

Direct Dial: 020-7901 7412

25 September 2001

The National Grid Company, BSC Signatories and
Other Interested Parties

Your Ref:
Our Ref : MP No: P008

Dear Colleague,

Modification to the Balancing and Settlement Code - Decision and Direction in relation to Modification Proposal P008: "Introduction of A Price Adjuster to Reflect Option Fees for Balancing Services Contracts in Setting System Buy Price and System Sell Price".

The Gas and Electricity Markets Authority (the "Authority") has carefully considered the issues raised in Modification Proposal P008 "Introduction of A Price Adjuster to Reflect Option Fees for Balancing Services Contracts in Setting System Buy Price and System Sell Price".

The Balancing and Settlement Code Panel (the "Panel") recommended to the Authority that the Modification Proposal be approved with an implementation date of 25 September 2001. The Panel recommended that Settlement runs carried out after the implementation date in respect of Settlement Days prior to that date should not be carried out taking account of the Modification Proposal P008.

The Authority agrees with the Panel's recommendation.

This letter explains the background to the Modification Proposal and sets out the Authority's reasons for its decision. In addition, the letter contains a direction to The National Grid Company plc ("NGC") to modify the Balancing and Settlement Code ("BSC") as set out in Modification Proposal P008.

Background to the proposal

On the 27 March 2001 Modification Proposal P03: "Correction Of Price Spikes Generated By De-Minus NGC Purchases" was put forward by Electricity Direct. Modification Proposal P03 proposed changes to the BSC that would prevent the occurrence of price spikes when option

fees, paid by NGC for the provision of reserve, were included in the numerator of the energy imbalance price calculations but there is a very small volume of accepted Offers (or Bids) in such periods. Modification Proposal P03, as originally submitted, sought to cap the maximum contribution that the option is permitted to make to System Buy Price to 25%.

On 5 April 2001 the BSC Panel made the recommendation to Ofgem¹ that no modification to the BSC was required, on the basis that the issue would be addressed by amending NGC's BSAD Methodology. After consulting on the proposed revisions to its BSAD Methodology Statement, NGC made two alternative recommendations. In the first revision, option fees were removed from the BSAD calculation. In the second revision, option fees remained and a price adjuster was included.

In the April 2001, Decision Document² "Correction of Price Spikes in the Balancing Mechanism", the Authority stated that option fees should be included in the calculation of energy imbalance prices. However, that the current methodology for allocating option fees to settlement periods, could cause unduly high prices during periods when a relatively small volume of offers was accepted.

The Authority recognised that the addition of a price adjuster would be difficult to implement immediately via the BSC due to the time required to develop and implement changes to the BSC Central Systems. In these circumstances the Authority decided that a more immediate solution to the anomalous price spikes was required. As an interim solution the Authority directed NGC to amend the BSAD Methodology to calculate a price adjuster for System Sell Price ("SSP") and System Buy Price ("SBP"). This was implemented via Workaround W024. The Authority recommended that a full solution within the BSC should be developed.

On 20 April 2001, NGC proposed Modification P008 to provide an enduring solution that calculated imbalance prices within BSC Systems and replaced Workaround WO24.

The Modification Proposal

Modification Proposal P008 seeks to amend the SBP and SSP Imbalance Price calculations within the BSC by introducing price adjusters. The Modification Group identified that this would involve the following changes:

- incorporating the submission, storage and reporting of new Sell Price Price Adjustment ("SPA") and Buy Price Price Adjustment ("BPA") data items within the central systems;

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

² A copy of this document can be found on the Ofgem website under Publications – www.ofgem.gov.uk

- revising the BSAD Methodology to include the submission of SPA and BPA. The section, which describes the temporary process for inputting the SPA/BPA data into the settlement systems using existing Sell Price Cost Adjustment (“SCA”) and Buy Price Cost Adjustment (“BCA”) data items, will need to be removed. This is outside the remit of Modification P8, which only covers changes to the BSC and BSC Central Services³;
- discontinuing the current arrangements in Workaround WO24 for a scheduled additional Settlement run using revised BSAD data;
- changing BSC Parties associated processes and systems to reflect changes to the reporting of BSAD data within the current Settlement Reports; and
- making the necessary changes to the BSC and subsidiary documents.

