

# Assessment Procedure Consultation Responses

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



This Assessment Procedure Consultation was issued on 30 July 2014, with responses invited by 20 August 2014.

Please note that the responses showing as grey in the table below have not been considered by the P304 Workgroup. This is because they were received after the deadline and therefore not in time for the Workgroups final meeting.

What stage is this document in the process?

- 01 Initial Written Assessment
- 02 Definition Procedure
- 03 Assessment Procedure
- 04 Report Phase

### Consultation Respondents

Respondent	No. of Parties/Non-Parties Represented	Role(s) Represented
GDF SUEZ	14 / 0	Generator, Supplier
SmartestEnergy Ltd	1 / 0	Supplier
Drax	2 / 0	Generator, Supplier
Co-Operative Energy	1 / 0	Supplier
National Grid	1 / 0	Transmission Company
Utilita Energy Limited	1 / 0	Supplier
Flow Energy Ltd	1 / 0	Supplier
EDF Energy	10 / 0	Generator, Supplier, Non Physical Trader, ECVNA, MVRNA, Exemptable Generator, Aggregation
IBM UK Ltd on behalf of ScottishPower group	9 / 0	Generator, Supplier, Distributor, Non Physical Trader, ECVNA, MVRNA, Supplier Agent
E.ON	5 / 0	Generator, Supplier, Interconnector User, Non Physical Trader
Centrica	13 / 0	Generator, Supplier, Interconnector User
Good Energy	1 / 0	Supplier, ECVNA, MVRNA
First Utility Limited	1 / 0	Supplier
Hudson Energy UK	1/0	Supplier
SSE	8/0	Generator, Supplier, Interconnector User
BES Commercial Electricity Ltd	1/0	Supplier

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Question 1: Do you agree with the Proposers view that P304 does better facilitate the Applicable BSC Objectives than the current baseline?

## Summary

Yes	No	Neutral/No Comment	Other
6	8	1	1

## Responses

Please note that the responses showing as grey in the table below have not been considered by the P304 Workgroup. This is because they were received after the deadline and therefore not in time for the Workgroups final meeting.

Respondent	Response	Rationale
GDF SUEZ	No	<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</p>

Respondent	Response	Rationale
		<p>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 have to 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>
SmartestEnergy Ltd	Yes, but. . .	<p>Any reduction in PAR will sharpen imbalance prices and this will lead to greater attention on imbalance volumes which, it could be argued, will increase efficiency. We would, however, make the following observations:</p> <ol style="list-style-type: none"> <li>1) It could also be argued that the best indicator of whether the market (in a dual cash-out world) is working efficiently is when RCRC is trending towards zero. We do not believe that it is correct to remove dual cash out and the incentives and counterbalances that system provides. In a single cash-out world, it is inevitable that the argument that a lower PAR improves the incentives to balance will prevail.</li> <li>2) P205 (which increased PAR from 100 to 500) was approved by Ofgem in late 2006 and yet not much later Ofgem started saying that they had "long standing" concerns over the incentives to balance.</li> <li>3) In conjunction with P305 it is said that the changes will make the market value flexibility more. In our view, moving to single cash-out offsets to some extent the incentivising element of a reduced PAR. Overall, the changes are unnecessary at best.</li> </ol>

Respondent	Response	Rationale
Drax	Yes	Based on the analysis provided to date, we agree that P304 marginally better facilitates the applicable BSC Objective relative to the baseline. However, we note that further analysis is being undertaken on behalf of the Workgroup. It is important that the Workgroup considers this analysis at the next Workgroup meeting to confirm the efficacy or not of P304.
Co-Operative Energy	Comments	<p>We agree that a reduction in PAR to 250MWh from the current level of 500MWh could be considered to better facilitate Applicable BSC Objective (b) efficient, economic and co-ordinated operation of the national electricity transmission system, in that sharper cash-out pricing based on a smaller PAR volume will provide a greater incentive to participants to balance themselves as a result of more marginal imbalance charging in tight network situations.</p> <p>However, it could also be argued that implementation could run counter to Applicable BSC Objective (c) promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity, particularly if the current dual-priced cash out arrangements are retained.</p> <p>At present, suppliers face an asymmetric risk in relation to electricity cash-out as the amount charged at System Buy Price (SBP) for being "short" (energy supplied is less than demand) is always greater than (or, at best in certain uncommon situations, equal to) the amount paid at System Sell Price (SSP) for being "long" (energy supplied is more than demand). This is particularly true of domestic suppliers who can never be perfectly balanced due to the difficulty of accurately estimating the consumption behaviour of their customer bases.</p> <p>It seems likely that the effect of reducing the PAR to 250MWh as proposed under the current dual-priced cash out mechanism will be to increase cash-out prices for those market participants with a short position while failing to correct the current situation whereby market participants with a long position receive, in general, less payment for supplying excess energy than they are charged for not supplying enough. It also heightens the incentive for vertically integrated market participants to hold</p>

Respondent	Response	Rationale
		back generation from the market for the purposes of fine tuning their positions within day, potentially further increasing the SBP price charged to short participants. Introduction of a single-priced cash-out mechanism (where SBP and SSP are always the same) would remove some of this incentive and also reduce risk around asymmetric dual priced cash-out for smaller players without access to generation who cover all their customer demand through traded market purchases. We would therefore request that the reduction to PAR 250 does not go ahead without the simultaneous introduction of a single-priced cash-out mechanism in order to reduce both this heightened asymmetric cash-out risk for smaller, non-vertically integrated market participants and the incentive for larger vertically integrated market participants to hold back generation to fine tune their positions within day.
National Grid	Yes	<p>For the reasons set out in the Proposal, we believe that applying a lower PAR volume in the imbalance price calculation will better facilitate Applicable Objectives (b) and (c).</p> <p>Applicable Objective (b) is facilitated by ensuring that the value of flexible capacity is more accurately reflected in the price signals to market, which should help mitigate tightening margins.</p> <p>A lower PAR value helps concentrate the costs of balancing the system more on those participants whose imbalance positions have contributed to the requirement for the System Operator (SO) to take energy balancing actions. The incentives on market participants thereby ensure more effective competition by aligning incentives of taking balancing actions closer to the value provided to consumers, supporting Objective (c).</p>
Utilita Energy Limited	No	See answer to Q8.
Flow Energy Ltd	No	The effect of P304 will be to both increase barriers of entry to new independent suppliers, and put additional- disproportionate- pressure on existing smaller independent suppliers. This will therefore advantage larger suppliers. The impact of these changes will make it much harder to achieve BSC objective C. The increase in price volatility in the a market and the significant increase in operating costs placed on smaller independent energy suppliers has the potential to significantly reduce

Respondent	Response	Rationale
		the number of suppliers who are able to effectively operate in the market, and to significantly increase the operating costs of those smaller independent suppliers who remain.
EDF Energy	Yes, but only slightly	<p>The most relevant Applicable BSC Objectives are (b) and (c).</p> <p><b>BSC Objective (b):</b></p> <p>We think P304 would 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.</p> <p>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. Incentives to improve forecasting, schedule generation efficiently (and/or demand where there is capability) and trade ahead of Gate Closure would be increased. This should reduce the volume and cost of balancing actions required to be taken by the System Operator, which should better facilitate BSC Objective (b). However, the extent of systematic behavioural changes resulting from a reduction in PAR volume from 500MWh to 250MWh remains uncertain and is probably relatively small.</p> <p>NGET states that making cash-out prices sharper “signals the commencement of reforms designed to better reflect the value of flexible plant in the balancing arrangements. It may therefore contribute to deferring the mothballing of flexible plant and help counteract potential tightening of margins”. We are not completely persuaded that a reduction in PAR volume from 500MWh to 250MWh would make a material difference to a generator’s decision to mothball.</p> <p><b>BSC Objective (c):</b></p> <p>We believe P304 would slightly improve achievement of BSC Objective (c) concerning competition, compared to the existing baseline.</p> <p>More cost-reflective incentives should encourage forward trading and other actions to avoid</p>

