

March 2002

**MODIFICATION REPORT -
MODIFICATION PROPOSAL P12
Reduction of Gate Closure from 3.5
Hours to 1 Hour**

**Prepared by ELEXON on behalf of the Balancing
and Settlement Code Panel**

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b Distribution

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Each BSC Agent	Various
The Gas and Electricity Markets Authority	Ofgem
Each BSC Panel Member	Various
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1 SUMMARY AND RECOMMENDATIONS

1.1 Recommendation

On the basis of the analysis, consultation and assessment undertaken in respect of this Modification Proposal during the Assessment Phase, and the resultant findings of this report, the BSC Panel recommends that:

The Proposed Modification P12 should be made with an Implementation Date of Settlement Period 31 on 2 July 2002

1.2 Background

Modification Proposal P12 was submitted by Damhead Creek Ltd on 9 May 2001. The Modification seeks to move Gate Closure from 3.5 hours to 1 hour ahead of real time to reduce the imbalance risk faced by market participants and increase liquidity in short-term markets.

The Modification Proposal was considered under both the Definition and Assessment Procedures. Consultation and analysis conducted during the Assessment Procedure indicated a high level of support for a reduction in Gate Closure and that the bulk of system changes necessary to implement a reduction would fall on the Transmission Company. The majority of Parties reported that only minor changes would be required to their systems. In any case, in the Group's opinion, trading closer to real time would be an option open to Parties and not compulsory.

The Assessment Report prepared by the P12 Modification Group (the Group) and presented to the Panel on 14 March 2002 recommended acceptance of the Modification Proposal. The Panel endorsed this recommendation.

1.3 Rationale for Recommendations

The Panel agrees that reducing the Gate Closure period will result in increased opportunities to trade and gains in forecasting accuracy. These will:

- reduce the imbalance risk faced by market participants; and
- increased liquidity in short-term markets

On this basis the Panel agrees that implementation of the Modification Proposal would improve competition (i.e. Applicable BSC Objective (c)) in the generation and supply of electricity. In addition, the Panel agrees that the more competitive trading environment would not compromise any of the following:

- the efficient discharge by the Transmission Company of its obligations under the Transmission Licence (i.e. Applicable BSC Objective (a));
- the efficient, economic and co-ordinated operation of the transmission system (i.e. Applicable BSC Objective (b)); and
- the efficiency of the balancing and settlement arrangements (i.e. Applicable BSC Objective (d)).

The Panel noted that the Transmission Company had reported that it anticipated that reducing Gate Closure to one-hour would not have a significant impact on the Balancing Mechanism, either in terms of the price or volume of actions taken. Providing that the Transmission Company's experience of a winter under NETA satisfied the Transmission Company that it can use pre-Gate Closure actions to

balance the system securely, and providing the Transmission Company had sufficient of the required pre-Gate Closure contracts in place, it was their view that the system should be balanced with similar efficiency to now. However, the Transmission Company noted that, based on their experience of NETA Go-live, there may be a transition period in which efficiency temporarily decreases and balancing mechanism costs temporarily increase. As with NETA Go-live, the greater uncertainty associated with balancing the system under new conditions will lead the Transmission Company, initially, to hold higher levels of reserve and response.

It should be noted that one Panel Member felt strongly that the Group had not addressed the concerns of smaller generators properly. The smaller players had not been included in the consultation as he had requested and they would possibly be disadvantaged by a reduction in Gate Closure. Whereas larger players with 24 hour/7 day cover would be able to take advantage of the reduction of Gate Closure to 1 hour, many smaller players without access to 24 hour/7 day cover would not be in a position to take advantage in the reduction. The Proposed Modification as it stood, therefore, discriminated strongly against smaller players and in favour of larger players. The Panel Member supported the principle of reducing Gate Closure nearer to real time but felt that the market was not yet in a position to accept a reduction to 1 hour.

The Panel noted that the Group had taken the view that smaller generators would not be unduly disadvantaged because trading is a 24-hour per day activity regardless of whether Gate Close was for 1 hour or 3.5 hours. The Group felt that those market participants that did not want to deal as close to real time as 1 hour could continue to operate 3.5 hours ahead of Gate Closure. The Group also felt that the consultation carried out under the P12 Assessment Procedure had been published on the BSC website and had been open to all market participants to respond to.

The Panel had sought the Authority's provisional thinking on the Implementation Date for the Modification Proposal. The Authority had indicated in their response that, without prejudice to the Authority's considerations after receipt of the Final Modification Report for P12, on the basis of the respondent's views received by the Group during the Assessment Procedure, an Implementation Date of July 2 2002 for Modification Proposal P12 would be appropriate. The Panel took this view into account in reaching their decision on the Implementation date.

2 INTRODUCTION

This Report has been prepared by ELEXON Ltd., on behalf of the Balancing and Settlement Code Panel ('the Panel'), in accordance with the terms of the Balancing and Settlement Code ('BSC'). The BSC is the legal document containing the rules of the balancing mechanism and imbalance settlement process and related governance provisions. ELEXON is the company that performs the role and functions of the BSCCo, as defined in the BSC.

