficient signals to the market of the value of flexible capacity when margins are tight. As a result, cash-out price signals have failed to create appropriate incentives for investment in flexible capacity (such as flexible generation, Demand Side Response (DSR) services and storage).</p> <p>A chief cause of this price dampening is the level of PAR"</p> <p>Whilst we agree that the current cashout arrangement do not on their own sufficiently value flexibility, artificially increasing the bias to a structurally long system will further weaken the 'value signals' for flexible plant. P304 therefore does not address the defect as set out in the Modification Proposal.</p> <p>Furthermore, to restore the system to overall balance, the System Operator (SO) will having to</p>

Respondent	Response	Rationale
		<p>take inefficient additional balancing actions to reduce output.</p> <p>The Proposer also considers that P304 will make a contribution to deferring the mothballing of flexible plant and help counteract potential tightening of margins. This contribution is likely to be very minor due to the weak link between cashout prices and forward prices, particularly longer term forward prices that would provide a signal for mothballed plant to return to service. GDF SUEZ believes that this part of the justification for the modification lacks any foundation.</p> <p>In combination, GDF SUEZ believes that P304 will be a backward step in facilitating Objective B - the efficient, economic and co-ordinated operation of the National Transmission System.</p>
InterGen (UK) Ltd.	No	<p>InterGen believes that proposed modification P304 better facilitates Applicable BSC Objectives (b) and (c) and therefore should not be rejected. We would argue that P304 supports the efficient and economic operation of the NETS (b) by making the main imbalance price signal more cost reflective, providing added incentive on BSC parties to balance ahead of gate closure and thereby reducing the number of balancing actions required to be taken by the System Operator. P304 also supports competition in the generation and supply of electricity (c) by providing sufficient indication to the market of the value of flexible capacity when margins are tight. The conclusions of Ofgem's EBSCR (and Project Discovery, prior to that) drew a direct link between dampened cashout prices and risks to future security of supply. Sharpening imbalance prices to incentivise generators to invest (in new build as well as existing capacity) will benefit consumers by providing adequate system margins in the long run (and by reducing the number of 'out of system' actions required to be taken by the SO, such as SBR, in the short term). The proposals under P304, InterGen believes, give sufficient time for market participants to adapt to the long term changes to be implemented under the EBSCR. A reduction to PAR 250 ahead of Winter 14/15 is an adequate first step towards a fully marginal PAR value which will, in our opinion, allow market participants to gradually transition to a single cashout price whilst also beginning to realise the benefits of a sharpened imbalance prices earlier.</p>

Respondent	Response	Rationale
		<p>InterGen does not agree that there has not been sufficient time to allow industry to determine the full extent of the impact of P304 (an issue which has not been raised under P314, even though the modelling requirements are surely the same). InterGen is satisfied with the impact assessments produced at this report phase and argue that the modest impact P304 will have on Winter 14/15 system prices is far outweighed by the benefits to the industry of this proposed phasing, and time given to prepare for, a single cashout price.</p>
Good Energy	Yes	<p>We consider P304 to be neutral with regard to all Applicable BSC Objectives other than Objective (c) which is not better facilitated by P304. P304 does not better facilitate Objective (c) because the P304 Workgroup analysis shows that Independent Suppliers (small suppliers) are disadvantaged compared to Vertically Integrated Parties as they are more likely to be impacted by the sharpened imbalance prices, and insufficient time would be provided for those most affected to amend their systems, processes and hedging strategies to cope with the change.</p> <p>P304 is neutral with regard to the other Applicable BSC Objectives because they are not affected by P304. [For example Objective (d) is not affected because P304 will not improve efficiency in undertaking the balancing of supply and demand.]</p>
SmartestEnergy	Yes	<p>Ofgem have not considered the impact on small suppliers when proposing a reduction in PAR not in conjunction with single cash out. This is, however, something of a technicality.</p>
National Grid	No	<p>We agree with the majority Panel view that P304 better facilitates the achievement of Applicable BSC Objective (b) by creating a more cost reflective imbalance price signal and its subsequent impact on the incentives on market participants to balance. We do not agree with the majority Panel view that the benefits under (b) would be outweighed by detrimental impacts to BSC Objective (c).</p> <p>The principal purpose of this modification is to take the first step in improving the efficiency with which imbalance price signals capture the value of flexible capacity to the system, realigning incentives to party behaviour accordingly (as envisaged in Ofgem's EBSCR Final Policy Decision). During the P304 workgroup meetings it was recognised that</p>

Respondent	Response	Rationale
		<p>the analysis, being based on historical data where PAR500 had been in place, would be limited in what it can demonstrate to the extent that it does not account for changes to market participant behaviour.</p> <p>We note the concerns expressed in the Assessment Consultation responses for distributional impacts as well as the results of ELEXON's analysis which looked at trading charge impacts on parties. ELEXON's analysis shows that based on assuming unchanged imbalance positions, there would have been a range of £/MW impacts for different parties from a change to PAR250. This was particularly true for periods with system scarcity where we would expect the SBP difference to be greater between PAR500 and PAR250 and therefore the imbalance costs to be accentuated. However we also note that against the baseline the analysis found a net impact to independent Suppliers of less than £100 per day.</p> <p>In forming our view we assume that smaller parties have the capability to respond to changes in incentives, in particular that they are equipped to manage their traded positions and that the market will deliver the necessary products to allow them to manage the imbalance risk that they face.</p>
VPI Immingham	No	<p>We do not believe that the proposed solution should be rejected as, on balance, it would still better deliver the applicable BSC objectives compared to the current baseline. Reducing the PAR would be more cost reflective as it would sharpen the price signals associated with balancing the system and hence incentivise participants to balance their position ahead of gate closure. This would incentivise market participants to trade, improving liquidity and hence improving competition. It would also better reflect the value of flexible plant, particularly in times of system scarcity which, given the current situation in the market is more likely in Winter 2014/15 than anticipated, hence enhancing competition. All of these combined factors better deliver objectives (b) and (c) of the BSC objectives and therefore we think the proposal should be implemented.</p>