Respondent	Response	Rationale
		<p>expensive imbalances. This could increase liquidity in the forward market and the value of flexible resources, potentially benefitting competition by promoting trade and by encouraging investment in flexible capacity (flexible generation, demand participation and other technologies).</p> <p>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>However, improved cost-reflectivity will create winners and losers. Small suppliers appear to lose from the proposed change, although the materiality is difficult to assess. It is natural for new and smaller participants to have more difficulty predicting their customer demand and purchase and/or sale prices, and weathering cashflow and credit volatility. If competition is currently working and small suppliers are benefiting unduly from smeared charges, then it would be more economically efficient to move to more cost-reflective marginal pricing. However, if the natural forecasting and trading disadvantages of small scale faced by small participants are not outweighed by their natural advantages of flexibility and innovation, and systematic business failure or lack of future investment occurs, then reduction in PAR volume could have a detrimental impact on competition. We have no information on the true business situation of small independent participants and the relative significance of imbalance costs, or the measures they could take to better manage imbalance risks.</p> <p>On balance, we think making cash-out sharper in steps starting with PAR250 this winter will provide parties with the time required to get used to lower PAR values and to change behaviours accordingly.</p> <p><b>BSC Objective (d):</b></p> <p>Overall we think the impact will be insignificant on BSC Objective (d) concerning efficient implementation and administration of the balancing and settlement arrangements.</p> <p>We anticipate that the implementation costs, both</p>

Respondent	Response	Rationale
		central and for participants, will be relatively small compared with the materiality of changes in the allocation of imbalance costs and resulting expected reductions in future system operator balancing costs relative to the status quo. Participants may wish to modify their forecasting, risk management, forward contracting, generation scheduling and/or customer portfolio processes, but this should be part of normal business processes. At most, we expect only small changes in the ongoing central administration processes of the BSC, perhaps involving an increased demand for explanation of more extreme outturn imbalance prices.
IBM UK Ltd on behalf of ScottishPower group	No	We believe that the Proposed Modification will have a disproportionately negative impact on small Parties, being hit with higher imbalance prices, combined with higher credit cover requirements. This magnified impact on small Parties is a detriment to Objective c), as they will be less able to absorb these pricing shocks, compared to larger, more vertically integrated Parties.
E.ON	No	<p>Although under P304 it seems that we might actually benefit from rcrc offsetting increased imbalance charges in the majority of periods, we do not believe that the existing arrangements need to change.</p> <p>It has not been demonstrated that a change to solely reduce the PAR volume to 250 MWh would be any more efficient than the current arrangements, as opposed to ending dual pricing, not included in P304. In contrast, reducing PAR but continuing the dual pricing system would lead to sharper prices, increased volatility and the Main/Reverse spread posing a greater risk to parties. This spread being a risk and inefficiency that Ofgem set out to address in the EBSCR, it would seem perverse to actually increase this risk and cost to parties and ultimately customers for a year or more through P304. While the impact of a PAR reduction to 250MWh might look comparatively small at an average/quarterly/monthly level, extreme periods could clearly have a considerable financial impact on parties and this remains a serious concern. In exacerbating the risk and potential cost to a party of being penalised by sharper imbalance costs, even if balanced across both accounts under the dual pricing system, P304 is detrimental to efficiency.</p> <p>Furthermore, as Elexon's analysis confirmed that the</p>



Respondent	Response	Rationale
		<p>introduction of PAR 250 MWh alone would have varying impacts on different types of party, with the most negative impact seeming likely particularly for independent suppliers, it is hard to see how this could promote competition.</p> <p>We disagree with the Proposer's view that P304 might have a positive impact on BSC Objective B. Parties balance their positions to the best of their ability; forecasting will never be perfect and better forecasting not suddenly possible if the costs of imbalance rise. It seems more realistic that a lower PAR value might encouraged parties if in doubt to err on the side of going long because of the risk of more penal imbalance charges if short. This could ultimately require more actions from the SO to balance the system, i.e. potential for a negative impact on BSC Objective B. On the whole however, parties are incentivised to balance and a change to PAR 250 MWh would not carry the risk of this to the same extent as a lower figure.</p> <p>Thus fundamentally we believe that in introducing a lower value of PAR under a dual pricing system, P304 would increase cost and risk to parties, and to a greater or lesser extent for different types of parties: in both aspects detrimental to Objective C, while also having a negative impact on BSC Objective D, for efficiency, and potential for a minor negative impact on Objective B.</p>
Centrica	Yes	<p>Reducing the level of PAR should make the cash-out price more cost reflective and should therefore provide an incentive for parties to balance their position, reducing the number of actions taken by National Grid to balance the system (Applicable BSC Objective B). Furthermore this should encourage the trading of positions and increase liquidity in the market (Applicable Objective C)</p>
Good Energy	No	<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. 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</p>

Respondent	Response	Rationale
		efficiency in undertaking the balancing of supply and demand.
First Utility Limited	No	<p>We do not agree with this proposed Modification P304.</p> <ol style="list-style-type: none"> <li>1. Modification P304 increases the economic benefits of vertical integration, increases the barriers to new entry and competition, and increases the risk of independent exits. Thus P304 in isolation would represent an adverse impact on competition and we do not support it.</li> <li>2. The modification was raised with a very short period between the proposal date and planned implementation date and we never expected a more marginal PAR calculation to be treated in isolation from other parts of the original cash-out SCR discussions and consultation / recommendations.</li> <li>3. We believe there has been insufficient time taken to fully understand the impacts (including the distributional effects on different market participant types) of P304. This has been to the detriment of those who will be most affected by the changes and have the least resource to analyse and engage with the modification process.</li> <li>4. We are concerned about the combined impact of this modification with other imminent changes (for example the introduction of DSBR and SBR and the effects these will also have on System Buy Price). This could work to exacerbate the sharpening of the dual priced cash-out regime to the detriment of single sided market participants, with consequential adverse effects on competition.</li> </ol> <p>The analysis that has been performed to date indicates that there will be an adverse distributional effect on smaller and non-integrated players in the market. The analysis has been performed on historic cash-out data for settlement periods with adequate generation capacity in the system, leading to less volatile cash-out signals. This modification however, is designed to deal with times of generation scarcity. A complete analysis of the effects of this modification needs sufficiently consider the distributional impacts of the change during times of scarcity. Without such an analysis it is impossible to make a fully informed judgement on BSC objective c, although we do expect the impact on independent suppliers to be more damaging at times of scarcity than the impact predicted in the</p>