This Modification Report is addressed and furnished to the Gas and Electricity Markets Authority ('the Authority') and none of the facts, opinions or statements contained herein may be relied upon by any other person.

An electronic copy of this document can be found on the BSC website, at www.elexon.co.uk

3 HISTORY OF PROPOSED MODIFICATION

Damhead Creek Ltd submitted the Modification Proposal on 9 May 2001. An Initial Written Assessment (IWA) of the Modification Proposal was prepared by ELEXON and presented to the Panel meeting on 31

May 2001. The Panel agreed that the Modification Proposal progress to the Definition Procedure and that a Definition Report should be presented to the Panel meeting on 26 July 2001.

A Modification Group ('the Group'), comprising members with relevant expertise, was convened to consider the Modification Proposal. The Group produced a Definition Report recommending that the Modification be progressed to a 9-month Assessment Procedure, which would provide the Transmission Company with the operational experience of a full winter period that it believed was necessary. The Panel noted the recommendations of the Group, and decided to submit the Modification to the Assessment Procedure with an Assessment Report scheduled for the 14 March 2002 Panel meeting.

The Panel also asked the Group to establish a set of Assessment Criteria against which the merits of the Modification Proposal could be evaluated. The Group prepared Assessment Criteria that were agreed by the Panel meeting held on 31 October 2001.

Consultation and analysis conducted during the Assessment Procedure indicated a high level of support for a reduction in Gate Closure and showed that the bulk of system changes necessary to implement a reduction would fall on the Transmission Company. The majority of Parties reported that only minor changes would be required to their systems. In the Group's opinion, trading closer to real time would be an option open to Parties and was not compulsory.

The Group assessed the Proposed Modification against the assessment Criteria agreed by the Panel. The Group concluded that, on balance, the pricing analysis carried out as part of the assessment was sufficient to anticipate that reducing Gate Closure would not have a dramatic negative impact on imbalance prices – prices would probably either be unchanged or largely reduced. The Group also believed that the Transmission Company's ability to manage the system and balance the market efficiently would not be diminished by movement to a 1 hour Gate Closure. The Group also anticipated that 1 hour Gate Closure would deliver real benefits to market participants and that a secure and balanced system could be maintained with relatively small implementation costs. The Group anticipated that the costs of implementing the Proposed Modification would be minor compared with the benefits delivered.

The Group prepared an Assessment Report¹ that was presented to the Panel meeting on 14 March 2002. The Panel endorsed the Group's recommendation that the Proposed Modification should be made with an implementation date of Settlement Period 31 on 2 July 2002. The Panel also agreed that a draft Modification Report should be prepared and consulted on and presented to the Panel meeting on 18 April 2002.

4 DESCRIPTION OF PROPOSED MODIFICATION

The Proposed Modification seeks the reduction of Gate Closure time from 3.5 hours to 1 hour. The Proposed Modification was intended to increase competition in the generation and supply of electricity, without compromising the physical balancing of the system.

The Modification Proposal stated that early experience of the market had highlighted the close to real time nature of the Transmission Company's trades for balancing purposes. In the light of this experience the rationale for a 3.5 hour Gate Closure period is not valid and the Proposed Modification sought to reduce the Gate Closure period. The current length of Gate Closure exposed market participants to a significant imbalance risk. Any unforeseen changes in demand or generating capability, such as plant failure, occurring after the Gate had closed could not be acted upon. The

¹ The P12 Assessment Report can be found on the BSC website, at www.elexon.co.uk

potential to trade up to 2.5 hours closer to real time would reduce this risk and improve liquidity in short-term markets.

5 RATIONALE FOR PANEL RECOMMENDATIONS

The Panel agreed with the Group's view that reducing the Gate Closure period will result in increased opportunity to trade and gains in forecasting accuracy. These will:

- reduce the imbalance risk faced by market participants; and
- increased liquidity in short-term markets

On this basis the Panel agreed with the Group that implementation of the Proposed Modification would improve competition (i.e. Applicable BSC Objective (c)) in the generation and supply of electricity. In addition, the Panel agreed that the more competitive trading environment would not compromise any of the following:

- the efficient discharge by the Transmission Company of its obligations under the Transmission Licence (i.e. Applicable BSC Objective (a));
- the efficient, economic and co-ordinated operation of the transmission system (i.e. Applicable BSC Objective (b)); and
- the efficiency of the balancing and settlement arrangements (i.e. Applicable BSC Objective (d)).
- the efficiency of the balancing and settlement arrangements (i.e. Applicable BSC Objective (d)).

In the light of the above the Panel agreed that the Proposed Modification would better facilitate achievement of the Applicable BSC Objective (c) contained in Condition C3(3) of the Transmission Licence.

The Panel also agreed with the Group's recommendation that the Proposed Modification should be implemented for Settlement Period 31 on 2 July 2002 and accepted their reasoning for making this recommendation.

