P194 – Impact Assessment

Thank you for the opportunity to comment on the draft impact assessment (IA)

ICHP has been opposed to P194 throughout the assessment and reporting process as it is likely to increase imbalance risk and therefore total balancing costs. It is not obvious why amplifying price signals based on a generalised and arbitrary calculation so that they systematically diverge from actual costs can be considered cost-reflective.

From a generator's perspective the exposure to a SBP closer to the system marginal cost will increase the risk premium included in offers irrespective of whether individual participants try to second guess the marginal price in any one half hour (the concept of pay-as-bid anyway suggests that a party should offer its marginal costs and not estimate those on the wider system). This higher estimation of costs has nothing to do with repricing, as the information available to the market is absolutely no different, but a response to the higher risk environment and the costs the generator would see if for whatever reason it was unable to deliver its contracted position.

We also consider that sharpening price signals to get purchasers to reduce the overall system reserve is counter-productive when there is a system operator who can and should exercise this activity in the interests of the market as a whole. Contrary to various assertions in the report, most participants are not able to balance their own portfolios at the margin at lower cost than the system operator during most periods. In this regard National Grid should have a more informed view of the overall least cost of doing so in the interests of the market as a whole and therefore consumers.

At the same time the report identifies a number of deficiencies in the current pricing arrangements that if addressed could materially address the problem at hand. These include the treatment of reserve option fees and tagging. Both are widely recognised as undermining the cost reflectivity of imbalance pricing, and if addressed could potentially increase the tendency of average prices to converge to the system marginal cost. In our view these are the main identifiable reasons why imbalance prices could be argued to be non-cost reflective (problems arising from NG interventions in energy markets are probably a further significant contributor, but this supposition cannot be tested as there is no disclosure of the relevant transactions). It follows that P194 is addressing the effect of these deficiencies and not the cause.

We also have a number of observations and criticisms of the draft regulatory assessment, and these are summarised below.

- Fundamentally we fail to see a shift to more marginal pricing can be considered cost reflective especially as it will result in the collection of a larger surplus that by definition does not relate to costs that have been incurred;

- The surplus itself is rebated to market participants through RCRC, further distorting price signals and aggravating the problem of forecasting likely net costs;

- The analysis is silent on wider impacts of NG interventions in energy markets and other non reserve balancing products and the impact of these interventions on cashout prices;

- The proposal if introduced is likely to lead to an increase in part loading, and the environmental cost of this are not considered;

- Higher and unforecastable imbalance prices are likely to increase problems of risk management for non-integrated players, further undermining their ability to compete in the market place; and

- They are also likely to increase barriers to entry.

Please let me know if I can provide further information or clarification of our views.

Kirsten Elliott-Smith
Immingham CHP