On the 20 July 2001 the Modification Group (“the Group”) issued an Assessment Report of Modification Proposal P008 to the Panel for review. In the Assessment Report the Group recommended that the Modification Proposal should be implemented and include three additional functions to the main changes to modify Settlement Administration Agent (“SAA”) and Balancing Mechanism Reporting Agent (“BMRA”) Reporting. These are:

- introducing a new version of the SAA-I014 Settlement Report and phasing it in, so that both the old and new versions of the SAA-I014 flow could be sent in parallel for a period of three months;
- upgrading the Transmission Company interface to BSC Systems for BSAD data from a manual interface to an automatic interface; and
- adding a facility to the BMRA to report the BSAD data used in the calculation of indicative imbalance prices on the Balancing Mechanism Reporting Service (“BMRS”) website.

The objective of these additional functions is to ensure that Parties are advised of the variables used in the imbalance price calculations and to improve transparency.

In the Assessment Report, the Group recommended that the Modification be approved and implemented in August 2002 but become effective from Settlement Date 5 April 2001.

³ On the 20 September 2001 the Authority directed NGC in accordance with Condition 7B.6(c)(iv) of NGC’s Transmission Licence to consult on, for a period of one working day commencing at or before 10.00 am on the 21 September 2001 and expiring at 17.30, their proposed modification to the BSAD Methodology to align the BSAD Methodology with changes to the BSC to accommodate BSC Modification Proposal P08 if Approved and the Approved Modification P18A (Removing/Mitigating the Effect of System Balancing Actions in the Imbalance Price Calculations). On the 24 September 2001 the Authority directed NGC to make the revisions to the BSAD Methodology as set out in Appendix C of their Report to the Authority.

The Panel met on the 26 July 2001 to consider the Assessment Report and endorsed the views set out in the Assessment Report. ELEXON published a Draft Modification Report for consultation on 30 July 2001 that invited respondents' views by 13 August 2001.

Following the publication of the Draft Modification Report some concerns were raised in regard to the proposed retrospective implementation date.

As a result, ELEXON issued a consultation proposing a revision to the implementation date of the Modification Proposal to 25 September 2001. This consultation paper was issued on 7 September 2001, and requested views by 14 September 2001.

Respondents' views

In total, ELEXON received 9 responses (representing 37 Parties) to consultation on the Draft Modification Report. Of the responses, 8 respondents (representing 34 Parties) expressed support for the Proposed Modification and 1 respondent (representing 3 Parties) expressed concerns in regard to the Proposed Modification.

Support for the Modification Proposal was based on the argument that the incorporation of price adjusters into Central Systems should reduce the risk of human error during the Workaround process.

The respondent who expressed concerns regarding the Modification Proposal questioned the inclusion of the price adjusters. The respondent argued that it was premature to make systems changes given that further changes may be required to provide an optimum solution and that alternative Workarounds should be considered which would allow Balancing Mechanism prices to be published more quickly and reliably.

ELEXON received 12 responses (representing 22 Parties) in response to the consultation on the implementation date of the Modification Proposal. Of the respondents, 10 (representing 17 Parties) supported revising the implementation date to 25 September 2001, 1 respondent (representing 1 Party) expressed concerns over changing the implementation date and one respondent (representing 4 Parties) provided a comment which was not within the remit of the consultation.

In the responses which supported revising the implementation date to 25 September 2001, it was suggested that retaining a retrospective implementation date of 5 April 2001 might result in the Modification Proposal being rejected by the Authority. Consequently it was argued that it would be preferable to revise the implementation date to reduce the risk of the Modification Proposal being rejected as this would prolong the use of Workaround W024. One respondent also noted that delaying the effective date of P008 would have little impact on prices given that Workaround W024 is intended to achieve the same price outcome as P008.

The respondent who expressed concerns over revising the implementation date indicated that in general they are against retrospective changes to cash-out prices. However in this particular case they would be sympathetic to retrospective implementation if this has no systematic effect on cash-out prices as the Workaround is not very robust.