6 LEGAL TEXT TO GIVE EFFECT TO THE PROPOSED MODIFICATION

The changes to the legal text of the Code in the following section are based on version 3.0 of Section T, version 3.0 of Annex X-1 and Version 4.0 of Table X-2, and are the changes necessary to implement the Proposed Modification only. If the baseline of the Code changes prior to implementation of the Proposed Modification, or if other Modification Proposals are to be implemented at the same time as the Proposed Modification, the legal text may need to be amended.

6.1 Proposed Modification

Implementation of the Proposed Modification would require the following changes to the Code:

- **Section T3.1A.1 (a):** change 'eight Settlement Periods' to 'three Settlement Periods'
- **Section T3.1A.1 (b):** change 'eight Settlement Periods' to 'three Settlement Periods'
- **Annex X-1:** under Gate Closure entry, change '3 ½' to '1'
- **Table X-2 in Annex X-2:** under 'Balancing Mechanism Window Period' entry, change '3 ½' and '4' to '1' and '1 ½' respectively

7 ASSESSMENT

Consultation carried by the Group as part of the Assessment Procedure indicated a high level of support for a reduction in Gate Closure and that the bulk of system changes necessary to implement a reduction would fall on the Transmission Company. The majority of Parties reported that only minor changes would be required to their systems. In any case, in the Group's opinion, trading closer to real time would be an option open to Parties and not compulsory.

The Group assessed the Proposed Modification against the assessment Criteria agreed by the Panel. The Group concluded that, on balance, the pricing analysis carried out as part of the assessment was sufficient to anticipate that reducing Gate Closure would not have a dramatic negative impact on imbalance prices – prices would probably either be unchanged or largely reduced. The Group also believed that the Transmission Company's ability to manage the system and balance the market efficiently would not be diminished by movement to a 1 hour Gate Closure. The Group also anticipated that 1 hour Gate Closure would deliver real benefits to market participants and that a secure and balanced system could be maintained with relatively small implementation costs. The Group anticipated that the costs of implementing the Proposed Modification would be minor compared with the benefits delivered.

The Group believed that reducing the Gate Closure period would result in increased opportunity to trade and would provide gains in forecasting accuracy. These will:

- reduce the imbalance risk faced by market participants; and
- increased liquidity in short-term markets.

On this basis the Group believed that implementation of the Proposed Modification would improve competition (i.e. Applicable BSC Objective (c)) in the generation and supply of electricity. In addition, the Group believed that the more competitive trading environment would not compromise any of the following:

- the efficient discharge by the Transmission Company of its obligations under the Transmission Licence (i.e. Applicable BSC Objective (a));
- the efficient, economic and co-ordinated operation of the transmission system (i.e. Applicable BSC Objective (b)); and
- the efficiency of the balancing and settlement arrangements (i.e. Applicable BSC Objective (d))

The Transmission Company had reported that it anticipated that reducing Gate Closure to one-hour would not have a significant impact on the Balancing Mechanism, either in terms of the price or volume of actions taken. In addition, it was confident that its ability to balance the market would not be compromised provided that a minimum number of its proposed 'Pre-Gate Closure BMU Transaction' ('PGB Transaction') contracts with appropriate credit arrangements were in place.

The Group recommended that the Proposed Modification be made because implementation would better facilitate achievement of the Applicable BSC Objective (c) contained in Condition C3(3) of the Transmission Licence.

The Group believed the Proposed Modification should be implemented for Settlement Period 31 on 2 July 2002. The Transmission Company had recommended this date and time for the following reasons:

- all necessary changes would be fully deployed and operational by July 2002;

- Monday 1 July 2002 was not recommended because Mondays characteristically had issues associated with staff availability and a more severe electricity demand profile; and
- Settlement Period 31 was the optimum time in terms of availability of appropriate staff resources, lowest anticipated trading volumes, lowest computer system utilisation, and alignment with the four-hour Electricity Forward Agreement blocks.

The Group believed that the Transmission Company's recommended Implementation Date was compatible with Industry needs for the following reasons:

- Impact assessments had indicated that the majority of Parties would require 3 months or less notice to make the necessary changes to implement the Modification;
- The Authority has expressed a willingness to provide provisional thinking to the Panel on the implementation date;
- Should such provisional thinking be favourable and provided during March 2002, there would be 3 months between any statement and 2 July 2002; and
- The Transmission Company had recommended midweek implementation.

Details of the assessment by the Group can be found in the Assessment Report for P12, which can be found on the BSC website at www.elexon.co.uk

The Group noted that, in order to implement P12, an outage of the Energy Contract Volume Allocation Agent (ECVAA) system will be required for approximately 2.5 hours, finishing approximately 15 minutes before Gate Closure for Period 31 on 2 July 2002.

8 SUMMARY OF REPRESENTATIONS

[Insert summary of responses to consultation on Draft Modification Report. Insert copies at Annex 1.]

A summary and copies of the original representations received and considered by the Modification Group during the assessment Procedure for the Modification Proposal can be found in the relevant Assessment Report. This Modification Report should be read in conjunction with that Assessment Report.

ANNEX 1 – REPRESENTATIONS

[Insert copies of representations on Draft Modification Report]