Respondent	Response	Rationale
Gazprom Marketing & Trading Retail Ltd	Yes	<p>Yes, we agree with the Panel's view that P304 should be rejected for the following reasons:</p> <ul style="list-style-type: none"> <li>• We do not believe changes to make the cash-out price more marginal should be made without the introduction of a single price alongside it.</li> <li>• The short notice period between decision and proposed implementation does not give sufficient time for impacts to be properly assessed.</li> <li>• We do not believe investment signals sent shortly before the start of Winter 2014/15 will lead to a noticeable improvement in security of supply for Winter 2014/15.</li> </ul>
Drax Power Limited	No	<p>We believe that the advantages and disadvantages associated with the proposal raised by stakeholders (and detailed in the Report Phase consultation) are valid. The benefits in terms of increased efficiency, improved security of supply, more effective competition etc. are valid, although these benefits are likely to be small. Likewise, the costs in terms of adverse distributional effects (particularly for small domestic suppliers) are also valid, but the evidence presented suggests these impacts are also small. On balance we believe that the small benefits marginally outweigh the small costs and that therefore the proposal should be approved. However, we concede the case for approval or rejection is finely balanced.</p>
SSE plc	No	<p>SSE continues to believe that a reduction in PAR from 500 to 250 will help to incentivise more efficient forward contracting and balancing decisions by market participants. This should both assist the System Operator by reducing the amount of balancing actions that it needs to take to balance supply and demand; and assist in the encouragement of flexible generation to remain operational to help maintain security of sale in the event of tighter system margins for this Winter.</p> <p>We accept that the retention of dual prices in the proposal is unfortunate as it leads to distributional impacts, however we do not believe that the effects</p>

Respondent	Response	Rationale
		<p>will be significant based on the analysis conducted, when compared with the benefits, particularly as the PAR analysis does not attempt to model the impact of changed behaviour arising from a sharpened incentive.</p> <p>SSE continues to believe that the proposed modification does better facilitate objectives b) and c), albeit marginal.</p> <p>We believe that the argument against objective d) is particularly weak, as the administrative implementation cost (i.e. not including distributional effects) associated with this change is minimal, if not trivial. We would contend that any marginal benefit would outweigh the insignificant cost of change, even for a temporary solution for this Winter, particularly as it sends a strong signal of intent to deliver policy reform signalled through EBSCR.</p>
RenewableUK	Yes	<p>RenewableUK remains concerned that reducing the value of PAR before implementing single cash-out may have negative impacts on its members, which are variable renewable generators. Reduction of PAR to 250 will increase variable generators' exposure to balancing costs, with no additional means available to them to mitigate that cost. We would prefer the first step in the phasing in of reduced PAR to either be smaller or combined with the introduction of single cash-out, or both.</p>
Statkraft Markets GmbH	Yes	<p>P304 implies a reduction of the Price Average Reference (PAR) value from 500 MWh to 250 MWh ahead of Winter 2014-15, without the introduction of Single Marginal Price. The current dual price approach entails an implicit and artificially high penalty for imbalances. Reducing the PAR in the dual price approach will further increase this implicit penalty and will therefore have the effect of exposing parties to higher penalties, pushing up the cost of business and increasing the levels of credit that need to be posted. This change would also be implemented in a very short timescale, leaving little or no time for parties to react in the market and adjust contracts accordingly. We consider the negative aspects of this to clearly outweigh the positive aspects.</p> <p>We support the view expressed by a Panel Member that there would definitively be a large adverse impact on independent parties such as small</p>



Respondent	Response	Rationale
		<p>suppliers and intermittent generators. Larger vertically integrated parties will be better able to manage the effects of a reduction in PAR without a move to a single cashout price through the diversity in their portfolio and the effects of RCRC. This would indicate a disproportionately negative affect on smaller independent parties through this modification hindering competition in the market.</p> <p>We believe intermittent generators are already incentivised to do their best to balance their positions and there is a limited amount they can do to react to sharper price signals. The current price differences between APX RPD intraday prices and SSP and SBP are high enough to trigger active 24/7 management of physical positions in order to keep imbalances as low as possible. These current differences are based on the most expensive 500MWh.</p> <p>We are also concerned about the knock on impacts a reduction in PAR would have on the credit arrangements. The larger the imbalance price, the more Credit Cover a party will need. We agree with the view expressed that this issue may be exacerbated by a reduction in PAR in a dual price market.</p> <p>Adverse impacts of sharper balancing prices can be somewhat mitigated if Elexon provides reliable online information about the actual status of the grid and committed generation through the Balancing Mechanism. Thus, we strongly recommend transparent online publishing of grid balance and activated reserves (and related costs), including proposed flagged actions which are currently not visible to the market until after delivery.</p> <p>We are convinced that a single price is the most efficient way of reducing balancing costs, because it not only incentivises balancing but goes one step further as it rewards participant actions that support the grid. The single price will benefit parties by not having a penalty both ways for imbalance. However information will need to be provided in a timely fashion on the anticipated NIV to allow parties to react to balancing signals. It is noteworthy that Germany has a single cash-out price system. Over the last years balancing costs remained stable or even decreased while at the same time the share of intermittent renewable production has grown</p>

