

All interested parties,  
stakeholders in GB and beyond,  
and other regulatory bodies

Email: Alastair.Owen@ofgem.gov.uk

Date: 15 December 2021

Dear colleagues,

**Decision to approve the proposal from the Electricity System Operator to amend the existing Imbalance Settlement Harmonisation Methodology.**

On 15 October 2021, we<sup>1</sup> received a proposal from the Electricity System Operator (“ESO”) to amend the Imbalance Settlement Harmonisation Methodology (“ISHM”)<sup>2</sup> in accordance with Article 6(3) of the Commission Regulation (EU) 2017/2195 establishing a guideline on electricity balancing (the “EBGL Regulation”),<sup>3</sup> as amended by the Electricity Network Codes and Guidelines (Markets and Trading) (Amendment) (EU Exit) Regulations 2019.<sup>4</sup> In this amendment, the ESO proposes to rename the methodology from ISHM to the Imbalance Settlement Methodology (“ISM”), i.e. removing the harmonisation element and proposing the main features of imbalance settlement in Great Britain (“GB”).

This letter sets out our decision to approve the proposed amendments to the existing ISHM, renaming it as ISM and refocusing it for GB.

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<sup>1</sup> The terms “we”, “us”, “our”, “Ofgem” and “the Authority” are used interchangeably in this document and refer to the Gas and Electricity Markets Authority. Ofgem is the office of the Authority.

<sup>2</sup> ISHM is accessible at: <https://documents.acer.europa.eu/en/Electricity/MARKET-CODES/ELECTRICITY-BALANCING/10%20ISH/Action%205%20-%20ISH%20ACER%20decision%20annex%20I.pdf>

<sup>3</sup> Commission Regulation (EU) 2017/2195 of 23 November 2017 establishing a guideline on electricity balancing. The EBGL came into force on 18 December 2017. Accessible at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017R2195>

<sup>4</sup> Schedule 2 of the Electricity Network Codes and Guidelines (Markets and Trading) (Amendment) (EU Exit) Regulations 2019 No. 532 is accessible at: <https://www.legislation.gov.uk/uksi/2019/532/schedule/2> :

## Background

In December 2018, the European Network of Transmission System Operators for Electricity ("ENTSO-E") submitted an All-TSOs' proposal<sup>5</sup> to further specify and harmonise imbalance settlement in accordance with Article 52(2) of the EBGL regulation. This proposal was approved<sup>6</sup> by the Agency for the Cooperation of European Regulators ("ACER") on 15 July 2020. In accordance with Article 52(4) of the EBGL Regulation the proposal shall provide an implementation date no later than eighteen months after approval and thus must be implemented by 15 January 2022.

The ESO and Elexon<sup>7</sup> were part of the working group with other European TSOs to draft the ISHM and used their current understanding to map GB's current imbalance settlement process to the ISHM. As a result of this process, the ESO was able to establish that there was only one outstanding area of non-compliance – how the value of avoided activation ("VoAA")<sup>8</sup> is calculated. The current ISHM states that the VoAA shall be calculated using the value of real energy bids available during the affected settlement period. In GB, Elexon currently use the Market Index Price ("MIP") to represent a price during these VoAA settlement periods. The MIP is derived from the wholesale energy markets and is therefore no longer aligned with the current ISHM which was approved by ACER.

So as to align the method for the calculation of the VoAA, Balancing and Settlement Code ("BSC") modification P410<sup>9</sup> was raised on 3 July 2020. A workgroup was established, which attempted to find the best way of implementing necessary changes to the VoAA for GB settlement calculations. The feedback from the workgroup via a cost-benefit analysis ("CBA") conducted by Elexon showed that the possible options for a new VoAA calculation will have a negative impact on the market when compared to the MIP.<sup>10</sup>

The EBGL regulation has been retained, with amendments, in UK law following the UK's exit from the European Union. As a result of these amendments, while the ESO is still required to have an imbalance settlement methodology, it is no longer required to