Respondent	Response	Rationale
		<p>analysis.</p> <p>We also question whether the sharper price signal, in a dual priced cash-out regime, has the potential to improve BSC objective b. A sharper dual priced cash-out signal has the potential to encourage participants to go 'long' into imbalance, driving extra inefficiencies and costs in the balancing regime.</p> <p>In summary we believe that P304 undermines BSC objectives b and c.</p>
Hudson Energy UK	n/a	I cannot comment on this section as I am not close enough to the specific detail
SSE	Yes	<p>SSE believe that the value of flexibility and risk are not sufficiently priced into the energy market currently, dampening price signals and undermining the credibility of cash-out as an incentive price. This has resulted in a lack of investment in all generation and particularly flexible capacity as well as the imposition of higher balancing costs on the System Operator, at a time when such capacity is needed to cope with the system management complexities and costs created reductions in existing flexible capacity due to environmental regulation as well as an increased penetration of intermittent generation. In particular for this Winter, the SO and Ofgem have clearly signalled a potential for tightening of system margins through several studies and reports, as well as the development of additional balancing tools (e.g. DSBR), which suggests the need to offer sufficient incentive to low load factor capacity to defer any plans for mothballing.</p> <p>Reducing the PAR value will lessen the impact of volume weighting on the price formulation, particularly at times of system stress, thus improving the price signal for flexibility and the potential income that can be captured to cover system stress scenarios, thus better justifying continued investment in low load factor capacity in particular and contributing to the deferral of potential mothballing.</p> <p>Reducing the PAR value to 250MWh for this Winter is therefore an incremental improvement on the current baseline and a step in the right direction, although SSE would like to see a fully marginal price to be implemented at the earliest opportunity to properly reflect value and risk.</p>

Respondent	Response	Rationale
		<p>We share the concerns of some members of the working group that reducing the PAR value to a more marginal value, whilst retaining a dual system price structure, does have the potential to increase the distributional effects of the price spread demonstrated by Ofgem in their EBSCR impact assessment, and therefore the introduction of a reduced PAR without a single price for this Winter seems a little disjointed. However, notwithstanding this concern, we believe that the distributional effects demonstrated through historic analysis thus far are not excessive and that in any event they would reduce as forward behaviour changes to respond to an increasing price risk (albeit modestly increasing).</p> <p>On balance therefore, we agree with the proposer's contention that the modification proposal will better facilitate objectives b) and c).</p>
BES Commercial Electricity Ltd	No	The change is unproven and likely to have competitive distortions. It is likely to increase risks faced by smaller, one-sided players and increase rentals rebated across the market.

## Question 2: Do you agree with the Proposers view that PAR should be reduced to a volume of 250MWh?

### Summary

Yes	No	Neutral/No Comment	Other
4	10	0	2

### Responses

Please note that the responses showing as grey in the table below have not been considered by the P304 Workgroup. This is because they were received after the deadline and therefore not in time for the Workgroup's final meeting.

Respondent	Response	Rationale
GDF SUEZ	No	GDF SUEZ would support a reduction in PAR to 250MWh or any other value lower than 500MWh only if it was accompanied by a single cashout price. We see the two changes together as coherent and complimentary in addressing Ofgem's concern in the EBSCR (that imbalance prices are not creating the correct signals to allow the market to balance, leading to increased risks to future security of supply). As set out in the response to Q1, P304 does not address this concern and we do not believe that it is a positive improvement.
SmartestEnergy Ltd	Yes	On the basis that it is Ofgem's intention to reduce PAR to 1, but to do so in a staged manner, the value of 250 is not an unreasonable stepping stone.
Drax	Yes	Yes this is consistent with Ofgem's EBSCR Final Policy Decision.
Co-Operative Energy	Qualified Support	Please see our answer to Question 1 above. While we understand the rationale for Ofgem's intent to reduce PAR from 500MWh to 250MWh, we would request that this change does not go ahead without the simultaneous introduction of a single-priced cash-out mechanism for the reasons discussed above as well as consideration of the likely effects on imbalance and possibly trading credit requirements for smaller suppliers. We also believe that the proposed change will be more manageable for smaller suppliers once SMETS 2 domestic smart meters are widely rolled out as this will give smaller suppliers better visibility of the likely consumption of their customer base.
National Grid	Yes	Reducing the PAR volume from 500 to 250MWh represents the first step towards implementing policy changes under the Electricity Balancing

Respondent	Response	Rationale
		<p>Significant Code Review (EBSCR) that strengthen the price signals for cash-out. 250MWh is a level of PAR which provides an improvement in the efficiency of the imbalance price signal to the market. However, we do not believe the magnitude of the change is such that it would be difficult for market participants to adjust to in a single step (e.g. as opposed to a direct move to 50 or 1MWh). This volume helps form a smooth transition to sharper cash-out arrangements.</p>
Utilita Energy Limited	No	<p>Reducing PAR from 500 to 250 appears to be entirely based on a simplistic implementation of marginal cost pricing (MCP). There is no consideration given to the fact that market participants cannot see the price ahead of time and therefore the efficiency of MCP is highly questionable. MCP is even more questionable when it is recognised that suppliers of NHH metered customers have no control over the HH demand allocated to their account. There is considerable doubt on the limitations of MCP when transaction costs are significant, and it seems to me that this is true of this proposal.</p> <p>Higher balancing prices will disproportionately impact smaller suppliers who will inevitably have a greater proportion of their demand in balancing due to minimum trade sizes, the limitation on demand forecasting accuracy relative to larger players, and a less stable customer base. This is not because the small suppliers increase risk; it is simply a reflection of the way in which demand is aggregated in the current balancing rules. NGC should balance the national aggregate position and be incentivised to minimise balancing costs for the benefit of all. If that is not the case consumers of all supply companies will be paying more than necessary.</p> <p>The proposal seems to assume that suppliers will take more action over balancing their positions. I believe most suppliers already do everything they can to balance their positions. A lower PAR is therefore a penalty for being smaller, and will also increase credit cover requirements.</p>
Flow Energy Ltd	No	<p>Reducing the PAR will, in all cases, increase volatility in the system pricing- this will increase operating risks of all suppliers- and especially smaller independent suppliers- as detailed below. No reduction in the PAR volume should take place until it can be demonstrated that it will not</p>

Respondent	Response	Rationale
		undermine competition in both the wholesale and retail electricity market- and in particular in the domestic sector. Half-hourly settlement of profile classes 1-8 (p300 & p272) and the wider introduction of both smarter markets and domestic smart metering, will put smaller domestic suppliers in a much better position to cope with, and mitigate against the impacts of, the volatility created by reducing the PAR volume.
EDF Energy	Yes	As stated above, making cash-out sharper should allow BSC Objectives to be better met. Changing in steps, starting with PAR250 this winter, will provide parties with time to adjust gradually to lower PAR values and to change behaviours accordingly.
IBM UK Ltd on behalf of ScottishPower group	No	<p>We acknowledge that PAR will reduce as a result of the Authority direction; however we believe that this should be intrinsically linked to the introduction of a single market price. As the ELEXON analysis has shown, reducing PAR leads to an increase in spiky pricing and will have a significant impact on smaller Parties, greater impact than that on integrated Parties. Ideally PAR should remain at 500MWh until next winter (2015/16) when single pricing is also due to be introduced, or single price should be brought forward to this year.</p> <p>We also note from the analysis that the impact on smaller Parties is mitigated somewhat by moving to 350MWh, however there is still a definite negative impact on those smaller Parties over the current baseline, at a time when we need to encourage smaller Parties into the market.</p> <p>Our preference is to move either; the implementation date of P304 to next winter; the introduction of a single price market to this winter, or move to PAR350 in the current timescales.</p>
E.ON	No	As per our answer to question 1, we do not believe that the existing arrangements need to change. The only reason for changing PAR 500 MWh to 250MWh is as a step towards the potential changes to PAR 50MWh and PAR 1MWh that are proposed in modification P305, but to implement PAR 250MWh without changing to single pricing would have a greater adverse impact than if switching to single pricing at the same time.
Centrica	No	We do not consider that a volume reduction to PAR 250 will have the required impact on imbalance