Respondent	Response	Rationale
		<p>significantly.</p> <p>We agree that balancing prices could be sharper after introduction of a single balancing price. The reduction must be done in steps with sufficient time for the market to adapt. Finally the price should reflect the true cost of balancing.</p> <p>The increase in volatility (and therefore risk) in the cash out price is likely to impact directly into the market price increasing volatility and the risk premiums especially with respect to a reduction in PAR without the introduction of a single cash out price. This change in market price is likely to be reflected in customer bills, Therefore we believe that implementation of these measures is likely to increase cost and risk for the industry and therefore overall increase the cost to the consumer.</p>
ESB	No	<p>We believe that a move towards more marginal cash-out prices is necessary in order to ensure the market receives the correct signals with regards to balancing positions and ensuring security of supply. Given National Grid's forecast of tight system margins through this winter we believe that this signal should be as strong as possible and that we should therefore move to PAR250 as proposed under P304.</p> <p>Also, given the wider set of cash-out reforms proposed under P305 due to come into effect in 2015/16 we believe that a period of market adjustment is necessary, and that reducing PAR from 500MWh to 250MWh would provide a sufficiently measurable effect on cash-out prices. This would allow industry to model and manage the effects of PAR reductions in the transitional phase reducing the potential for negative impacts when the market moves to PAR50 in 2015/16</p> <p>We are of the view that P304 would better fulfil BSC Objective B as sharpening the imbalance price signal would provide greater incentives for parties to balance positions ahead of gate closure, thus reducing the requirement for balancing actions by the system operator.</p> <p>We are also of the view that P304 would better fulfil BSC Objective C as more marginal imbalance charges would provide stronger signals to market participants to balance their positions in the forward markets, thus increasing liquidity and encouraging the participation of more flexible capacity in the</p>

Respondent	Response	Rationale
		<p>forward market. We note the view of the BSC panel regarding the impact on small suppliers, however remain unconvinced that they would be put at a significant disadvantage as the analysis of the distributional impacts presented does not account for change of behaviour or improved forward market liquidity that is likely to result from more marginal cash-out prices.</p> <p>We note the panel's view that implementation of P304 could be seen as a temporary modification and therefore not fulfil BSC Objective D, however it is important to allow industry a period of adjustment between current arrangements and those proposed under the EBSCR and that the proposed amendment should be viewed as a transitional modification under the wider implementation of cash-out reform rather than simply as a temporary modification.</p>
Centrica	No	<p>We believe that P304 should be implemented as it will provide a stronger, albeit only marginally, signal for parties to balance their position ahead of gate closure better facilitating applicable objective C. The sharper imbalance charges more accurately reflects the value of flexible generation and therefore provides a signal to the market better facilitating applicable objective B.</p>
Green Energy UK	Yes	<p>We agree with the panel that P304 should be rejected. We think it will negatively affect applicable BSC objectives B and C.</p> <p>P304 does not facilitate BSC objective B (efficient and economic operation of the transmission system) any more than the baseline arrangement as:</p> <ul style="list-style-type: none"> <li>it will incentivise market participants to go longer than they otherwise would have, to avoid additional imbalance costs;</li> <li>under P304 market participants will make inefficient contracting decisions and increase the cost to consumers of managing erratic spill volumes by the SO;</li> <li>generators will not be encouraged to increase availability any more than otherwise would have been the case; any generator overproducing will only receive the reverse price under the dual cash-out arrangements or if the system is long the generator would receive a lower price than under the baseline. There is therefore less incentive to</li> </ul>

Respondent	Response	Rationale
		<p>overproduce and a lower impact on security of supply.</p> <p>In terms of BSC objective C (competition in the generation, supply, purchase and sale of electricity) P304 will expose parties to increased imbalance costs and unequal impacts of RCRC.</p> <p>The analysis included in the consultation demonstrates the impact will be unequal among trading parties. Smaller suppliers and renewables generators will be more exposed to cash-out than their larger competitors. On average the analysis found smaller non-domestic suppliers saw some of the greatest impacts during most system stress events which were analysed.</p> <p>Higher overall imbalance charges under P304 will benefit larger parties with greater income from RCRC as the mechanism redistributes charges back to players with greater volumes. Smaller parties systematically see higher imbalance charges as it is more difficult for them to forecast imbalance. As a consequence the RCRC mechanism effectively ends up redistributing these surcharges back to the larger players. This creates a significant competitive distortion under the current dual pricing system, which Ofgem seemed to have recognised in its draft EBSCR decision.</p> <p>Increasing imbalance charges will have the effect of increasing credit requirements which could have a material impact on new entrants and a significant drain on the capital resources of smaller players.</p>
ScottishPower	Yes	<p>The step-change from PAR500 to PAR250 has been demonstrated through Elexon's analysis to have a significant impact on Parties' imbalance cashflows, particularly those of smaller suppliers and results in a significant distributional effect at times of scarcity. Therefore, we do not believe that the Proposal better facilitates objective (c). The Proposal does strengthen the signal to Parties to balance their positions before Gate Closure by making the main imbalance price signal more reflective of the marginal actions taken to balance the system and therefore better facilitates Objective (b). We believe that the Proposal is neutral against Objectives (a), (d) and (f) and on balance does not better overall meet the Applicable BSC Objectives.</p>
First-Utility	Yes	<p>Objective b – we are unconvinced that the sharpening of prices will bring forward any</p>

Respondent	Response	Rationale
		<p>additional generation or demand response this winter. We believe the initiatives taken by NGC will have a greater impact. We believe the sharper prices will encourage parties to go longer and result in more sell actions by NGC resulting in a less efficient market.</p> <p>Objective c – the adverse distortional effects will have an adverse impact on the ability of smaller non-vertically integrated parties to compete. It is not certain that any tools will be widely available in the market to assist smaller independent parties especially domestic suppliers in managing their risk. We are especially concerned that at times of scarcity, liquidity in the market may dry up as happened in 2006-8.</p>
LoCO2 Energy Supply Limited	Yes	<p>We agree with the panel that P304 should be rejected.</p> <p>We do not believe P304 will improve the operation of the transmission system any more than the baseline arrangement because:</p> <ul style="list-style-type: none"> <li>• the higher imbalance costs will incentivise independent suppliers to go longer than they otherwise would have in order to avoid the expected higher costs of being short;</li> <li>• if as anticipated the system tends towards being long the system sell price would fall so a generator would receive a lower price than before. There would therefore be a reduced incentive to overproduce which could impact on security of supply.</li> </ul> <p>We also think it would have a harmful effect on competition in the generation, supply, purchase and sale of electricity because the impact of this change would be unequal among trading parties.</p> <p>Smaller suppliers and renewables generators are typically more exposed to cash-out than their larger competitors because they do not have the same resources to forecast imbalance. Increasing imbalance charges will increase credit requirements (since parties will need greater insurance against imbalance risk) which could have a material impact on new entrants and the capital resources of established smaller players.</p>
EDF Energy	No	The most relevant Applicable BSC Objectives are (b) and (c).

