

Modification proposal:	<b>Incorporation of Revised Standing Reserve Weighting Factors and Clarification of the Treatment of Supplementary Standing Reserve in the Balancing Services Adjustment Data (BSAD) Methodology Statement</b>		
Decision:	<b>The Authority<sup>1</sup> agrees that National Grid Electricity Transmission plc may modify the BSAD Methodology Statement as proposed</b>		
Target audience:	National Grid Electricity Transmission Plc, Parties to the BSC and other interested parties		
Date of publication:	17 January 2007	Implementation Date:	22 January 2007

### **Incorporation of Revised Standing Reserve Weighting Factors and Clarification of the Treatment of Supplementary Standing Reserve in the Balancing Services Adjustment Data Methodology Statement**

The Gas and Electricity Markets Authority (the "Authority") has carefully considered the issues raised in the consultation on National Grid Electricity Transmission's proposed revisions to the BSAD Methodology Statement.

National Grid Electricity Transmission ("NGET") recommended to the Authority that the BSAD Methodology Statement be revised as set out in its Report to the Authority. The Authority has **decided to allow a revision** to the BSAD Methodology Statement. This letter explains the background to the revision and sets out the Authority's reasons for its decision.

#### **Background**

The electricity cash out prices include a Buy Price Adjustment (BPA) to the System Buy Price which, amongst other things, incorporates the costs relating to the availability costs for Standing Reserve and Supplementary Standing Reserve (SSR) contracts. The way in which these costs are allocated to individual settlement periods is specified in the Balancing Services Adjustment Data (BSAD) Methodology Statement.

At present, the allocation of Standing Reserve availability costs across settlement periods is based on the utilisation patterns from 2002/03. In other words, a weighting factor is defined for each settlement period that reflects the percentage of the total reserve usage over the day that occurred in each period of that day so that the weighting factors for all the settlement periods sum to a value of one. The utilisation patterns for Standing Reserve have changed since 2002/03 but the weighting factors have not been updated to reflect these changes.

The availability costs for SSR are, unlike Standing Reserve availability costs, spread equally over all the settlement periods for the service windows for these contracts. ("Service windows" are the settlement periods during which a market participant with a SSR, or Standing Reserve, contract must be available to provide the service.) This is not mentioned in the BSAD Methodology Statement because it contains no explicit discussion

<sup>1</sup> The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority, the regulator of the gas and electricity markets in Great Britain.

in of how SSR availability costs are treated, which in itself is an omission that should be rectified.

### **The proposed revisions**

On 11 December 2006, NGET issued a consultation paper<sup>2</sup> proposing to modify the treatment of Standing Reserve and SSR availability costs in the calculation of the BSAD.

The proposal is to change the weighting factors used to allocate the availability fees for both Standing Reserve and SSR based on the current service windows and the utilisation patterns for Standing Reserve that were seen in 2005/06.

This modification is intended as a temporary measure to last until the end of March 2007 whilst NGET brings forward more enduring proposals for how the weighting factors should be updated as utilisation patterns/service windows change. NGET intends to publish its more enduring proposals this month.

### **The Authority's decision**

The Authority has considered the issues raised by the consultation paper and taken into account the four responses to that consultation. The Authority has concluded that:

1. implementation of the modification proposal will better enable NGET to operate the transmission system in an efficient, economic and co-ordinated manner; and
2. directing the revision to be made is consistent with the Authority's principal objective and wider statutory duties.

### **Reasons for the Authority decision**

The intention of the Buy Price Adjustment is to include the availability fees from energy balancing contracts in a way that reflects the costs that NGET incurs in each settlement period. The Authority has taken the view that this can best be achieved by allocating the availabilities fees in line with the extent to which the underlying service is being used. To the extent that NGET's proposed weighting factors better achieve this objective than the current weighting factors, then the changes should provide more appropriate pricing signals to market participants in respect of the costs they impose on the system by being out of balance. This should improve the incentives on participants to balance their positions which, in turn, should enhance NGET's ability to operate the transmission system in an efficient, economic and co-ordinated manner.

