

Modification proposal:	<b>Balancing and Settlement Code (BSC) P335: Inclusion of Non-BM STOR costs and volumes in the indicative cashout price (P335)</b>		
Decision:	The Authority <sup>1</sup> directs that this modification be made <sup>2</sup>		
Target audience:	National Grid Transmission Plc (NGET), Parties to the BSC, the BSC Panel and other interested parties		
Date of publication:	19 September 2016	Implementation date:	2 November 2017

## Background

Electricity market participants are exposed to imbalance prices (known as the cash-out price) when they generate or consume more or less electricity than they have contracted for. The difference between actual electricity generated or consumed in a half hour period and the volume parties have contracted for is known as their imbalance volume. Cash-out prices are a key incentive to balance because parties face these prices on their imbalance volumes.

To provide the proper incentive, cash-out prices need to be accurate in the short term in order to form appropriate and timely market signals. It is important that the cash-out price reflects the true cost of actions taken by National Grid Electricity Transmission (NGET) in managing imbalances. The imbalance calculation used to derive the cash-out price is composed of a number of factors. One of those factors is Non-Balancing Mechanism Short Term Operating Reserve<sup>3</sup> (Non-BM STOR) costs and volumes.

The indicative cash-out price is calculated within 20 minutes (and then published within 45 minutes) of the end of every settlement period to provide a 'best-estimate' to market participants. However, an improved imbalance price, that contains more accurate volumes and data, is published five working days later, as part of the interim information (II) settlement run. This calculation reflects the actual volumes used by NGET in deriving the II settlement run imbalance price. Currently, Non-BM STOR costs and volumes are not included in the indicative cash-out price but are incorporated into the II settlement run cash-out price after five working days.

## The modification proposal

The modification proposer, Engie, raised this proposal on 19 February 2016. They contend that not including Non-BM STOR costs and volumes in cash-out until the II settlement run could result in misleading real-time signals being provided to market participants. They consider that this unreliability could reduce the incentive to balance and could lead to sub-optimal trading decisions being made.

They consider that delaying the inclusion of Non-BM STOR costs and volumes into the II settlement run could have a potentially significant impact because it can result in both a change in the direction of the Net Imbalance Volume (NIV), from long to short, and can lead to large changes in the cash-out price.

<sup>1</sup> References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

<sup>2</sup> This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

<sup>3</sup> A Short Term Operating Reserve instruction given by NGET outside of the balancing mechanism in order to increase generation or reduce demand.

To resolve this identified defect, P335 proposes to amend the BSC to require that, in any settlement period where Non-BM STOR is despatched, NGET submits an additional Balancing Service Adjustment Data (BSAD) submission relating to those non-BM STOR actions within fifteen minutes of the end of the relevant settlement period so that the data can be used in calculating the indicative cash-out price.

The proposer believes that P335 will better facilitate BSC objectives (b)<sup>4</sup>, (c)<sup>5</sup> and (d)<sup>6</sup> by ensuring that correct market signals are being sent thus reducing uncertainty, and ensuring that the whole market would have access to the same information. They contend that improved confidence in the accuracy of the indicative cashout price and the ability of market participants to value trades ahead of gate closure for subsequent Settlement Periods will be enhanced. Further, that reducing the incidence of cash-out price change will improve efficiency in implementing and administering the BSC arrangements and facilitating the efficient, economic and coordinated operation of the National Electricity Transmission System (NETS).

### **BSC Panel<sup>7</sup> recommendation**

At the BSC Panel meeting on 11 August 2016, the BSC Panel unanimously considered that P335 would better facilitate the BSC objectives and the Panel therefore recommended its approval. The Panel considered that BSC Objectives (b), (c) and (d) are better facilitated by the modification, and that the impact on objectives (a), (e), and (f) is neutral.

### **Our decision**

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 12 August 2016. We have considered and taken into account the responses to the industry consultations which are attached to the FMR<sup>8</sup>. We have concluded that:

- implementation of the modification proposal will better facilitate the achievement of the applicable objectives of the BSC;<sup>9</sup> and
- directing that the modification be made is consistent with our principal objective and statutory duties.<sup>10</sup>

### **Reasons for our decision**

We consider this modification proposal will better facilitate BSC objectives (b), (c), and (d) and has a neutral impact on the other applicable objectives.