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<sup>5</sup> ENTSO-E proposal is accessible at: <https://documents.acer.europa.eu/en/Electricity/MARKET-CODES/ELECTRICITY-BALANCING/10%20ISH/Action%201%20-%20ISH%20proposal.pdf>

<sup>6</sup> ACER decision is accessible at: <https://documents.acer.europa.eu/en/Electricity/MARKET-CODES/ELECTRICITY-BALANCING/10%20ISH/Action%205%20-%20ISH%20ACER%20decision.pdf>

<sup>7</sup> Elexon is a not-for-profit entity, funded by electricity market participants. It is the parent company of a group of companies whose principal role is to provide and procure the facilities, resources and services required for the implementation of the Balancing and Settlement Code.

<sup>8</sup> VoAA is the reference price that can be calculated by the TSO of a given imbalance price area after the balancing energy gate closure time for a given imbalance settlement period, at least when there is no balancing energy demand for that imbalance price area for that imbalance settlement period or no balancing energy activation for that imbalance price area for that imbalance settlement period.

<sup>9</sup> BSC P410 documents are accessible at: <https://www.elexon.co.uk/mod-proposal/p410/>

<sup>10</sup> The ESO highlighted Elexon's CBA that investigated 399 settlement periods in 2019 where the MIP was used to set the imbalance price. Elexon calculated what the new VoAA price using the ISHM would be for these settlement periods. They highlighted that this new VoAA price would have increased cashflow by £7.5m and raised the average price per megawatt.

*harmonise* imbalance settlement. As a result, the ESO have submitted a proposal to us to amend the existing ISHM, renaming it as ISM and refocusing it for GB, where the settlement calculation of the VoAA continues to use the MIP instead of using the real time value of energy. This proposal was submitted in accordance with Article 6(3) of the EBGL regulation. The proposal to amend the methodology was consulted on between 20 May 2021 and 21 June 2021, in accordance with Article 10 of the EBGL Regulation.

## **Decision**

We have reviewed the proposal to amend the existing ISHM to a GB ISM in line with the requirements of the EBGL Regulation and our statutory duties and obligations. We have also engaged with the ESO to better understand its proposal.

In making our decision, we took into consideration the responses to the consultation from industry stakeholders. Responses were generally favourable towards the amendments proposed by the ESO. Stakeholders mainly expressed concerns that if the MIP were to be replaced by a price derived from submitted balancing energy bids for an imbalance settlement period it would give a weaker incentive for parties to balance. One stakeholder also highlighted their concern with the ESO's proposal to include an Article 10(4)(d), the wording of which was very broad. This essentially stated that if Article 10(4)(a), (b) or (c) couldn't be used then the ESO could suggest any other price. The ESO subsequently removed this clause.

We also took the CBA provided by Elexon into consideration. This CBA showed that if the VoAA was to be calculated using the value of real time energy bids instead of the MIP, it would be detrimental to BSC Parties and GB consumers. We also note that the use of the MIP will be consistent with the current mechanics of the BSC and therefore provides an additional benefit in that there will be no need for changes to Elexon's infrastructure.

We believe that the ESO's proposal to amend the existing ISHM, renaming it as ISM and refocusing it for GB meets the requirements of Article 6(3) and 52(2) of the EBGL Regulation as amended, and in light of the above, we believe that the amended GB ISM, will provide greater benefit to GB consumers than the existing ISHM. We therefore approve the proposal to amend the ISHM to a GB ISM.

## **Next steps**

We expect the ESO to publish the GB ISM and a full account of the changes made from the ISHM to its website as soon as possible and to be implemented before 15 January 2022.

If you have any questions about the contents of this letter, please contact James Hill ([James.Hill@ofgem.gov.uk](mailto:James.Hill@ofgem.gov.uk)) or Luke McCartney ([Luke.McCartney@ofgem.gov.uk](mailto:Luke.McCartney@ofgem.gov.uk))

Yours sincerely,

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