Respondent	Response	Rationale
		<p>BSC Objective (b):</p> <p>As per our previous response, we think P304 should create a small but uncertain benefit for better achievement of BSC Objective (b) concerning the efficient, economic and co-ordinated operation of the National Electricity Transmission System. Sharpening energy imbalance prices would increase incentives for market participants to avoid expensive imbalances, particularly during times of system stress, rather than share costs incurred by NGET. The analysis conducted as part of the assessment indicates that the proposal supports the intention of the EBSCR to make the Main Price a more accurate signal of scarcity on the system.</p> <p>BSC Objective (c):</p> <p>While we believe P304 would slightly improve achievement of BSC Objective (c) concerning competition, compared to the existing baseline, we also hear the views of small independent suppliers. In our view, PAR reform would make the arrangements more reflective of marginal costs and thereby allow parties best able to manage their energy imbalances to gain a competitive advantage according to the value delivered to the consumer, ultimately supporting competition.</p> <p>Elxon applied PAR250 cash-out prices to BSC Parties' historical Imbalance Volumes to assess the impacts of Energy Imbalance charges and Residual Cashflow Reallocation Cashflow (RCRC) on BSC Parties. The findings showed that although vertically integrated parties and independent generators would have paid higher imbalance charges due to higher cash-out prices, these costs would be more than offset by higher receivable RCRC on average, leaving a very small £/MWh net benefit. Although smaller suppliers as a class appear to face a small disbenefit on average £/MWh costs, we note there is a significant range amongst them, with some potentially benefiting from the proposal and some losing, in varying amounts. This suggests that improvements in balancing performance are possible, which P304 could encourage.</p> <p>We have no information on the true business situation of small independent participants and the relative significance of net imbalance costs, or the measures they could take to better manage</p>

Respondent	Response	Rationale
		<p>imbalance risks. It is for Ofgem to decide whether any harmful effect of the distributional impacts on the level of market competition exceeds the expected economic merits of P304 and P314 in the presence of competition. In our view there is sufficient market competition and P304, P314 and P314 Alternative are all better than the current baseline.</p>
Utilita	Yes	<p>We agree with the panel that P304 should be rejected. We think it will negatively affect applicable BSC objectives B and C.</p> <p>P304 does not facilitate BSC objective B (efficient and economic operation of the transmission system) any more than the baseline arrangement as it will incentivise market participants to go longer than they otherwise would have. It is possible that to avoid additional imbalance costs under P304 market participants will make inefficient contracting decisions and increase the cost to consumers of managing erratic spill volumes by the SO.</p> <p>We do not believe the change would encourage more generators to increase their availability than they otherwise would have been. There is a flawed assumption behind the current spate of cash-out modifications as generation remuneration, which would still be based on pay-as-bid, would not be affected. A generator who spills when the system is short would still receive the MIDS price, whereas a generator who spills when the system is long would receive a lower price than under the baseline, there would be less incentive to over-generate and no impact on security of supply. Either way, it would not know with any certainty which circumstance would apply.</p> <p>P304 does not facilitate BSC objective C (competition in the generation, supply, purchase and sale of electricity) any more than the baseline arrangements as while all parties will be exposed to increased imbalance costs, the analysis included in this consultation demonstrates the impact will be unequal among trading parties with resulting distributional distortions.</p> <p>Under P304 smaller suppliers, especially independent non-domestic suppliers, and renewables generators will be more exposed to cash-out than their larger competitors. This is most notable during times of system stress as identified</p>

Respondent	Response	Rationale
		<p>in the analysis of changing PAR values; where on average smaller non-domestic suppliers saw some of the greatest impacts during most system stress events which were analysed.</p> <p>In turn under P304 larger parties will benefit from greater income from RCRC as imbalance charges would be higher and the mechanism redistributes charges back to players with greater volumes. Smaller parties systematically see higher imbalance charges as it is more difficult for them to forecast imbalance without diversified portfolios, compounded by lower customer numbers, fewer forecasting resources and less customer data, especially given most domestics are still using NHH meters. As a consequence the RCRC mechanism effectively ends up redistributing these surcharges back to the larger players. This creates a significant competitive distortion under the current dual pricing system, which Ofgem seemed to have recognised in its draft EBSCR decision.</p> <p>Furthermore, increasing imbalance charges will have the effect of increasing credit requirements which is a direct barrier to new entrants and a significant drain on the capital resources of smaller players.</p> <p>All these new costs and risks would have the effect of putting upward pressure on consumer prices all other things being equal.</p> <p>Implemented on its own, we therefore think P304 alternative would be significantly detrimental.</p>
UK Power Reserve Ltd	No	<p>Regards objective B of the BSC.</p> <p>UK Power Reserve believes that the price signals to counter imbalance are presently insufficient to correctly, efficiently and economically provide for the security of supply required by National Grid to maintain transmission system stability, also without this price signal the market cannot adequately gauge what level of mitigation will be required in future and therefore will be inefficient in responding.</p> <p>We believe that through the decrease of PAR these price signals can be improved and lead to better efforts on the part of generators, suppliers and customers to better balance their positions while offering clearer pricing signals to those whose actions can contribute to post gate closure balancing actions. We also believe that such actions</p>