Panel's Recommendation

The Panel met on 20 September 2001 and considered the Modification Report, the views of the Modification Group and the consultation responses received.

The Panel recommended that the Authority should approve the Proposed Modification and that, if approved, the Proposed Modification should be implemented on the 25 September 2001. Settlement runs carried out after the implementation date in respect of Settlement Days prior to that date should not be carried out taking account of the Modification Proposal P008.

Ofgem's view

Ofgem considers that option fees should be included in the calculation of energy imbalance prices. All the costs of Electricity balancing services purchased or sold should be appropriately targeted to energy imbalance prices and therefore to those participants who are in Electricity imbalance. This includes both the option and utilisation fees of reserve services contracted by NGC prior to purchases in the Balancing Mechanism. Ofgem believes that there is strong economic rationale for signalling the total costs of reserve costs (i.e. including option fees) through energy imbalance prices.

Ofgem considers that the addition of price adjusters to reflect option fees for Balancing Services Contracts in setting SSP and SBP does further the Objectives of the BSC by making energy imbalance prices reflective of the cost involved in balancing the system whilst removing the distortions to imbalance prices that occur when option fees paid by NGC for the provision of reserve are included in the numerator of the energy imbalance price calculations, but there is a very small volume of accepted Offers (or Bids) in such periods.

Ofgem considers that Modification Proposal P008 will better facilitate the relevant objectives of the BSC given that it will promote efficiency in the implementation and administration of the Balancing and Settlement arrangements.

Currently the SBP and SSP Adjusters are implemented via Workaround WO24 as an interim solution. Workarounds are manual processes that are used to deliver changes quickly. Given the manual nature of Workarounds, the risk of incorrect prices occurring on the BMRA and in settlement processes are increased. By automating a manual process the opportunities for errors will be reduced.

The Authority's decision

The Authority agrees with the Panel's recommendation that Modification Proposal P008 should be made and implemented on 25 September 2001. Moreover, the Authority agrees with the Panel's recommendation that Settlement runs carried out after the Implementation Date in respect of Settlement Days prior to that date should not be carried out taking account of the Modification Proposal P008.

Direction under Condition 7A.5(a) of NGC's Transmission Licence

Having regard to the above, the Authority, in accordance with Condition 7A.5(a) of the licence to transmit electricity granted to NGC under Section 6 of the Electricity Act 1989 as amended (the "Transmission Licence"), hereby directs NGC to modify the BSC as set out in Modification Proposal P008, a copy of which is attached to this letter.

The modification is to take effect from 25 September 2001.

In accordance with Condition 7A.5(b) of NGC's Transmission Licence, NGC shall modify the BSC in accordance with this direction of the Authority.

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the above number.

Yours sincerely,

Sonia Brown
Senior Manager System Operation

Signed on behalf of the Authority and authorised for that purpose by the Authority

LEGAL TEXT TO GIVE EFFECT TO THE PROPOSED MODIFICATION

Section Q 'Balancing Mechanism Activities'

'6.3.2 The Balancing Services Adjustment Data shall comprise the following data in respect of each Settlement Period:

- (a) Sell Price Cost Adjustment SCA
- (b) Sell Price Volume Adjustment SVA
- (c) Buy Price Cost Adjustment BCA
- (d) Buy Price Volume Adjustment BVA
- (e) Buy Price Price Adjustment BPA
- (f) Sell Price Price Adjustment SPA.'

Section T 'Settlement and Trading Charges'

'4.4.5 In respect of each Settlement Period, if $\{\sum_i \sum^n \{QAO_{ij}^n * TLM_{ij}\} + BVA_j\}$ is not equal to zero then the System Buy Price will be determined as follows:

$$SBP_j = \{\sum_i \sum^n \{QAO_{ij}^n * PO_{ij}^n * TLM_{ij}\} + BCA_j\} / \{\sum_i \sum^n \{QAO_{ij}^n * TLM_{ij}\} + BVA_j\} + \{BPA_j\}$$

where \sum_i represents the sum over all BM Units and \sum^n represents the sum over those accepted Offers that are not De Minimis Accepted Offers and not Arbitrage Accepted Offers and not Trade Tagged Offers.