Although the current weighting factors for Standing Reserve sum to one across a day, some of these are omitted in the calculation of BPAs because they fall outside the 2005/06 service windows. This means that the costs that are currently included in the BPA can be less than the total availability fees that NGET actually pays on any given day. For example, on 6 November 2006 approximately 2.4% of the availability fee costs were not allocated to any period. If no adjustments are made, this will be the case during the period from 22 January 2007 (NGET's proposed implementation date) to 1 April 2007.<sup>3</sup>

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<sup>2</sup> "Proposed Revisions to the Balancing Services Adjustment Data Methodology Statement Incorporation of Revised Standing Reserve Weighting Factors and Clarification of the Treatment of Supplemental Standing Reserve"

<sup>3</sup> In 2002/03, there was an early morning service window (00:00-03:00) during this period that no longer exists. (Appendix 1 shows the service periods from October to April for 2002/03, 2005/06 and 2006/07.) In

In addition, the weighting factors for the SSR availability fees do not reflect the utilisation of this service since the costs are simply spread evenly over all the service window settlement periods. The lack of any weighting factors can give rise to spikes in the BPA during periods that are outside the current Standing Reserve service windows so that the adjustment depends solely on the average availability fee costs and contracted volumes for a SSR service window. One such example, presented by NGET in its consultation paper occurred in period 31 on 6 November 2006 and resulted in a BPA of nearly 23 £/MWh. Under NGET's proposed weighting factors, the BPA would have been zero.<sup>4</sup>

The adjusted weighting factors that NGET is proposing would address both of these issues to a large extent<sup>5</sup> and all the respondents to NGET's consultation expressed support for the proposed changes. However, we note that the weighting factors for the Supplementary Standing Reserve availability fees will be based on the service windows for Standing Reserve and the two do not precisely coincide (see Appendix 1).<sup>6</sup> Consequently, in a relatively small number of periods NGET's proposed weighting factors will provide anomalous results in the case of SSR availability fees. This fact was commented upon by one of the respondents to NGET's consultation.

Another respondent, whilst broadly supportive of the proposals, expressed some concerns that adjusting the weighting factors midway through the winter could adversely impact on the volatility of imbalance prices. Whilst we agree that it would have been preferable to implement these changes before the winter began, the changes in the weighting factors do not appear likely to alter materially the volatility of imbalance prices, but there may be some changes to their profile across the day. In general, the weighting factors will spread reserve availability costs more evenly across the day (see Appendix 2). In addition, the BPA spikes associated with SSR availability fees will disappear as there will be no periods when, as far as reserve is concerned, it is only SSR costs that set the BPA.

The Authority welcomes the fact that the proposed amendments to the BSAD Methodology Statement will clarify how SSR availability fees are treated.<sup>7</sup> We believe that the current situation, where there is no mention of their treatment in the BSAD Methodology Statement, is unsatisfactory and that the adjustments will increase the transparency of the electricity trading arrangements.

Ofgem initially had some concerns as to whether the choice of utilisation patterns from January to March 2006 would be representative of likely utilisation patterns for the same period in 2007, given the impact that the failure at the Rough gas storage facility had upon the electricity market. However, we concluded that whilst these exceptional circumstances may have materially affected the overall level of reserve utilisation, they

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addition, there are also at least 3 afternoon settlement periods that fell within a service window in 2002/03 but no longer do so.

<sup>4</sup> As explained later in this letter, it can be argued that the adjusted BPA for this period would also have been incorrect but, based on the revised weighting factors for period 32 it is likely to be closer to a cost-reflective value than the actual BPA.

<sup>5</sup> Note that an early morning service window was still in place in 2005/06 but the weighting factors proposed by NGET are zero during these settlement periods.

<sup>6</sup> Period 31 (15:00-15:30) falls into a Supplementary Standing Reserve service window until 5 February 2007 but does not fall within the Standing Reserve service window. This is also true for period 33 (16:00-16:30) for the period from 5 February 2007 to 24 March 2007. Conversely, periods 41 and 42 (20:00-21:00) fall within a Standing Reserve service window until 5 February 2007 but do not fall within a Supplementary Reserve service window.

<sup>7</sup> Note that in Section C of the revised version of the BSAD Methodology Statement that NGET sent out with its consultation, NGET had mistakenly omitted to include the MWh capability for SSR in the denominator of the BPA. This mistake has now been corrected.

are less likely to have influenced the pattern of utilisation across a day. Since it is only the latter data that are used to derive the weighting factors, we accept that the use of 2005/06 data is appropriate since the service windows for that year are closer to those for this year than those from 2002/03.