Respondent	Response	Rationale
		<p>to improve the market signals on imbalance will more accurately reflect market conditions and costs incurred by the System Operator.</p> <p>Regards objective C of the BSC.</p> <p>We strongly believe that the strengthening of the energy imbalance prices will result in all parties being incentivised to contribute to a more balanced market whilst encouraging investment and efficient operation of flexible generation assets.</p> <p>We believe that the highlighted disadvantage offered to small suppliers is negligible when compared to the benefit to small generators, we also note that from Elexon's analysis not all small suppliers would be negatively impacted and that through the improved incentives offered to counter imbalance that changes in business practice would arise to offer a more efficient and balanced service. We also note that UK Power Reserve, as a small flexible generator is able to offer services to such small suppliers if they are facing difficulties balancing their position.</p> <p>We disagree that there is insufficient time to access the impact of the proposal in time for this winter and believe that with forecast low generating reserve margins there is considerable pressure to implement any incentive to flexible generation as soon as possible to preserve system security.</p>

## Question 2: Do you agree with the Panel that the draft legal text changes deliver the intention of P304?

### Summary

Yes	No	Neutral/No Comment	Other
15	0	5	0

### Responses

Respondent	Response	Rationale
GDF SUEZ	Yes	None provided.
InterGen (UK) Ltd.	Yes	InterGen agrees that the draft legal text changes deliver the intention of P304.
Good Energy	Yes	The change is a straightforward change to the level of PAR.
SmartestEnergy	No comment	None provided.
National Grid	Yes	None provided.
VPI Immingham	Yes	None provided.
Gazprom Marketing & Trading Retail Ltd	Yes/No	No comments.
Drax Power Limited	Yes	We believe it does.
SSE plc	Yes	None provided.
RenewableUK	Yes/No	Not qualified to answer.
Statkraft Markets GmbH	Yes/No	We do not have specific views on this question.
ESB	Yes/No	No comments.
Centrica	Yes	We also agree that the legal text changes deliver the intention of P304.
Green Energy UK	Yes	We agree that the draft legal changes would deliver the intention of P304.
ScottishPower	Yes	None provided.
First-Utility	Yes	None provided.
LoCO2 Energy Supply Limited	Yes	We agree that the draft legal changes would deliver the intention of P304.

Respondent	Response	Rationale
EDF Energy	Yes	Yes, the draft text merely changes PAR 500 to PAR 250.
Utilita	Yes	We agree that the draft legal changes would deliver the intention of P304.
UK Power Reserve Ltd	Yes	The draft legal text is straightforward and unambiguous. We are in agreement with the Panel that it is serving the intention of the P304.

### Question 3: Do you agree with the Panel's recommended Implementation Date?

#### Summary

Yes	No	Neutral/No Comment	Other
12	8	0	0

#### Responses

Respondent	Response	Rationale
GDF SUEZ	Yes	None provided.
InterGen (UK) Ltd.	Yes	InterGen agrees with the recommended Implementation Date. We consider it highly appropriate that any change to PAR be implemented as soon as practicable to allow industry to adapt ahead of Winter 14/15, when margins are anticipated to be most tight.
Good Energy	Yes	We believe that the October 2014 date is too soon. Parties have already prepared their hedging position for the winter and will have insufficient time to change that strategy, or to implement coping strategies for a more sensitive imbalance system. A January/April 2015 start date would be more appropriate.
SmartestEnergy	No	This is a strange question because the recommended implementation is to reject. We have always been against implementation this year because a significant amount of trading has already taken place for Winter '14 (even before the modification was raised) and we believe it would be fairer to defer the implementation till next year.
National Grid	Yes	The Panel's recommended Implementation Date maximises the opportunity for the PAR change to be delivered for this winter (2014/15) whilst providing a reasonable notice period to industry. Since concerns for system scarcity are greater over winter months we believe it is important that the more efficient price signal is implemented ahead of or soon after November 2014. In terms of the question of what constitutes a 'winter period', given that the winter product in the forward market spans the inclusive period October to March and the Triad season runs November to February, we consider it appropriate to incorporate November 2014 in the implementation of a reduced PAR solution.

Respondent	Response	Rationale
VPI Immingham	Yes	We agree that this proposal should be implemented ahead of Winter 2014/15 to ensure that the sharper imbalance prices are in place for Winter, and therefore we support the proposed implementation date of 31st October. However, should a decision not be reached by 17th October, we agree that it is suitable to allow for 10 working days from the decision for implementation.
Gazprom Marketing & Trading Retail Ltd	No	We do not believe P304 should be implemented due to the reasons outlined in question 1.
Drax Power Limited	Yes	Yes this is consistent with Ofgem's EBSCR Final Policy Decision, although we note that this implementation date will provide market participants with limited time to respond to the change.
SSE plc	Yes	None provided.
RenewableUK	No	Implementing PAR 250 ahead of this winter will bring no additional benefit, as it is too late to incentivise meaningful changes in behaviour, while introducing the change early will incur costs and uncertainty, as the change is not well understood across the sector and will be a surprise to most. More time to implement the change would be beneficial, and as stated above, we believe that date should ideally be combined with the introduction of single cash-out.
Statkraft Markets GmbH	No	Our view is that a reduction in PAR should only take place in conjunction with the introduction of a single balancing price, and that the Implementation Date should be pushed back to allow this.  The suggested early implementation date also reduces the visibility industry needs in order to assess future imbalance prices, reflect the changes into contracts and make informed decisions.
ESB	Yes	We agree with the panel's recommended implementation date and would encourage a decision to be made as quickly as possible. This will ensure that the correct price signals are in place for as much of the winter period as possible.  We also agree that there should be a degree of flexibility to avoid certain implementation dates, however the number of applicable dates should be kept to a minimum (e.g. CM auction dates and national holidays) to ensure there is no significant impact on implementation.