Respondent	Response	Rationale
		prices, we suggest that a lower PAR volume of 100 MWh is more likely to have the desired effect, whilst maintaining a stable and operational market.
Good Energy	No	<p>The P304 Workgroup has analysed the effect of reducing PAR to 350, 250 or 100MWh. The analysis shows that in each case Independent Suppliers (small suppliers) are disadvantaged compared to Vertically Integrated Parties and the extent to which they are disadvantaged increases progressively the more the PAR volume is reduced. Hence we believe any reduction in PAR volume will not better facilitate the Applicable BSC Objectives than the current baseline. However, 350MWh is less bad than 250MWh.</p> <p>The Workgroup analysis of the impact of reducing PAR to 350, 250 or 100MWh is based on historic data starting on 15/02/10. This is later than the start date of the historic analysis undertaken by Ofgem for their Electricity Balancing Significant Code Review (EBSCR), which started from 01/01/10, and we note that System Buy Prices were significantly higher during the 1½ months prior to 15/02/10 than the period of only 1½ months of winter 2009/10 that is included in the analysis. Moreover, prior to 01/01/10 there have been periods when cash-out prices have been somewhat more volatile than since that date. By starting at 15/02/10 we believe the analysis may understate the extent to which small suppliers are disadvantaged compared to Vertically Integrated Parties.</p> <p>The Workgroup analysis shows only the cash impact on Parties of reducing PAR to 350, 250 or 100MWh. This does not indicate the scale of the impact on different types of Party, as any cash amount will have a substantially larger impact on the small suppliers than the Vertically Integrated Parties. We consider the impact on Party types provided should include the change in £/MWh supplied or generated and £/MWh of credited energy volume.</p>
First Utility Limited	No	<p>We do not agree with this proposed Modification P304.</p> <p>We support making cash-out more marginal (e.g. By a slow incremental reduction of PAR) but not in a dual priced cash-out regime. PAR reductions must occur either coincident with or after a move to single priced cash-out if they are to avoid adverse</p>



Respondent	Response	Rationale
		impacts running contrary to BSC objectives.
Hudson Energy UK	No	At this time we feel no change should be made to PAR
SSE	Yes and No	<p>As stated in question 1 we would prefer a move to a fully marginal price at the earliest opportunity to ensure that flexibility and risk are properly reflected into the system economics, thus sharpening incentives to balance and trade. As such, we would advocate the introduction of PAR1 (one), whilst accepting that this may create too much volatility and inability to hedge risks for a number of actors in the market for this Winter.</p> <p>Of the options analysed thus far, we would prefer PAR100 over PAR250, as a better incentive to realise the balancing and investment benefits outlined in question 1 above, but would accept PAR250 as a minimum.</p>
BES Commercial Electricity Ltd	No	See answer to Q1.

## Question 3: Will P304 impact your organisation?

### Summary

Yes	No	Neutral/No Comment	Other
16	0	0	0

### Responses

Please note that the responses showing as grey in the table below have not been considered by the P304 Workgroup. This is because they were received after the deadline and therefore not in time for the Workgroup's final meeting.

Respondent	Response	Rationale
GDF SUEZ	Yes	<p>P304 will have the following impacts on GDF SUEZ:</p> <ul style="list-style-type: none"> <li>it will increase the imbalance exposure cost of any unplanned outages.</li> <li>it will increase balancing costs for our retail business which in turn will increase costs for end users.</li> <li>it will also reduce revenues for certain embedded generation installations where "spill" contracts are not uncommon.</li> </ul> <p>It will increase balancing costs for retail businesses which in turn will increase costs for end users</p> <p>It will also reduce revenues for certain embedded generation installations where "spill" contracts are not uncommon</p>
SmartestEnergy Ltd	Yes	We anticipate imbalance costs to increase and this will not immediately be mitigated by single cash out. However, we believe that the costs will be manageable.
Drax	Yes	There will be an impact although we do not expect it to be significant.
Co-Operative Energy	Yes	<p>While we believe that this change will not make any significant difference to Co-Operative Energy's cash-out risk in the majority of cases we are concerned about the possible effects in a tight network period such as a very cold day in winter or a very hot day in summer, particularly if this change is implemented while retaining the current dual-priced cash-out mechanism.</p> <p>Smaller domestic suppliers do not have access to generation which they can use to fine tune their within day positions and are less able to weather</p>

Respondent	Response	Rationale
		<p>any extended period of high electricity cash-out prices in a tight network situation. The reduction of PAR from 500 MWh to 250 MWh will make it more likely that SBP will be higher in situations of this kind as a smaller quantity of more marginally priced generation purchased through the Balancing Mechanism will set the price for each period. This increases a potential risk which smaller suppliers are less well equipped to deal with for the reasons already discussed and makes it harder for them to compete on a level playing field. In addition, we would question as to whether now is the right time to make this change. Once SMETS 2 compliant domestic smart meters have been widely rolled out, this will then make it easier for smaller suppliers to have visibility of the likely consumption of their customer base at any given time and then take appropriate steps to manage the increased imbalance risk resulting from the proposed change.</p> <p>We think it would have been useful if the analysis used had included data over a longer period and, in particular, from the winters of 2005/06 and 2008/09 when a combination of factors resulted in significantly higher cash-out prices than have been seen in more recent years. As an increasing amount of generating plant is retired due to the effects of the Large Combustion Plant Directive (LCPD) and lower wholesale prices the margin between demand and supply will diminish prior to new plant coming on line and the risk that cash-out prices will, in the case of a cold winter, reflect the prices seen during those winters increases.</p>
National Grid	Yes	We do not perceive there to be any direct impacts to National Grid as a result of P304. However, as market participants' behaviour is likely to adapt in response to a stronger imbalance price signal, driving greater incentives to balance their positions, fewer energy balancing actions should be required to be taken in our role as System Operator (SO).
Utilita Energy Limited	Yes	<p>Reducing PAR will increase balancing prices within the current financial year. This is at a time when all suppliers are under considerable political pressure to reduce retail prices.</p> <p>Higher cashout prices may be entirely spurious, but nonetheless drive up credit cover requirements.</p>
Flow Energy Ltd	Yes	Increased balancing cost volatility will greatly increase the operating risks of all independent,

Respondent	Response	Rationale
		<p>smaller, and growing, suppliers. Those suppliers (often larger suppliers) who see less customer churn (as a proportion of their total volume) will usually have much longer term data on consumption at each of their sites. Consequently sharper imbalance prices will have a disproportionate impact on the operation- and operating risks- on those suppliers who may be less able to absorb such risks.</p> <p>Non-domestic suppliers are more likely to be able to mitigate the risks of increased volatility by using mechanisms such as DSR which are not available to the domestic sector.</p> <p>There are further risks associated for those suppliers who are not large enough to justify 24 hour trading. The costs of moving to 24 hour trading cover would be significant, if not disproportionate, for smaller independent suppliers</p> <p>As a smaller, growing, independent supplier who operates only in the domestic market- the impact of p304 has the potential to be both significant and negative.</p>
EDF Energy	Yes	As a BSC Party, we will be impacted by the effects of the reduced PAR value on imbalance prices. The extent of the impact on operational risk management, forward trading strategies, demand forecasting etc. are currently being considered. We will need to spend time and effort training the impacted operational staff on the new arrangements. In addition, staff time will be spent in updating our traders' tools and processes used to forecast SBP and SSP.
IBM UK Ltd on behalf of ScottishPower group	Yes	While there are no implementation costs for P304, the effect of moving to a reduced PAR value will be to increase operating costs - costs which will ultimately be passed onto Consumers.
E.ON	Yes	Like other market participants we will feel the impact of sharper cash-out prices in the amount we have to pay or are paid for our imbalance, and the knock-on effects to rrcr received or paid.
Centrica	Yes	Introducing a lower PAR value will result in sharper and more volatile cash-out prices, in order to maintain our current level of imbalance costs, we expect to have to improve our forecasting techniques. Additionally, there is likely to be an increase to the amount of credit that will need to be

