Electricity cash out review open industry meeting, 30/03/07

Summary of discussion

Introduction

- Ofgem would like to thank attendees for their participation in a valuable discussion. The slides that were presented at the meeting should be viewed in conjunction with this note. They can be found at http://www.ofgem.gov.uk/work/index.jsp?section=/areasofwork/cashoutreview. We would welcome any feedback from individual parties on the issues that were raised in the presentations or during the meeting. If you would like to arrange a meeting or discussion, please contact ben.woodside@ofgem.gov.uk.

General discussion

- The three presentations were met with much interest. In particular NG's presentation was welcomed as it revealed analysis on the level of 'pollution' of the pricing stack that had not been shown before. The general reaction was of surprise at the extent of such pollution. As such there was widespread support for a change which would address the issue, although a range of opinions were put forward on the two models that Ofgem presented for discussion.

- Issues that arose that did not relate directly to the two models included concerns about transparency of information on NG's balancing actions, and the predictability of NIV. Views differed on the latter, but there was general agreement that more information, or more specifically better quality of information would be beneficial to the operation of the market. Customers would like to see a daily report in electricity similar to the one in gas.

- Other issues that were raised but not discussed in depth included:

    - Single vs dual pricing. It was recognised that this debate is relevant to both models presented;

    - Tolerance bands; and

    - Role of the System Operator. (This will also be addressed in Ofgem's SO review later this year).

Discussion of Model 1

- There was general support for this option as it was felt to represent the simplest pricing arrangements. It obviates the need for discussion of exactly what should be included in the price calculation. But it was recognised that the detail of the model is important:

- The calculation of the premium/discount is key. Suggestion it would need to be a dynamic number based on NIV in each period (although it was recognised this would reduce its simplicity). Other options discussed included a percentage figure set in advance (but possibly varying by period).

- The timing of gate closure was discussed, with the possibility that it could be reduced to, eg, a few minutes under this model.

- Some of the concerns raised with Model 1 include:

- the question was raised as to whether Model 1 might increase BM costs through changes to the incentives on participants to balance;

- there was a question as to whether parties would choose to cash-out at times of system stress;

- the argument was made that plant that won't be able to deliver due to constraints are nevertheless selling forward. This then "pollutes" the forward price which in turn feeds in to the "market price" in Model 1.

- Model 1 could provide a gaming opportunity, by allowing a free option to go long/short in an unlimited way against a known price. It was pointed out that for generation plant, this would be in contravention of the Grid Code.

Discussion of Model 2

- NG explained that, although the analysis did not differentiate between the four different categories of "Energy Plus", they were confident that transmission constraints were a relatively minor contributor, and most was due to "call back" for response and reserve (on the SSP side) and dispatching additional units for reserve (on the SBP side).

- Significant discussion around the problem of how to define the unconstrained stack, and how to take account (or not) of dynamic constraints, etc. There was a concern that not including the dynamic characteristics of plant in the price characteristics risks "creating perverse incentives". It was also noted that the model doesn't take account of how option fees and BPAs feed into cash out.

- There was also discussion around an ex-ante vs ex-post unconstrained stack. It was suggested an ex-ante stack could be created based on forecasts, but there was debate over whether forecasts were accurate enough.

- Issue raised as to what would happen with post-gate closure problems. A signal needs to be sent, for example, for generator trips to provide incentives for parties. One suggestion was to charge the costs of plant trips through a targeted BSUoS payment.

- Comment that Model 2 was basically just an alternative tagging methodology, and suggested that the rules might still be very complex.

Parties agreed to consider further the issues surrounding both models. It was suggested that the use of "Issues Groups" may be a useful forum ahead of modification proposals being raised.