On balance, and taking into account the fact that these amendments are only interim arrangements, we believe that NGET should be allowed to implement its proposed revisions to the BSAD Methodology Statement.

### **Related issues**

Ofgem agrees with the respondent to NGET's consultation who considered that the process for this adjustment had been unsatisfactory as regards the timing of the consultation. Ofgem therefore welcomes NGET's proposals to bring forward more enduring proposals for how the weighting factors should be updated on a regular basis. However, there are a number of issues that Ofgem believes should be considered in developing such arrangements. These include:

- greater transparency in how NGET derives the weighting factors;
- consideration of the appropriate trade-offs between stability and cost-reflectivity in deciding on how often the weighting factors should be changed and whether they should represent utilisation patterns from a single year or an average of several years' utilisations; and
- consideration of whether there should be separate weighting factors for SSR and, if not, what to do when service windows for Standing Reserve and SSR do not coincide.

Any proposals that NGET bring forward will also need to be considered in the broader context of a fresh look at the overall electricity cash out arrangements.

### **Decision notice**

**In accordance with Standard Condition C16(8)(b) of NGET's electricity transmission licence, the Authority agrees that NGET may modify the BSAD Methodology Statement, and that such modification will take effect from 22 January 2007, in respect of the weighting factors for the availability fees of Standing Reserve and Supplementary Standing Reserve contracts.**

Yours sincerely,



**Sonia Brown**  
**Director, Wholesale Markets**

Signed on behalf of the Authority and authorised for that purpose

# Appendix 1 – Standing Reserve and Supplementary Standing Reserve (SSR) service windows for 2002/03, 2005/06 and 2006/07

## Working days

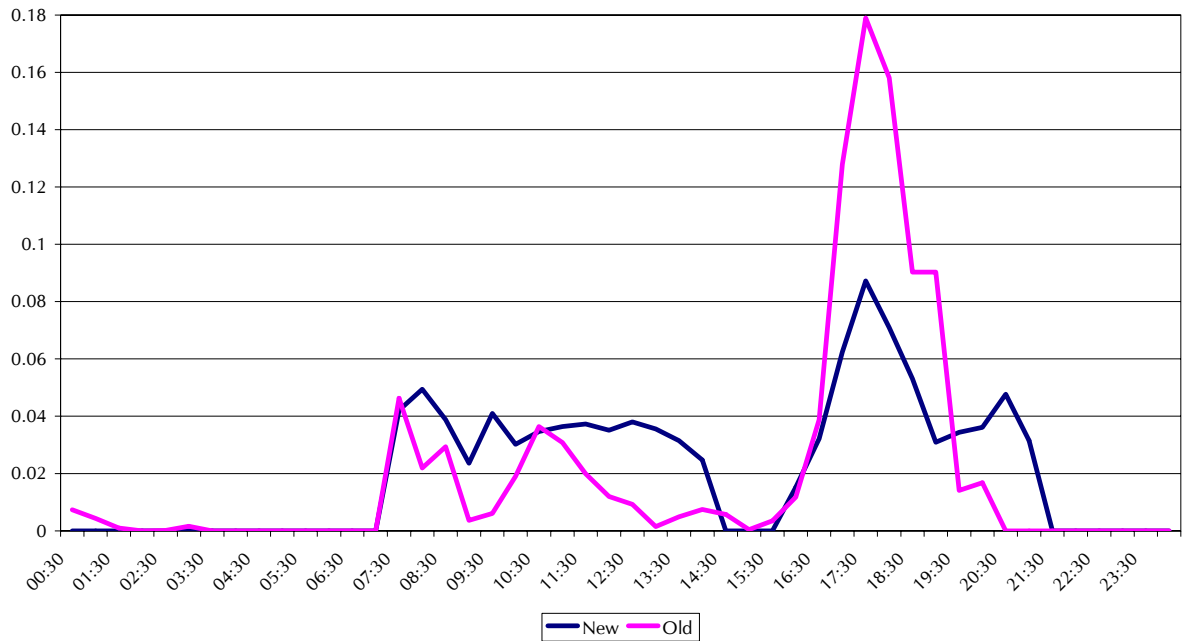
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	2002	2005	2006	2005	2006	2002	2005	2006	2005	2006	2002	2005	2006
Start	28-Oct	29-Oct	29-Oct	31-Oct	30-Oct	03-Feb	06-Feb	05-Feb	06-Feb	05-Feb	03-Feb	26-Mar	25-Mar
End	03-Feb	06-Feb	05-Feb	04-Feb	05-Feb	01-Apr	26-Mar	25-Mar	25-Mar	24-Mar	01-Apr	01-Apr	01-Apr
Period no	Period ending												
1	00:30												
2	01:00												
3	01:30												
4	02:00												
5	02:30												
6	03:00												
7	03:30												
8	04:00												
9	04:30												
10	05:00												
11	05:30												
12	06:00												
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39	19:30												
40	20:00												
41	20:30												
42	21:00												
43	21:30												
44	22:00												
45	22:30												
46	23:00												
47	23:30												
48	00:00												