Respondent	Response	Rationale
Centrica	Yes	We agree with the working group's proposed implementation date (as also agreed by the panel).
Green Energy UK	No	<p>We do not agree with the Panel's recommended implementation date for introducing more marginal cash-out price with dual pricing on 31 October or 10 working days from an Authority decision, as:</p> <ul style="list-style-type: none"> <li>• Ofgem made no reference to this change being made on its own or as soon as this winter in the EBSCR documentation despite the significant impact this change will make to the current commercial baseline;</li> <li>• recent regulatory practice (such as in the CUSC) is more major changes to be announced at least one year ahead in order to allow parties to adapt to the changes. This change would come midway through a contract year and in timescales that do not permit trading parties the opportunity to vary their contracting strategies appropriately; and</li> <li>• we note this change does not have widespread industry support, and industry participants have brought forward a competing modification with the stated intention of delaying the changes in PAR until after the expected period of winter scarcity (P314).</li> </ul>
ScottishPower	Yes	As the changes required to central systems and Parties' systems are minimal, if the change is to be implemented, it should be done so as quickly as possible.
First-Utility	No	The dates are too early; they do not give parties enough time make changes to their trading and financial arrangements.
LoCO2 Energy Supply Limited	No	<p>We do not agree with the Panel's recommended implementation date for introducing more marginal cash-out price with dual pricing on 31 October or 10 working days from an Authority decision, as:</p> <ul style="list-style-type: none"> <li>• Ofgem made no reference to this change being made on its own or as soon as this winter in the EBSCR documentation despite the significant impact this change will make to the current commercial baseline this winter;</li> <li>• We think major changes should be announced at least one year ahead in order to allow parties to adapt to the changes. This change would come midway through a contract year and in timescales that do not permit trading parties the opportunity to</li> </ul>

Respondent	Response	Rationale
		vary their contracting strategies appropriately.
EDF Energy	Yes	<p>The Panel recommends an Implementation Date for P304 of:</p> <ul style="list-style-type: none"> <li>– 31 October 2014, if the Authority's decision is received on or before 17 October 2014; or</li> <li>– 10 Working Days following an Authority decision if the decision is received after 17 October 2014.</li> </ul> <p>Provided that we have 10 working days following an Authority decision, we should be able to make necessary changes.</p>
Utilita	No	<p>We do not agree with the Panel's recommended implementation date for introducing more marginal cash-out price with dual pricing this winter. There was no reference to this change being made on its own or as soon as this winter in the Ofgem documentation despite the significant impact this change will make to the current commercial baseline. This is midway through a contract year and in timescales that do not permit trading parties the opportunity to vary their contracting strategies appropriately.</p> <p>The change to PAR values this winter would also be in contravention of recent regulatory practice whereby significant changes to market rules are announced at least a year ahead of implementation (such as in the CUSC).</p> <p>It is also worth noting that this change does not have widespread industry support, and industry participants have brought forward a competing modification with the stated intention of delaying the changes in PAR until after the expected period of winter scarcity (P314).</p>
UK Power Reserve Ltd	Yes	<p>We believe that any change to the market imbalance price must be brought in in time for this winter season so we are in agreement with the BSC Panel for the recommended implementation date.</p>

Question 4: Do you believe that commercial terms offered to intermittent generators, under power purchase agreements, will be impacted by any reassessment of balancing risks which may arise following a reduction in PAR to 250MWh?

## Summary

Yes	No	Neutral/No Comment	Other
11	3	6	0

## Responses

Respondent	Response	Rationale
GDF SUEZ	Depends	Windfarms will pass the balancing risk onto their PPA provider. With most PPAs having a tenor of 5-15 years then for the most part, the cashout changes are only a matter when a new contract is being negotiated. However, some PPA's may contain clauses stating that a renegotiation of price will take place if balancing costs exceed a certain level.
InterGen (UK) Ltd.	No	In InterGen's opinion, intermittent generators will face an increase in their imbalance discounts in PPA's regardless of the outcome of EBSCR as a result of the forecast increase in intermittent generation onto the system as a whole in the coming years. Moving to a single marginal cashout price will have a direct impact on the wholesale cost of electricity (as generators price in cashout risk, it is assumed) and therefore intermittent generators will be able to offset higher imbalance charges through CfD's and PPA's based on the increase market price for their power.
Good Energy	Yes	This will be especially true for those Power Purchase Agreements (PPAs) related to intermittent generators that do not currently have a proportion of the imbalance risk directly passed through to generators. This increased risk is likely to now be passed through to mitigate the increased risk on the supplier/aggregator, who have no control over the output of the generator.
SmartestEnergy	Yes	We anticipate imbalance costs to increase. <i>Additional confidential information provided.</i>



Respondent	Response	Rationale
National Grid	n/a	Commercial terms offered to intermittent generators may be impacted by a change in the imbalance risk resulting from P304; however National Grid is not best placed to comment on the nature or extent of this potential impact.
VPI Immingham	Yes	We are not in a position to comment in detail on Power Purchase Agreements (PPA) for intermittent generators. However, PPAs usually factor in a percentage discount to accommodate expected balancing costs, recognising the additional risk that the purchaser is taking on in balancing an intermittent generator. Therefore, one could assume that this term would likely be affected should the imbalance price change. However, given the nature of the proposal and that many purchasers have a larger portfolio to balance and are therefore less exposed to balancing risk and looking at Elexon's impact analysis, we are unsure that this would lead to a material change to PPAs.
Gazprom Marketing & Trading Retail Ltd	Yes/No	No comments.
Drax Power Limited	No Comment	We are not best placed to respond to this question.
SSE plc	Yes/No	No comments.

