4.5. MP Form

Modification Proposal – BSCP40/03	**MP No: P316** *(mandatory by BSCCo)*

Title of Modification Proposal

Introduction of a single marginal cash out price

Submission Date

4 November 2014

Description of Proposed Modification

This Modification proposes that a single marginal cash out price is introduced with effect from 1 September 2015, or from the Implementation Date of this Modification if this date is after 1 September 2015.

Reduction in the PAR and RPAR volumes
It is proposed that both the Price Average Reference (PAR) value and Replacement Price Average Reference (RPAR) values are reduced to a volume of 1MWh.

A single cash-out price per Settlement Period
The existing System Buy Price (SBP) and System Sell Price (SSP) main price calculations will continue to be used to derive a single imbalance price. The Net Imbalance Volume (NIV) (Transmission System imbalance) will determine whether the main pricing method is based on the SBP or SSP calculations, as follows:

- if the NIV is negative, the single energy imbalance price will be determined according to the existing Main Pricing methodology for calculating the System Sell Price, with the SBP being set equal to the SSP;
- if the NIV is positive, the single energy imbalance price will be determined according to the existing Main Pricing methodology for calculating the System Buy Price, with the SSP being set equal to the SBP; or
- if NIV is equal to zero or no energy bids or offers are taken in a single half hour the default single price shall be the market reference price, calculated on the basis of the current methodology.

Description of Issue or Defect that Modification Proposal Seeks to Address

This Modification Proposal seeks to implement two key elements of the cash out reform identified by Ofgem in its Electricity Balancing Significant Code Review (EBSCR) with effect from 1 September 2015. These are:

- a marginal cash out price; and
- a single cash out price.

We note that this Modification Proposal interacts with P305, which includes (in addition to a

single marginal price) a reserve pricing function and the pricing of demand control into cash out. While these are desirable elements of the reformed cash out regime, the potential solutions are complex which may preclude early implementation of P305 (at least in time for winter 2015/16).

In our view this Modification would increase the certainty that two key elements of the cash out reform included in P305 (a single marginal price) would be implemented in a timely manner and ahead of winter 2015/16. Consequently the Modification would form a new baseline for the assessment of P305.

The rationale for the implementation of a single marginal cash out price has been set out under Modification Proposal P305 as follows:

Rationale for a Single Marginal Price, as set out under P305

The existing cash-out arrangements do not currently provide an efficient signal of scarcity in the market as prices do not accurately reflect the marginal costs of generation dispatch. As a result the balancing and investment decisions of market participants are not aligned to the interests of consumers. In particular, the dampened signals when system margins are tight send insufficient signals to consumers about the value of flexible capacity. Therefore the current arrangements undermine the efficiency of signals to incentivise :

- the dispatch and utilisation of flexible generation and Demand Side Response (DSR);
- imports during tight margins via interconnectors;
- investment in flexible generation;
- Suppliers to offer Time of Use tariffs to customers; and
- innovation in flexible technologies (e.g. storage).

PAR Level

PAR is the maximum volume over which the weighted average of the most expensive energy actions to the System Operator (SO) are taken. This is currently set at a value of 500MWh. Deriving a weighted average from a volume of 500MWh creates an imbalance price which does not reflect the marginal cost of balancing energy for a given Settlement Period. This may lead to parties overlooking balancing opportunities available before Gate Closure which are cheaper than actions available to the SO. This is especially material during very tight system margins when differences between the costs of accepted balancing actions are greatest. Therefore this Modification proposes to reduce the PAR volume to 1MWh.

RPAR is a set volume of the most expensive priced actions remaining at the end of the Main Price calculations, and is currently 100MWh. The volume-weighted average of these actions, known as the Replacement Price, is used to provide a price for any remaining unpriced actions prior to PAR Tagging. In order to align this Modification with the EBSCR and to mitigate any risk due to the value of RPAR being greater than the value of PAR, this Modification also proposes a reduction in the RPAR value to 1MWh.

Single Cash-out Prices

Under the existing dual pricing arrangements, any party that has an imbalance position for a Settlement Period that is in the opposite direction to the system's imbalance will be exposed to a 'reverse price'. The reverse price is calculated to estimate the market price parties might have received had they traded their imbalance position ahead of Gate Closure. The reverse price ensures parties will not benefit from a more favourable price due to their imbalance position. However, imbalance positions that effectively help to reduce imbalance on the Transmission System will mean that fewer balancing actions are required to be taken by the SO. The reverse price is therefore not cost-reflective as it does not reflect the costs the SO has avoided as a result of imbalances in the opposite direction to the system imbalance.

Efficient cash-out signals require that parties which provide opposing imbalance positions (to that of the system) gain the full benefit of what their opposing imbalances deliver. Moving to single cash-out arrangements removes the existing inefficient price spread and should have the effect of reducing the net imbalance costs faced by parties depending on the frequency at which they have opposing imbalances.

Impact on Code

Section T 'Settlement and Trading Charges'

Section V 'Reporting'

Impact on Core Industry Documents or System Operator-Transmission Owner Code

TBC

Impact on BSC Systems and Other Relevant Systems and Processes Used by Parties

TBC

Impact on other Configurable Items

TBC

Justification for Proposed Modification with Reference to Applicable BSC Objectives

This proposed Modification would better facilitate Applicable BSC Objectives (b) and (c) (based on P305 justification):

(b) The efficient, economic and co-ordinated operation of the National Electricity Transmission System

The proposed changes to the cash-out price calculation make prices more reflective of the value to consumers of balancing, particularly during times of very tight system margins. In doing so, market participants will be incentivised to make more efficient balancing and investment decisions. This should result in a reduction in the total costs (to the SO and market) of maintaining a balanced system, whilst presenting savings on the costs of delivering secure electricity supplies in the future.

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.

(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

Reflecting the value that actions deliver supports effective competition by aligning competitive incentives of market participants with the interests of the consumer. A single marginal cash out price eliminates distortions in the arrangements that currently impede value reflectivity, thereby supporting effective competition that drives value for the consumer.

Strengthening the energy imbalance price signal, through PAR reform should incentivise market participants to trade to balance their positions ahead of Gate Closure. This should increase liquidity in the forward market and benefit competition by encouraging investment in flexible capacity (flexible generation, demand participation and other technologies).

The inclusion of a single imbalance price removes the existing inefficient price spread and for many market participants, in particular smaller parties who are less likely to drive the system length. This should reduce net imbalance costs and therefore help to mitigate the potential imbalance risk faced by market participants.

The single marginal cash out price may alter the incentives for parties to enter the market. The reforms address existing inefficiencies which limit the potential for some parties, in particular those offering services that facilitate flexibility and balance (such as DSR or storage), to participate in the wholesale electricity market.

Is there a likely material environmental impact?

No

Urgency Recommended:

No

Justification for Urgency Recommendation

N/A

Self-Governance Recommended:

No

Justification for Self-Governance Recommendation

N/A

Fast Track Self-Governance Recommended:

No

Justification for Fast Track Self-Governance Recommendation

N/A

Should this Modification Proposal be considered exempt from any ongoing Significant Code Reviews? No ongoing SCRs
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Attachments: No