Respondent	Response	Rationale
		posted.
Good Energy	Yes	<p>As a small supplier we expect to be adversely affected by higher imbalance charges (net of RCRC), if P304 is implemented, due to sharpened imbalance prices. Elexon has provided an historic analysis of the impact for all BSC Parties but this does not enable the impact on Good Energy to be determined over the period of the analysis, because for most of the period Good Energy's energy volume was the subject of a 100% MVRN to another BSC Party. We raised this issue with Elexon several weeks ago but, despite repeated requests, it was not until 18 August that they sent us data for the full period of their analysis. Until we are able to complete a comparable impact assessment for ourselves as has been provided by Elexon for other Parties, we are placed at a significant disadvantage to other suppliers and this represents a significant risk to our business.</p> <p>As explained in response to Question 5, Good Energy would also expect to be faced with additional costs to meet credit cover requirements.</p>
First Utility Limited	Yes	<p>We do not agree with this proposed Modification P304.</p> <p>P304 will adversely affect First Utility.</p> <p>We are concerned about the distributional effects of this modification at times of scarcity under the current dual priced cash-out regime. We believe the effects of P304 are significant and adverse to some market participants. Implementing the proposal prior to winter 2014 will not give adequate time for market participants to plan and react to the change. The existing analysis clearly shows the extra cost to independent suppliers versus the extra benefit provided to integrated suppliers. We are also concerned that P304 will lead to behavioural changes in the spot and forward wholesale markets, increasing wholesale costs of electricity at peak times also.</p> <p>These increased costs could, at a time of scarcity, lead to increased risk of higher retail prices as a direct result of P304. It would be a bad result for the industry if, as a result of a modification to attempt to increase efficiencies, the converse occurred and costs increased for consumers.</p> <p>Further, suppliers have some customers who are on fixed price contracts that cannot be changed even in</p>

Respondent	Response	Rationale
		reaction to increased costs. Had suppliers known about this modification earlier they might have deployed different customer acquisition strategies and / or set their fixed price tariffs differently.
Hudson Energy UK	Yes	Analysis performed by Cornwall suggests we will receive higher imbalance charges but not benefit from any additional RCRC payouts – which will disproportionately impact us and other smaller suppliers verse the integrated players
SSE	Yes	SSE is a large physical player in both the supply and generation markets and an active trader in the energy commodities markets, and is therefore exposed to imbalance prices on our electricity generation and supply portfolios. A more marginal approach to imbalance price formulation will sharpen incentives to balance, influence the value of risk feeding back into the forward price and impact optimisation and trading decisions.
BES Commercial Electricity Ltd	Yes	It will increase exposure to costs that are difficult to manage in a market where smaller players find it difficult to access product and buy flexibility. It could have particularly adverse impacts this winter given the lack of notice and the failure of the change proposal to also include a shift to a single marginal price.

## Question 4: Will your organisation incur any costs in implementing P304?

### Summary

Yes	No	Neutral/No Comment	Other
9	6	1	0

### Responses

Please note that the responses showing as grey in the table below have not been considered by the P304 Workgroup. This is because they were received after the deadline and therefore not in time for the Workgroup's final meeting.

Respondent	Response	Rationale
GDF SUEZ	No	-
SmartestEnergy Ltd	No	As the document states PAR is calculated centrally and we do not use the value to replicate system prices.
Drax	No	We do not expect that our organisations will incur any additional internal system costs due to the implementation of P304.
Co-Operative Energy	Yes	We believe that potentially higher cash-out prices are likely to result in a requirement to post larger levels of credit for imbalance purposes and also potentially to trading counterparties as they may believe that this change is likely to increase their risk exposure in terms of trading with us.
National Grid	No	-
Utilita Energy Limited	No	-
Flow Energy Ltd	Yes	Aside from some more minor IT changes which will be needed to allow us to forecast imbalance prices and risks P304 will increase our operating risks, this will have to be quantified and accounted for as a cost our business plan.
EDF Energy	Yes	As described above, we anticipate making changes to our operational processes which will require resources. Staff time, while not a line item like IT change, still has a cost.
IBM UK Ltd on behalf of ScottishPower group	No	-

Respondent	Response	Rationale
E.ON	Yes	Some cost will be incurred to change the value of PAR held in our systems.
Centrica	-	We anticipate minimal costs associated with implementing this change.
Good Energy	Yes	We would seek to invest in improved forecasting systems to mitigate some of the impact of the higher expected imbalance costs referred to above to the extent that this seemed economic but doubt that this is feasible. Until we are able to make a reasonable estimate of the likely impact of P304 on ourselves we are unable to have a proper view on this, so we do not have any cost estimates for any such investment at present.
First Utility Limited	Yes	We do not agree with this proposed Modification P304.  Parties are expected to take action to reduce their imbalance exposures to mitigate the associated price and volume risks where possible. It is very difficult to understand the impact of P304 in general, and it is especially difficult to understand at such short notice in order to determine any required mitigating strategies, let alone implement them. The cost of any such work at such short notice will likely attract a higher cost. Moreover, there are limitations in what an independent supplier can do to minimise the impact of P304 due to the inherent structural differences to other market participants.
Hudson Energy UK	Yes	We will need to invest more in improving our forecast demand, although we currently see no additional information being generated centrally to help support us
SSE	Yes	There will be minor systems impact to price calculation tools and the need for minor amendments to processes and education tools.
BES Commercial Electricity Ltd	Yes	There will be additional hedging costs to mitigate higher costs, higher costs from balancing where this is not achievable and credit costs will increase in either case.



## Question 5: Will the current Credit arrangements be impacted if there is a reduction in the PAR value?

### Summary

Yes	No	Neutral/No Comment	Other
13	2	1	0

### Responses

Please note that the responses showing as grey in the table below have not been considered by the P304 Workgroup. This is because they were received after the deadline and therefore not in time for the Workgroup's final meeting.

Respondent	Response	Rationale
GDF SUEZ	Yes	We agree with the view expressed by a Member of the modification group that the larger the imbalance price, the more Credit Cover a Party may need.
SmartestEnergy Ltd	Yes	There will inevitably be some impact if imbalance costs increase. However, we do not believe this will be significant. For one thing the industry is massively over-collateralised anyway and the effect will not be so great. It is our perception that the reduction of PAR from 500 to 250 will have less of an effect than reducing it from 250 to 1.
Drax	Yes	We expect there will be some impact, but note that no evidence has been produced to date indicating that the impact is likely to be significant.
Co-Operative Energy	Yes	Yes, please see our answer to Question 4 above. We believe that the reduction to PAR 250 will result in higher credit costs to Co-Operative Energy in terms of imbalance credit and potentially credit payments to trading counterparties.
National Grid	n/a	National Grid's credit arrangements will not be impacted by the reduction in PAR value. However, we are aware that there is potential for the Credit arrangements of some parties to be impacted, though it is difficult to comment on the extent of these impacts for other organisations.
Utilita Energy Limited	Yes	Credit arrangements would be impacted to the extent that the amount of credit cover required from each party is likely to go up.
Flow Energy Ltd	No	Imbalance charges generally lie outwith the credit arrangements. An increase in price volatility may require some parties to lodge additional cover, but this will not impact the overall arrangements.