P333 will cost between £112,000 and £197,000 to implement and these costs will be largely<sup>11</sup> incurred by NGET. The benefits of this modification are difficult to quantify, but the majority of working group members considered that the associated benefits outweigh

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<sup>4</sup> The efficient, economic and co-ordinated operation of the National Electricity Transmission System

<sup>5</sup> Promoting effective competition in the generation and supply of electricity and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity

<sup>6</sup> Promoting efficiency in the implementation and administration of the balancing and settlement arrangements

<sup>7</sup> The BSC Panel is established and constituted pursuant to and in accordance with Section B of the BSC and Standard Special Licence Condition C3 of the Electricity Transmission Licence available at:

[www.epr.ofgem.gov.uk](http://www.epr.ofgem.gov.uk)

<sup>8</sup> BSC modification proposals, modification reports and representations can be viewed on the Elexon website at [www.elexon.co.uk](http://www.elexon.co.uk)

<sup>9</sup> As set out in Standard Condition C3(3) of NGET's Transmission Licence: <https://epr.ofgem.gov.uk>

<sup>10</sup> The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Electricity Act 1989.

<sup>11</sup> Estimated implementation costs of £240 for Elexon and between £112,000 and £197,000 for NGET.

the costs. We agree with working group members that the potential materiality of inaccurate indicative pricing justifies the costs of implementing the modification.

***(b) the efficient, economic and co-ordinated operation of the national electricity transmission system***

Cash-out prices are intended to provide short-term market signals. Including Non-BM STOR volumes and prices in the indicative cash-out price will improve the accuracy of the imbalance price published at the end of the Settlement Period. It will reduce the incidence of changes to the imbalance price between the indicative imbalance price calculation and the II Settlement Run.

We agree with the proposer and the Panel that improving market participants' confidence in the accuracy of the imbalance price should enhance the ability of market participants to value trades ahead of gate closure for subsequent Settlement Periods. In turn, this should reduce the number of actions the System Operator has to take after Gate Closure to balance the System, therefore better facilitating the efficient, economic and co-ordinated operation of the NETS.

***(c) promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity***

Including Non-BM STOR volumes in the indicative cash-out price will ensure that all market participants have access to the same information with respect to Non-BM STOR at times when Non-BM STOR is despatched. It is important that all parties have access to as much information as possible, and that the provision of that information is transparent. Ensuring that Non-BM STOR actions are accounted for in the indicative cash-out price should also assist smaller market participants who might not be able to accurately forecast Non-BM STOR prices and volumes. Ensuring market participants have access to the same information relating to Non-BM STOR, and the market more widely, provides for a more level playing field.

By reducing uncertainty around later changes to cash-out prices, and providing better information to all market participants, we consider that P335 will facilitate more efficient and economic decisions and therefore better facilitate effective competition in the market at times when Non-BM STOR is called.

***(d) promoting efficiency in the implementation and administration of the balancing and settlement arrangements***

We agree that objective (d) is better facilitated because including Non-BM STOR prices and volumes in the indicative cash-out price will reduce the frequency of Non-BM STOR related cash-out repricing, therefore improving efficiency in the implementation of the balancing and settlement arrangements.

**Implementation Date**

We note, and share, the working group's concerns with the proposed implementation date of November 2017. Given that the modification addresses a known problem, we are disappointed that NGET consider November 2017 to be the earliest practical date for implementation. We strongly encourage NGET to consider potential actions it could take to bring forward the implementation date of this modification to the earliest date possible. We encourage NGET to provide an update to the BSC Panel if an earlier implementation date can be achieved.

## **Decision notice**

In accordance with Standard Condition C3 of NGET's Transmission Licence, the Authority hereby directs that modification proposal BSC P335: *Inclusion of Non-BM STOR costs and volumes in the indicative cashout price* be made.

**Mark Copley**

**Associate Partner – Wholesale Markets**

Signed on behalf of the Authority and authorised for that purpose