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*Promoting choice and  
value for all customers*

Your Ref:  
Our Ref:  
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Email: Philip.davies@ofgem.gov.uk

Date: 20 December 2007

Dear Mr Senior,

### **Electricity cash-out modifications**

I am writing to urge you to consider what steps Elexon can take to speed up the current timetable for Modification Proposal P217.

As I am sure you can appreciate, we have stressed for some time that effective imbalance pricing (cash-out) arrangements are a critical part of well-functioning competitive wholesale electricity market. Significant problems with the cash-out arrangements can harm competition and customers.

As you know, we have made clear the importance we attach to reviewing the current cash-out arrangements. As a consequence, we have been working with the industry to review the operation of the cash-out arrangements. Our review has highlighted a number of concerns with the way the cash-out rules currently operate.

Any changes to the cash-out arrangements must be assessed through the Balancing and Settlement Code modifications process, administered by Elexon. It is vital that this process reflects the importance of cash-out.

The industry has brought forward three proposals for modifying the operation of cash-out (P211, P212 and P217). Unfortunately, these proposals are being considered under inconsistent timescales and are mutually incompatible (only one could be in place at any time). We are concerned that this will give rise to a situation which might lead to delays or inefficiencies in the implementation of changes to the cash-out regime. I illustrate some of our concerns below (I would like to make it very clear at this stage that no decision has been made in relation to any of the proposals currently under assessment and the scenarios set out below simply outline a range of possible outcomes).

We will shortly be issuing an IA in relation to proposals P211 and P212. The potential exists for P211 or P212 to be approved in February 2008 (with an implementation date of November 2008); however, there is scope for P217 to be approved in its place later in the year (i.e. perhaps in May/June 2008 at the earliest). This creates a risk that, if P211 was approved in February, significant costs (both central and at party level) could be incurred on a modification which might become redundant either before or shortly after going live. This situation may give rise to concerns about the uncertainty and lack of stability generated by the industry change process.

The only way to avoid that risk would be to defer the direction to implement P211/212 (if either was approved) until such time as a decision on P217 is taken. Given the timescales

for implementation, the consequence could be that P211/212, and potentially P217 would not be in place until June 2009, more than two years after the original proposals were raised. It would be useful if you were able to give us an early indication of the likely implementation timescales for P217, should it be approved.

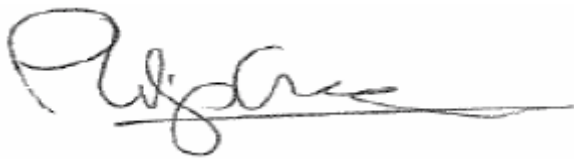
The assessment process for P217 is still underway. We would urge Elexon and the industry to complete this work as quickly as possible. The earlier that Ofgem can decide on P217, the lower the uncertainty for the market, the lower the risk of wasted costs being incurred should P211/P212, and subsequently P217, be approved, and the higher chance there is of any changes being in place for winter 08/09.

We would welcome your thoughts on whether there is any scope to shorten the process for assessing P217 without sacrificing good process given that the industry has been discussing and analysing these issues through their assessment of modifications 211 and 212 for some time.

As this is an issue that I am sure many stakeholders will have views on I am copying this letter to them so that they can feed in their views as you consider what, if anything can be done to speed up the assessment process for this modification.

I would be happy to meet to discuss the issues raised in this letter if you would find that useful.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Philip Davies', with a long horizontal flourish extending to the right.

**Philip Davies**  
Director, GB Markets