Respondent	Response	Rationale
EDF Energy	Yes, potentially a small impact	<p>An increase in imbalance charges may increase the level of credit to be provided under the BSC. Managing this should be part of the process changes BSC Parties ought to be considering.</p> <p>It has been suggested at industry and workgroup meetings that the EBSCR proposals would encourage BSC Parties to take a longer position. If this arises from increases in forward purchases by suppliers, as might be expected particularly at times of system shortages, there could be more credit associated with forward bilateral trading, with little change or even a reduction in the amount required under BSC credit arrangements. However parties suffering a short position at time of scarcity, for example generators experiencing unexpected failure, would face a potential increased credit requirement. We suspect materiality will be relatively small for the level of change proposed, but a stepped approach should allow behaviours to adapt with experience.</p>
IBM UK Ltd on behalf of ScottishPower group	Yes	While an decrease in PAR will not change the mechanism of the Credit arrangements, the consequential increased price spikes will cause credit cover requirements to spike more aggressively, disproportionately hitting those smaller Suppliers who will be required to lodge more cover than is currently the norm.
E.ON	No	We do not believe so but like the Workgroup have not considered the credit impacts in detail.
Centrica	Yes	Any potential increase in the levels of cash-out will result in increased credit requirements.
Good Energy	Yes	The analysis by the P304 Workgroup shows that a reduction in the PAR value will make imbalance prices more volatile and increase imbalance charges for small suppliers. The higher imbalance charges will increase Actual Energy Indebtedness and hence the amount of credit cover required to be lodged. Also, the increased volatility of imbalance prices and hence volatility in imbalance charges, will cause sudden, more rapid, change in indebtedness which would increase the credit cover requirement on Good Energy even further as, even if the credit is not lodged, Good Energy will need to have cash available to post as credit cover when indebtedness changes.
First Utility Limited	Yes	We do not agree with this proposed Modification

Respondent	Response	Rationale
		<p>P304.</p> <p>Depending upon the impacts at times of scarcity, this could increase the level of collateral required for credit:</p> <ol style="list-style-type: none"> <li>1. PAR 250 would make dual priced cash-out more punitive leading to an increase in both cash-out volatility and commodity cost.</li> <li>2. We anticipate that this will feed into behavioural changes on the intra-day market and the day-ahead market that will in turn drive higher costs and greater volatility of costs.</li> </ol> <p>These would likely both act to increase the cost and volatility of credit requirements on the day-ahead and intra-day markets.</p> <p>There has not been enough time for us to quantify the implications on volatility and cost of collateral posted for BSC credit cover for imbalance, but we do expect a consequential increase in collateral costs is likely and so have significant concerns in this area.</p>
Hudson Energy UK	Yes	<p>We will need to post more credit and this will impact our cash flow, as a new/small business this will ultimately reduce our ability to operate successfully in the UK market</p>
SSE	Yes	<p>If forward price responds sufficiently to the incentives created by a more marginal price, then it is probable that Credit Assessment Price will rise with an increased exposure calculated for the assessed element of the credit calculation.</p> <p>The actual indebtedness element of the calculation is likely to increase as prices rise, particularly at times of system stress, although the effect will be mitigated to a large extent by behavioural changes as Parties are incentivised to better balance and reduce exposure to imbalance prices.</p> <p>The most likely impact in our view therefore is to reduce some of the length in credit positions currently held in the industry. We remain to be convinced that the impact on prices from this modification would be significant enough for Parties to increase their credit cover to any great extent, as the exposure is calculated over a rolling 29-day window, so the effects of occasional peaks in prices are smoothed in the exposure calculation. The exception to this would be if there is a sustained</p>

Respondent	Response	Rationale
		peak in prices over a longer period, in which case the underlying energy economic fundamentals and system conditions would suggest that increased credit cover is warranted.
BES Commercial Electricity Ltd	Yes	More credit will be required given potential exposure to higher and more volatile imbalance costs.

## Question 6: Do you agree with the Workgroup that the draft legal text delivers the intention of the P304 proposed solution?

### Summary

Yes	No	Neutral/No Comment	Other
12	1	3	0

### Responses

Please note that the responses showing as grey in the table below have not been considered by the P304 Workgroup. This is because they were received after the deadline and therefore not in time for the Workgroup's final meeting.

Respondent	Response	Rationale
GDF SUEZ	Yes	-
SmartestEnergy Ltd	No comment	-
Drax	Yes	We believe it does.
Co-Operative Energy	Yes	Should Ofgem proceed with the proposal as currently envisaged then, yes, we believe this will deliver that intent.
National Grid	Yes	The intention of P304 is to reduce the PAR volume to 250MWh, this is captured by the proposed change to the parameter in the draft legal text.
Utilita Energy Limited	No response	-
Flow Energy Ltd	Yes	The drafting is a simple change to a value, and as such the intention has been delivered.
EDF Energy	Yes	The draft legal text merely changes the PAR value from 500 to 250.
IBM UK Ltd on behalf of ScottishPower group	Yes	-
E.ON	Yes	-
Centrica	Yes	-
Good Energy	Yes	We believe that the draft legal text delivers the intention of the P304 proposed solution because a change to the PAR value has been implemented previously.
First Utility Limited	No	We do not agree with this proposed Modification

Respondent	Response	Rationale
		P304.  We do not believe that the draft legal text delivers the stated BSC objectives, please see our answer to Q1 for further details.
Hudson Energy UK	No Response	I cannot comment on this section as I am not close enough to the specific detail
SSE	Yes	-
BES Commercial Electricity Ltd	Yes	-

## Question 7: Do you agree with the Workgroup's recommended Implementation Date?

### Summary

Yes	No	Neutral/No Comment	Other
5	11	0	0

### Responses

Please note that the responses showing as grey in the table below have not been considered by the P304 Workgroup. This is because they were received after the deadline and therefore not in time for the Workgroup's final meeting.

Respondent	Response	Rationale
GDF SUEZ	No	GDF SUEZ does not see the benefit in implementing P304 and would rather wait until P305 can be introduced.
SmartestEnergy Ltd	No	Ofgem believe this should be implemented before Winter 2014. Ofgem have initiated the change and will be the ones to decide. It could be said therefore that setting a later implementation date is not credible. However, 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.
Drax	Yes	Yes this is consistent with Ofgem's EBSCR Final Policy Decision.
Co-Operative Energy	No	We are of the view that it would be premature to introduce this change prior to the introduction of a single-priced cash out mechanism and wider smart meter roll out, as the information from these will allow smaller domestic suppliers a better view of the likely consumption of their customer base in any given period. We believe that there may also be scope for discussion around the current credit arrangements for imbalance in electricity with regard to the increased burden that will result to smaller suppliers from the proposed change to PAR.
National Grid	Yes	The Workgroup's recommendation provides a reasonable lead time for market participants to have notice of the change, whilst adhering to the aspiration of implementing the PAR reduction for winter 2014/15.
Utilita Energy Limited	No	There should not be a reduction to PAR in the current financial year. This goes against precedents Ofgem have set on other matters such as AUGÉ and