Respondent	Response	Rationale
RenewableUK	Yes	<p>For generators that have already signed power purchase agreements with offtakers, additional costs due to change in the value of PAR will have to be absorbed by those offtakers under the terms of those deals. However, new generators seeking to sign PPAs will be directly affected by this change, as offtakers will seek to modify the terms offered to reflect the reduction in PAR. This is especially problematic at this time as many variable generators are either seeking to sign deals in order to meet the hard deadline of the closure of the Renewables Obligation, or will be looking to find PPAs that dovetail with the new Contract for Difference. For the latter, a new instrument which has not yet been implemented for real projects, the appropriate PPA terms are not yet clear. Having this change implemented now will make the task of creating new PPAs relevant to the CfD harder at a time of high uncertainty in the commercial value of the instrument itself. For those under time pressure to meet the RO deadline, having to factor this issue into negotiations could affect very tight timelines and derail developers' ability to secure RO accreditation.</p>
Statkraft Markets GmbH	Yes	<p>The assumption that many intermittent generators have a PPA that will shield them from the effects of sharper cash out prices we don't consider valid. This is unlikely to be the case as PPA providers will not be able to bear this increased risk and will have to pass it back to the generator at least in part. Statkraft is a leading PPA provider in the UK market however at present we have no supply base and would face the full impact of the increased cost of imbalance on our intermittent portfolio (both for our own assets and 3rd party PPAs). We believe that this increased cost would reduce competition in the PPA market further as only the large vertically integrated players would have the advantage of a large and diversified supply portfolio to mitigate some of the cost.</p> <p>It is also worth noting that introduction of this (or any future modification to the cash out regime) may trigger change of law clauses under a PPA. This would mean that at least partially intermittent generators would be exposed to the increased costs presented by any such modification.</p> <p>In its Impact Assessment the regulator argued its reforms were unlikely to affect the cost of the</p>

Respondent	Response	Rationale
		<p>process of entering and exiting the market. We clearly disagree with this assessment, imbalance and trading are key costs for a supplier or generator looking to enter the market or enter into a PPA. Managing the imbalance cost is a key element in the discounts PPA providers have to offer. Increasing the cost of managing this imbalance by moving to a more marginal cash-out price effects the discounts offered by PPA providers like Statkraft into the offtake market and could have a negative impact on renewable projects looking for a route to market.</p> <p>Although we strongly support a move to single cash out price, we do not believe that it will fully mitigate the other negative impacts especially with regard to impacts on intermittent generation. The ability to forecast wind generation is constrained by the quality of the weather forecast and will never be 100% accurate. Intermittent generators will always be at a disadvantage to conventional generation in the market, and increased balancing prices will tend to increase this disadvantage.</p> <p>As we also pointed to under question 1, we already consider the balancing incentives for our wind power portfolio to be adequate.</p>
ESB	Yes/No	<p>Although the analysis of the distributional effect on intermittent generation suggests they would be adversely impacted by a move to more marginal cash-out prices this analysis does not take into account the likely positive impact of increased prompt market liquidity and participation of flexible capacity. Under this scenario PPA providers would have more tools at their disposal to actively manage an intermittent generation portfolio, helping to keep any increase in imbalance prices to a minimum.</p>
Centrica	No	<p>We do not believe that P304 creates a sufficient change in balancing risk to warrant any change in commercial terms for PPA contracts.</p>
Green Energy UK	Yes	<p>Commercial terms offered to intermittent renewables generators under Power Purchase Agreements (PPAs) could be impacted by making cash-out prices more marginal, as:</p> <ul style="list-style-type: none"> <li>the imbalance discount in a PPA (usually expressed as a percentage of the wholesale power price) is partly made up of compensation to the offtaker for the exposure to cash-out as a result of differences between the expected output of the</li> </ul>

Respondent	Response	Rationale
		<p>intermittent generator and the metered volume;</p> <ul style="list-style-type: none"> <li>decreasing PAR will increase cash-out prices and expose offtakers to higher imbalance charges. Offtakers will need to increase the imbalance discounts they offer to renewables generators – particularly intermittent technologies – and there is a risk that changing PAR values could result in some offtakers revising existing PPAs should it be permissible under change in law clauses; and</li> <li>increasing imbalance discounts could reduce the availability of economically viable PPAs for renewables projects. It could also increase the strike price bids under the CfD as generators increase their bids in order to cover the missing money created by the difference between the CfD reference price and the price paid by the offtaker.</li> </ul>
ScottishPower	Yes	<p>Parties offering PPA agreements to intermittent generators assume the imbalance risk arising from the difficulty in forecasting the generators' output. As the cost of managing that risk, particularly under a dual imbalance pricing regime, will increase with the introduction of P304, this is likely to be reflected in the terms offered to intermittent generators.</p>
First-Utility	Yes	<p>Suppliers or PPA buyers factor in the risks they face in purchasing the generation. If the risks increase so will the discount or fee charged for managing that risk. As the risk increases so does the risk premium for handing that risk, so the impact to the generator will probably be larger than the actual cost of the risk. Some generators will already be under contract, however, most contracts have change in law or trading arrangement clauses, so this could be a price reopener for existing contracts.</p>
LoCO2 Energy Supply Limited	Yes	<p>Commercial terms offered to intermittent renewables generators under Power Purchase Agreements (PPAs) will be impacted by making cash-out prices more marginal.</p> <p>Currently PPAs are typically discounted against the market to take account of imbalance (this is usually expressed as a percentage of the wholesale power price although it may also come through as a cut of any embedded benefits). This occurs partly to compensate the offtaker for the exposure to cash-out as a result of differences between the expected output of the intermittent generator and the metered volume;</p>

Respondent	Response	Rationale
		<ul style="list-style-type: none"> <li>decreasing PAR will increase cash-out prices and expose offtakers to higher imbalance charges. Offtakers will need to increase the imbalance discounts they offer to renewables generators particularly intermittent technologies such as wind turbines.</li> <li>Concerns over the liquidity of the PPA market have been made elsewhere and this is unlikely to help since increasing imbalance discounts would further reduce the availability of economically viable PPAs for renewables projects. This could make the PPA market further dependent upon an offtaker of last resort.</li> <li>The strike price bids under the CfD could also increase as generators seek to make up the missing money created by the difference between the CfD reference price and the price paid by the offtaker.</li> </ul>
EDF Energy	Yes	We expect the risk premium to increase but cannot quantify impacts at this stage.
Utilita	Yes	<p>We believe the commercial terms offered to intermittent renewables generators under Power Purchase Agreements (PPAs) would be impacted by making cash-out prices more marginal.</p> <p>PPAs contain an imbalance discount, usually expressed as a percentage of the wholesale power price offered under the PPA. A major component of this discount is money to compensate the offtaker for the exposure to cash-out as a result of differences between the expected output of the intermittent generator and the metered volume. Decreasing the PAR value will increase cash-out prices and therefore expose offtakers to higher imbalance charges. This will have an impact on the PPA market as offtakers will need to increase the imbalance discounts they offer to renewables generators – particularly intermittent technologies – and there is a risk that changing PAR values could even result in some offtakers revising existing PPAs should it be permissible under market change/change in law clauses. This could reduce the availability of economically viable PPAs for renewables projects, causing generators problems in finding suitable routes to market. It may also have the effect of increasing CfD auction bids in order to cover the missing money created by the CfD paying a top-up between the gross reference price and the strike price, and the impact of</p>

