

Cash-out review Open industry meeting

30th March 2007

Agenda

1. Objectives of review
2. Feedback from industry meetings
3. Summary of main options
4. Discussion and debate
5. Programme plan/next steps

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Objectives

Objectives of the review

To identify and implement a set of electricity cash out arrangements which:

Are simple and transparent

Provide appropriate signals

Are non-discriminatory

Promote competition in the electricity market

Context

Modifications

- Experience of market operating under different cash-out price regimes
- Shorter gate closure

SO Incentives

- Built up some history of regime working with and without SO incentives

Regional Initiatives

- Market coupling/new interconnectors

Environment

- EU targets (20% energy from renewables by 2020)
- Impact of intermittency on the grid
- Impact of LCPD on coal plant load factors

Logica contract

- Timing is a constraint on cash out review

Feedback from industry meetings to date

Key concerns raised

Cash-out prices
random/
volatile for

Parties **don't**
know their
position in run-

Difficult for small
players to source
required share

RCRC has
distortive effect
and favours VI
players

Difficult to
balance simplicity
and cost-
reflectivity

Incentive on
parties to contract
with SO rather
than self-balance
in highest price
periods

RCRC is
appropriate –
just a refund on
BSUoS charges

Greater role for
SO than
envisaged at

NG is **taking**
liquidity out of
the market

Locational BSUoS
to address
locational market

Cash out prices
have a small
impact on
investment
decisions

...so what is needed?

Arrangements
are very
complex

Pollution of
energy signal
in prices

Lack of
transparency in
NG's actions

More
simplistic
calculation
of prices?

Effective
mechanism
to extract
non-energy
actions?

More
information
on actions
taken by NG

Two Cash out models

Two main options for discussion based on ideas that have emerged

- Need more simplistic calculation of prices

- Effective mechanism to extract non-energy actions
- More information on actions taken by NG

Model 1

Market price +/- X%

X reflects 'inefficiency premium' of SO balancing

Model 2

SO creates ex-post unconstrained stack

Cash out price based on pure energy actions

Pros/Cons – Model 1 Simplified Cash-out

Pros

- Simplifies cash-out pricing leading to improved predictability and consistency
- Issue of system action pollution goes away
- Relatively simple to implement
- May encourage liquidity by creating a single within-day price reference

Cons

- May be moving too far from cost-reflective pricing
 - Market, and hence SO, may not carry out efficient level of balancing
- Premia/discounts would not reflect short notice changes in supply/demand
- Long term signals may still not be correct