Respondent	Response	Rationale
		what is emerging as good regulatory practice whereby a minimum of a year's notice is provided for significant changes to market rules.
Flow Energy Ltd	No	<p>As discussed above, other industry changes are needed before this change can be implemented without creating significant risks to competition within the market.</p> <p>Half-hourly settlement of profile classes 1-8 (p300 &amp; p272) and the wider introduction of both smarter markets and domestic smart metering, will put smaller domestic suppliers in a much better position to cope with, and mitigate against the impacts of, the volatility created by reducing the PAR volume.</p>
EDF Energy	No	<p>It is proposed that the change is implemented on 31 October 2014, if the Authority's decision is received on or before 24 October 2014; or 5 Working Days following an Authority decision if the decision is received after 24 October 2014.</p> <p>As described above, we expect to make a number of operational process changes. Preparation for these changes is being considered now but actual roll-out will not commence until the Authority's decision is confirmed. Therefore, as a minimum we would need 10 Working Days following the Authority's decision.</p>
IBM UK Ltd on behalf of ScottishPower group	No	As stated previously, we believe that this modification should be implemented to coincide with the introduction of single pricing (currently scheduled for winter 2015/16).
E.ON	Yes	Bearing in mind that parties require as much lead time as possible to assess the risks to their business and make even minor IT changes.
Centrica	Yes	-
Good Energy	No	<p>If P304 is to be implemented, this should be deferred until all Parties have had the opportunity to make a reasonable assessment of its likely impact and the time to prepare how to manage any expected adverse impact. As referred to in response to Question 3, Good Energy has been unable to undertake the historic analysis comparable to that undertaken by Elexon for other Parties.</p> <p>Ofgem's EBSCR did not envisage any change to PAR before moving to single cash-out pricing, so we are of the view that no change of PAR should take place before/if P305 is implemented. If it is to be</p>



Respondent	Response	Rationale
		implemented before P305, then it should be after the winter period to allow the impact to be assessed over the calmer summer period, i.e. not before spring 2015, or preferably delayed until spring 2016.
First Utility Limited	No	<p>We do not agree with this proposed Modification P304.</p> <p>We do not agree with this proposal unless single cash-out is implemented at the same time or earlier. One of our concerns is the enduring nature of this modification and that there is no mechanism currently proposed to link this modification to single cash-out. Given that P305 is not treated separately there is no guarantee that single cash-out will be implemented and so the BSC panel must consider the merits and risks of P304 in isolation.</p> <p>We support moving to a more marginal cash-out signal only in parallel with moving to a single priced cash-out regime. We also strongly believe that any move to a more marginal cash-out signal should occur in small incremental changes, so that the risk of unintended consequences is closely monitored and managed at each step. Halving the PAR volume is not incremental in our view and does risk unintended consequences.</p> <p>The implementation date does not give suppliers enough time to examine and improve their existing forecasting arrangements. However, more fundamentally we note that different market participant types have differing ability to forecast volumes and manage imbalance owing to the inherent nature of their portfolios:</p> <ol style="list-style-type: none"> <li>1. Larger retail portfolios have less variability than smaller portfolios, so are easier to forecast more accurately.</li> <li>2. Generation imbalance is easier to minimise than supplier imbalance owing to the ability to flex output from many power plants.</li> <li>3. Intermittent generation (e.g. wind generation) is harder to forecast owing to the challenge of forecasting wind velocities.</li> <li>4. Participants with a combination of generation and supply portfolios have more tools in their portfolios to minimise volumes exposed to imbalance, leading to the adverse distributional impact on independent suppliers.</li> </ol>

Respondent	Response	Rationale
		In the absence of a full and comprehensive analysis at times of generation scarcity of the distributional impacts of P304 in isolation, it is impossible to agree to the change on its proposed date. In any event, it would be more advisable to implement such a change after a winter rather than ahead of a winter.
Hudson Energy UK	No	No the implementation date is too short, we cannot change our operational processes in time to optimise against new position, nor can we price in the assumed underlying additional cost into contracts we have already signed
SSE	Yes	The SO and Ofgem have clearly signalled a potential for tightening of system margins for this Winter through several studies and reports, as well as the development of additional balancing tools (e.g. DSBR). It is important therefore to aim for introduction at the earliest opportunity for this Winter to provide an additional incentive to low load factor capacity to defer any plans for mothballing.
BES Commercial Electricity Ltd	No	Implementation in time for this winter is too early. A reduction in PAR should only be contemplated with parallel implementation of a single marginal price.

Question 8: Do you agree with the Proposer's view that P304 does better facilitate the Applicable BSC Objectives than the current baseline?

## Summary

Yes	No	Neutral/No Comment	Other
4	8	2	1

## Responses

Please note that the responses showing as grey in the table below have not been considered by the P304 Workgroup. This is because they were received after the deadline and therefore not in time for the Workgroup's final meeting.

Respondent	Response	Rationale
GDF SUEZ	No	Please see answer to Q1
SmartestEnergy Ltd	Yes	Sharper imbalance prices will improve the efficiency of the balancing arrangements as they will force suppliers to focus on their imbalance volumes.
Drax	Yes	Please see answer to question 1.
Co-Operative Energy	Comments	Please see our answer to Question 1 above.
National Grid	Yes	See question 1
Utilita Energy Limited	No	(b) the most efficient way to balance the system is for NGC to do this based on a national demand forecast and not on the less accurate aggregation of sub-forecasts. In practice this is what it does happen, at least at the regional level, where it maintains its own aggregate view of supply and demand. [NGC has other tools to manage imbalance].  (c) more extreme cashout prices are anti-competitive and will impose ncur unnecessary costs that will have to be passed on the consumers.  (d) balancing and settlement arrangements will be less efficient because of the greater credit requirements. They also increase market complexity.
Flow Energy Ltd	No	See question 1.
EDF Energy	No response	This is the same question as question 1.
IBM UK Ltd on behalf of ScottishPower	No	We believe that the Proposed Modification will have a disproportionately negative impact on small Parties, being hit with higher imbalance prices,

Respondent	Response	Rationale
group		combined with higher credit cover requirements. This magnified impact on small Parties is a detriment to Objective c), as they will be less able to absorb these pricing shocks, compared to larger, more vertically integrated Parties.
E.ON	No	Duplicate question – no, as per rationale given in answer to question 1.
Centrica	Yes	Yes, but we suggest that introducing a lower PAR volume of 100 MWh is more likely to deliver the expected results.
Good Energy	No	See answer to Question 1
First Utility Limited	No	We do not agree with this proposed Modification P304.  Please see our Q1 response.
Hudson Energy UK	n/a	Not close enough to the detail to comment
SSE	n/a	Please see our response to Question 1 above.
BES Commercial Electricity Ltd	No	The SO is better placed to manage balancing costs at the regional level. It is possible that to avoid additional imbalance costs under P304 market participants will make inefficient contracting decisions.  In terms of objective c), the change would prejudice independent and one sided players and provide further benefits already inherent under the trading rules to diversified and vertically integrated players. The will also be detriments to new entrants owing to the more complex rules and associated costs.  Under objective d) credit costs will increase for all players as will the burden of administering the associated rules.

## Question 9: Do you have any further comments on P304?

### Summary

Yes	No
8	8

### Responses

Please note that the responses showing as grey in the table below have not been considered by the P304 Workgroup. This is because they were received after the deadline and therefore not in time for the Workgroup's final meeting.