If for any Settlement Period $\{\sum_i \sum^n \{QAO_{ij}^n * TLM_{ij}\} + BVA_j\}$ is equal to zero, then:

- (a) if for that Settlement Period $\{\sum_i \sum^n \{QAB_{ij}^n * TLM_{ij}\} + SVA_j\}$ is equal to zero, the System Buy Price for that Settlement Period will be equal to zero;
- (b) otherwise, the System Buy Price will be determined as the maximum of System Sell Price and:
 - (i) the Offer Price of the cheapest Offer available in that Settlement Period:
 - (1) which has a positive Bid-Offer Pair Number; and
 - (2) which has an Offer Price greater than the Offer Price of any Offer which is an Arbitrage Accepted Offer in respect of that Settlement Period; and

(3) for which the value of Bid-Offer Volume ($qBO_{ij}^n(t)$) is greater than zero for all spot times t in that Settlement Period;

(ii) or, if no such Offer exists, zero.

4.4.6 In respect of each Settlement Period, if $\{\sum_i \sum^n \{QAB_{ij}^n * TLM_{ij}\} + SVA_j\}$ is not equal to zero then the System Sell Price will be determined as follows:

$$SSP_j = \{\sum_i \sum^n \{QAB_{ij}^n * PB_{ij}^n * TLM_{ij}\} + SCA_j\} / \{\sum_i \sum^n \{QAB_{ij}^n * TLM_{ij}\} + SVA_j\} + \{SPA_j\}$$

where \sum_i represents the sum over all BM Units and \sum^n represents the sum over those accepted Bids that are not De Minimis Accepted Bids and not Arbitrage Accepted Bids and not Trade Tagged Bids.

If for any Settlement Period $\{\sum_i \sum^n \{QAB_{ij}^n * TLM_{ij}\} + SVA_j\}$ is equal to zero, then:

(a) if for that Settlement Period $\{\sum_i \sum^n \{QAO_{ij}^n * TLM_{ij}\} + BVA_j\}$ is equal to zero, the System Sell Price for that Settlement Period will be equal to zero;

(b) otherwise, the System Sell Price will be determined as the minimum of System Buy Price and:

(i) the Bid Price of the most expensive Bid available in that Settlement Period:

(1) which has a negative Bid-Offer Pair Number; and

(2) which has a Bid Price less than the Bid Price of any Bid which is an Arbitrage Accepted Bid in respect of that Settlement Period; and

(3) for which the value of Bid-Offer Volume ($qBO_{ij}^n(t)$) is less than zero for all spot times t in that Settlement Period;

(ii) or, if no such Bid exists, zero.'

Section V 'Reporting'

2.6.5 The BMRA shall calculate:

(a) the Indicative System Buy Price (ISBP_j), and

(b) the Indicative System Sell Price (ISSP_j)

in accordance with the rules in Section T4.4 save that in each case the terms ETLMO⁺, ETLMO⁻, IQAB_{ij}ⁿ, IQAO_{ij}ⁿ, IBCA_j, IBVA_j, IBPA_j, ISCA_j, ISVA_j, ISPA_j, ISBP_j and ISSP_j, shall (for the purposes of this paragraph 2.6 only) be

substituted for the terms $TLMO^+$, $TLMO^-$, QAB_{ij}^n , QAO_{ij}^n , BCA_j , BVA_j , BPA_j , SCA_j , SVA_j , SPA_j , SBP_j and SSP_j in Section T.'

Annex V-1: Table 1

Balancing Services Adjustment Data (BSAD)	Daily	Tabular	None
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Section X, Annex X-2 'Technical Glossary'

Defined Term	Acronym	Units	Definition/Explanatory Text
Buy Price Price Adjustment	BPA_j	£/MW h	The amount sent by the Transmission Company as the 'Buy Price Price Adjustment' in accordance with Section Q6.3.
Sell Price Price Adjustment	SPA_j	£/MW h	The amount sent by the Transmission Company as the 'Sell Price Price Adjustment' in accordance with Section Q6.3.