Pros/Cons – Model 2

Ex-post Unconstrained Schedule

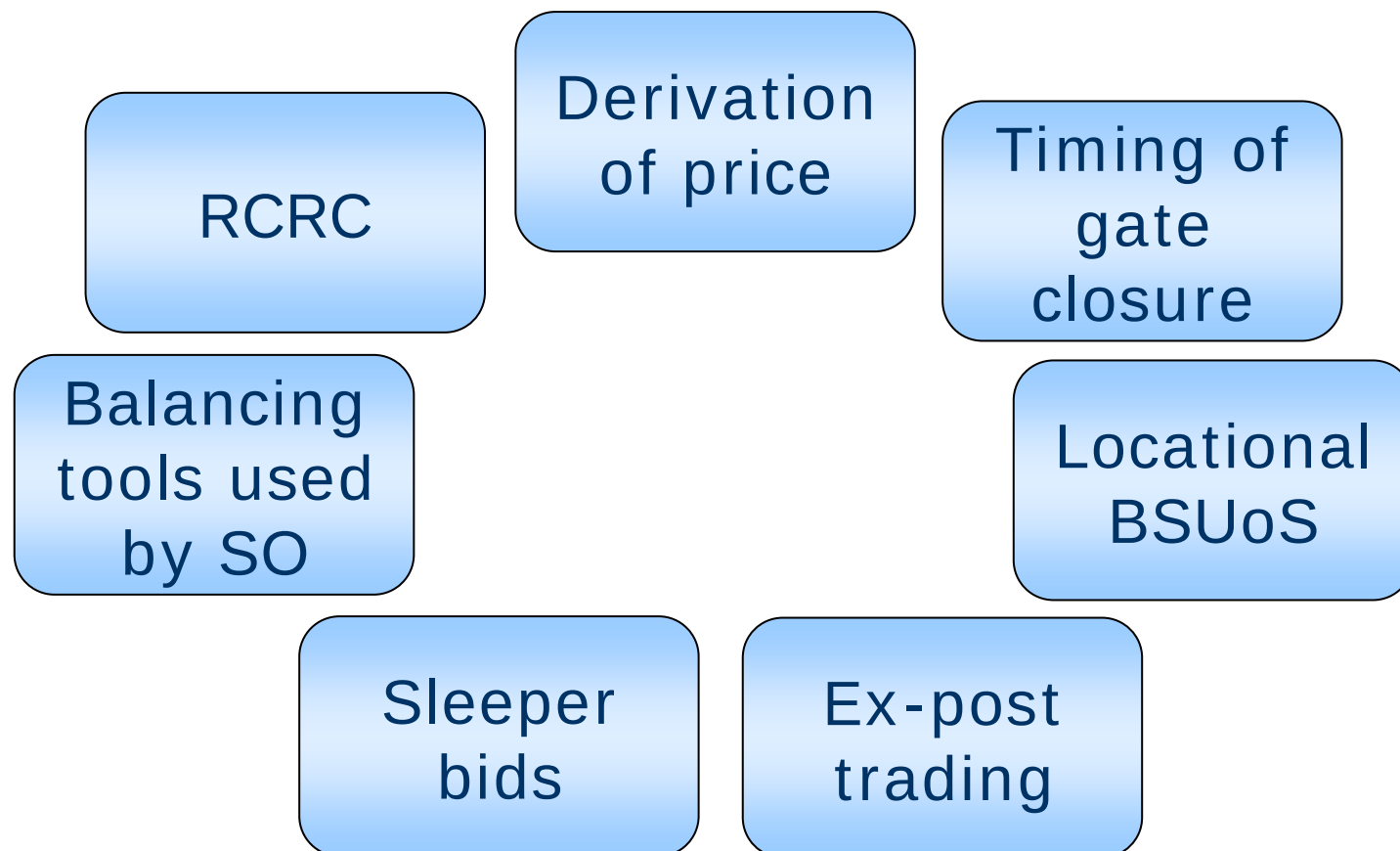
Pros

- More closely reflects costs of balancing the system
- Would create pure energy price
- Improves transparency

Cons

- Implementation would require new methodology for unconstrained energy schedule to be defined
- Pricing is ex-post
- Still need to consider how balancing services contracts are fed into cash-out prices

Additional issues for consideration



Evaluation criteria (for discussion)

(b) Efficient, economic and coordinated operation of the transmission system

e.g.

- Providing appropriate incentives to balance
- Providing LT investment signals
- Transparency
- Consistency and predictability

(c) Promoting effective competition in the generation and supply of electricity

e.g.

- Effective cost targeting
- Lower entry barriers
- Encouraging liquidity
- Non-discriminatory
- Difficult to game

Other objectives and duties

e.g.

- Ease of implementation
- Robustness to change
- Minimise environmental impact

Discussion and debate

A blue-tinted background image on the left side of the slide. It shows a close-up of a white power plug with three prongs at the top. Below it, a person is sitting at a desk, looking at a computer screen. The image is faded and serves as a background for the title box.

Programme plan/next steps

Process

- Changes have to be made through mods process
- Important that cash out review does not delay the raising of – commercially important - mods
- We encourage parties to bring forward mods at any time
- Potential need to carry out IA on any mod (or mods) that are raised

Cash out review process will be flexible in response to any mods that are raised

High level programme plan