Respondent	Response	Comments
GDF SUEZ	No	-
SmartestEnergy Ltd	No	-
Drax	No	-
Co-Operative Energy	Yes	<p>We would like to reiterate our view that the reduction of PAR from 500MWh to 250MWh will impact on the ability of smaller non-vertically integrated suppliers to compete on a level playing field. This is due to their inability to fine tune their position within day through access to generation, the higher cash-out costs they are likely to face in tight network periods (which is exacerbated by the asymmetric cash-out risk created by the dual-priced cash out mechanism) and the fact that this is likely to lead to higher credit costs in relation to balancing and possibly trading. Having to provide increased amounts of cash to cover these higher credit costs will have a negative cash flow effect and means that money tied up for credit purposes cannot then be used to grow the business.</p> <p>However, we feel that the introduction of a single-priced cash-out mechanism at the same time as the introduction of the reduction to PAR 250 may ameliorate this risk to some extent.</p>
National Grid	No	-
Utilita Energy Limited	Yes	<p>We are concerned about the context in which P304 has been raised. There was no involvement of independent suppliers in the significant code review which resulted in this proposal. Furthermore there has been insufficient analysis of the potential impact particular in consideration of the changes to bidding behaviour and how this would work in periods of system stress. Other elements of the significant</p>

Respondent	Response	Comments
		code review are not being implemented in this change proposal. In addition we would point to other developments, such a licence obligations on the major players and the introduction of the capacity market that may make this proposal redundant. All of which tends to suggest that this proposal is being rushed through without any justification.
Flow Energy Ltd	Yes	As detailed above, P304 (and therefore p305) has the potential to greatly reduce competition in the market. If implementation is needed it must be delayed until other industry changes allow all suppliers to operate in such a manner so that the benefits can be realised without a detriment to the independent sector.
EDF Energy	Yes	A change to imbalance pricing will necessarily result in a change to the costs incurred from imbalance by retail businesses. This may lead to a change in the imbalance risk premiums used by those retail businesses. This may have a knock-on impact on retail electricity prices.
IBM UK Ltd on behalf of ScottishPower group	No	-
E.ON	Yes	<p>It is regrettable that Elexon had not completed its analysis when issuing the consultation to parties on 30/07/14; we are concerned at the haste with which this modification appears to be being hurried through the BSC process without more analysis being made available in plenty of time for both market participants and the Workgroup to evaluate. Particularly when under 'What analysis has been done by Ofgem', p16 of the Assessment Consultation states:</p> <p>'The Ofgem representative confirmed that its updated modelling for the EBSCR Final Decision Impact Assessment included all aspects of the SCR final policy decision. They noted that this did not include analysis on PAR250 or any reduced PAR values in a dual prices market'.</p> <p>In other words it did not model all aspects? Only modelled the final P305 package, not the 'step-change' to PAR 250MWh at dual prices before directing National Grid to raise P304? If such analysis was to be left to Elexon/the Workgroup,</p>

Respondent	Response	Comments
		more time should have be allowed for this to be completed.
Centrica	No	-
Good Energy	Yes	Ofgem’s EBSCR never envisaged any change to PAR prior to the implementation of single price cash out. We therefore believe this modification is not supporting the policy intent in the EBSCR decision.
First Utility Limited	Yes	<p>Modification P304 in isolation increases the economic benefits of vertical integration, increases the barriers to new entry and competition, and increases the risk of independent exits. Thus P304 in isolation would represent an adverse impact on competition and we do not support it.</p> <p>First Utility support proposals to reduce PAR coincident with a move to single priced cash-out and we have made this clear in a number of consultation responses. However, that support has always been contingent on:</p> <ol style="list-style-type: none"> <li>1. Single priced cash-out being implemented beforehand or at the same time as a PAR reduction;</li> <li>2. A much more incremental approach to any PAR reductions than proposed here in order to carefully monitor and mitigate any unintended consequences on the market and competition;</li> <li>3. Wholesale market illiquidity issues being properly addressed before a more marginal cash-out signal is targeted. Poor liquidity exacerbates risks of imbalance at times when contracts to reduce imbalance are not trading;</li> <li>4. The final reduced target PAR level needs to be thoroughly analysed in order to determine an appropriate sharpening of the signal in light of the prevailing liquidity conditions in the wholesale market.</li> </ol> <p>It is clear from the analysis performed by Elexon that this modification leads to adverse distributional effects benefitting the integrated supply companies to the detriment of independent suppliers in the market. The analysis shows that in 2013 (a period without scarcity) a single larger company would have benefitted by up to £1.2m per year funded by the adverse financial impact of this change on other market participants.</p> <p>The adverse distributional effect arises due to two</p>

Respondent	Response	Comments
		<p>main factors:</p> <ol style="list-style-type: none"> <li>1. Independent suppliers inherently having higher percentage volumes exposed to the sharper cash-out prices than integrated suppliers; and</li> <li>2. RCRC benefits increasing by a higher percentage for integrated suppliers relative to independent suppliers. These distributional impacts on RCRC took many by surprise.</li> </ol> <p>In times of generation scarcity this adverse distributional effect is highly likely to increase, and therefore needs to be fully analysed in stressed generation market conditions so that the risks and benefits of this modification can be properly considered before any implementation decision.</p> <p>The data provided by Elexon included an event where the market was experiencing a brief period of scarcity during the winter of 2010. At that time when First Utility had approximately 49k customers, this change would have increased our costs by about £12k in the month of December 2010 alone. At the end of 2014 (when this change is scheduled to be implemented) we anticipate our customer base to have reached circa 500k domestic electricity customers. If a similar event were to occur in December 2014 we would experience an additional cost of £120k (£12k x 10). The event in December 2010 only significantly affected 5 days of balancing. If a more severe scarcity event was to occur then the cost increase is impossible to determine creating a commercial environment that would be extremely risky to participate in. If we were to model a period of scarcity at a similar level to that in December 2010, but for a sustained period of time, for example 30 days, the above £120k can be multiplied by 6 to obtain the potential cost of £720k. It should be noted that severe scarcity would likely result in significantly higher imbalance costs that could easily increase the exposure further for independent suppliers.</p> <p>In contrast, the vertically integrated suppliers would be enjoying significant benefits. The largest supplier (in terms of benefit) would have seen additional income of over £300k in the month of December 2010.</p> <p>All these conditions lead to increased uncertainty regarding wholesale costs, working capital requirements to fund imbalance costs and credit</p>



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		<p>cover, which would be to the detriment of the aims of increasing competition from smaller players and new entrants.</p> <p>This modification is intended to ensure an appropriate price signal at times of scarcity. We are concerned that we have been unable to properly assess the implications of the modification at times of sustained scarcity. Whilst the probability of any specific scarcity event might be low, the impact of a scarcity event is always high. P304 only acts to exacerbate the cost impact on non-integrated suppliers relative to integrated suppliers, which undermines competition to the detriment of UK energy consumers.</p>
Hudson Energy UK	No	n/a
SSE	No	n/a
BES Commercial Electricity Ltd	Yes	<p>More analysis is needed on the effects this change will have during times of system stress and under different market conditions. The analysis provided by Elexon looks backwards at a benign system, which was characterised by relatively flat system prices. However we are forecasting tighter system margins going forward, and this will exacerbate the effects of P304 on BSC parties.</p> <p>If implemented, the change will have the effect of exposing parties to more marginal cash-out prices, pushing up the cost of business, increasing the levels of credit that need to be posted and having a number of negative effects ultimately on consumers.</p>