Respondent	Response	Rationale
		increasing PPA discounts in diminishing captured strike prices. This would lead to an increased cost to consumers.
UK Power Reserve Ltd	No	We do not believe that this should form part of the discussion relating to P304 and that the majority of PPAs should already take into account regulatory change risk as part of their documentation.

## Question 5: Do you have any further comments on P304?

### Summary

Yes	No
11	9

### Responses

Respondent	Response	Rationale
GDF SUEZ	No	n/a
InterGen (UK) Ltd.	No	n/a
Good Energy	Yes	<p>Good Energy feels that P304 has been rushed through without proper consideration of the normal working practice, and without full consideration of competition in the market due to concerns about the level of supply margin this winter. In summary our key issues with P304 are:</p> <ul style="list-style-type: none"> <li>The majority of respondents to the assessment consultation phase were against its implementation.</li> <li>at no point has Ofgem suggested it was contemplating it was looking at implementing a reduced PAR without a single marginal price (SMP) until its final decision. To that end, there has been no detailed analysis of impacts of reduced PAR on its own.</li> <li>the proposed implementation timeline does not provide adequate notice from the point of decision, and no prior indication was given to the market of implementation for winter 2014-15.</li> <li>security of supply concerns this winter are being greatly exaggerated. A reduction in PAR itself will not make a significant difference and will only increase supplier and customer costs, especially for new entrants, smaller players, and those without significant vertical integration.</li> <li>Smaller suppliers and generators will be more significantly impacted compared to larger players due to the disproportionate effect of imbalance charge distributions, the credit cover impacts, and relative operational cost impact of making the changes to systems and processes.</li> </ul>
SmartestEnergy	No	n/a

Respondent	Response	Rationale
National Grid	No	n/a
VPI Immingham	Yes	We would also refer to our consultation response for P314. We believe that it is a more suitable step change ahead of the full implementation of the Electricity Balancing Significant Code Review than a smaller change to PAR.
Gazprom Marketing & Trading Retail Ltd	No	n/a
Drax Power Limited	Yes	<p>We note that P314 has been raised and is currently the subject of an Assessment Procedure Consultation to which we are also responding. The only differences between the P304 and P314 solutions relate to the PAR value (350/MWh rather than 250/MWh) and in the case of the current 'Proposed' solution a slightly later implementation date.</p> <p>We believe that P314 will tend to reduce both the advantages and disadvantages associated with P304. The arguments in favour of implementing P304 or P314 are very finely balanced. However, we believe that overall P304 represents a marginally better solution relative to P314 and as such P304 should be approved rather than P314.</p>
SSE plc	No	n/a
RenewableUK	No	n/a
Statkraft Markets GmbH	Yes	<p>We agree with the view expressed by a Panel Member that there should have been more details of the potential impact on intermittent generators. The effects of change on cash out needs to be better understood at the individual party level.</p> <p>More analysis is needed on the effects of these changes during times of system stress and under different market conditions.</p> <p>The analysis made did not include behavioural changes. We foresee that parties could be more cautious and go longer to avoid sharper imbalance prices, in effect providing free reserve to the system.</p>



Respondent	Response	Rationale
ESB	Yes	<p>Although we are supportive of the move to more marginal cash-out prices this winter we believe the move would be much more effective were it to be introduced alongside the move to single cash-out. Such a move would have reduced any potential negative impacts on parties by providing a stronger price signal to provide reducing imbalance and removed the inefficient reverse price mechanism currently in place.</p> <p>Although this position would have been preferable we are mindful of the timescales that would be involved in the introduction of such a modification at this stage, and would therefore suggest that introduction of more marginal cash-out should proceed at the earliest opportunity rather than delaying its introduction whilst a single cash-out modification is processed.</p>
Centrica	No	n/a
Green Energy UK	Yes	We would only support a more marginal cash-out price, through the manipulation of the PAR value, if it were accompanied by the introduction of the single cash-out price as was understood from Ofgem's EBSCR process.
ScottishPower	No	n/a
First-Utility	Yes	PAR should not be reduced unless the change is coincident with a change to single cash-out. The reduction in PAR should be more staged and gradual and analysis performed at each stage to understand the impact the change has had.
LoCO2 Energy Supply Limited	Yes	We would only support a more marginal cash-out price, through the manipulation of the PAR value, if it were accompanied by the introduction of the single cash-out price as was understood from Ofgem's EBSCR process.
EDF Energy	No	n/a
Utilita	Yes	We oppose any change to decrease the value of PAR without any corresponding change to the dual cash-out regime. Under P304 there will be no mitigation, at least until P305, through implementation of a single energy imbalance price. Until recently Ofgem envisaged both changes being implemented as a package.

Respondent	Response	Rationale
UK Power Reserve Ltd	Yes	<p>It is UK Power Reserves position that the modification to lower PAR to 250MWh is a good stepping stone move towards single imbalance price for the market and the future lower levels of 50MWh and 1MWh PAR that are envisioned to accompany this under P305. UK Power Reserve further believes that faster introduction of these changes would be of benefit to the market in the times of system stress and scarcity that are envisioned both this and next winters and that the current setup of system prices is directly contributing to system imbalance.</p> <p>As such we recommend the implementation of P304 as soon as possible.</p>