## Non-working days

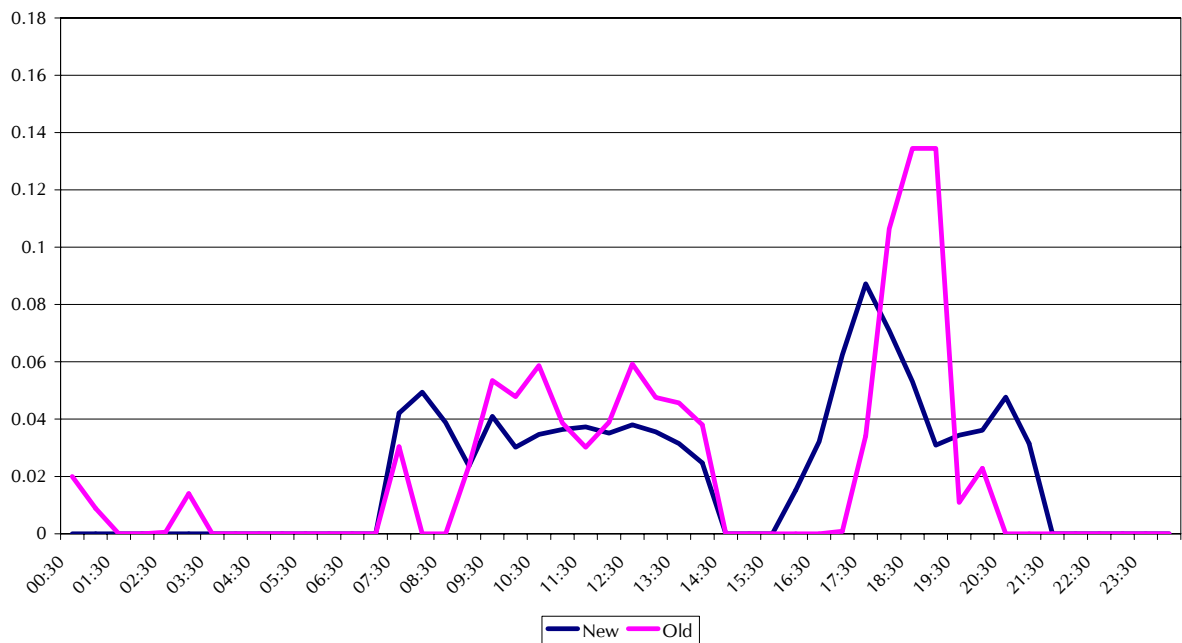
		Standing reserve			Standing reserve			Standing reserve		
Year starting		2002	2005	2006	2002	2005	2006	2002	2005	2006
Start		28-Oct	29-Oct	29-Oct	03-Feb	06-Feb	05-Feb	03-Feb	26-Mar	25-Mar
End		03-Feb	06-Feb	05-Feb	01-Apr	26-Mar	25-Mar	01-Apr	01-Apr	01-Apr
Period no	Period ending									
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2	01:00	Yellow			Yellow			Yellow		
3	01:30	Yellow			Yellow			Yellow		
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23	11:30	Yellow			Yellow			Yellow		
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46	23:00	White			White			Yellow		
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48	00:00	White			White			White		

**Appendix 2 – Comparison of current and proposed weighting factors for weekdays from 22 January 2007 to 1 April 2007**

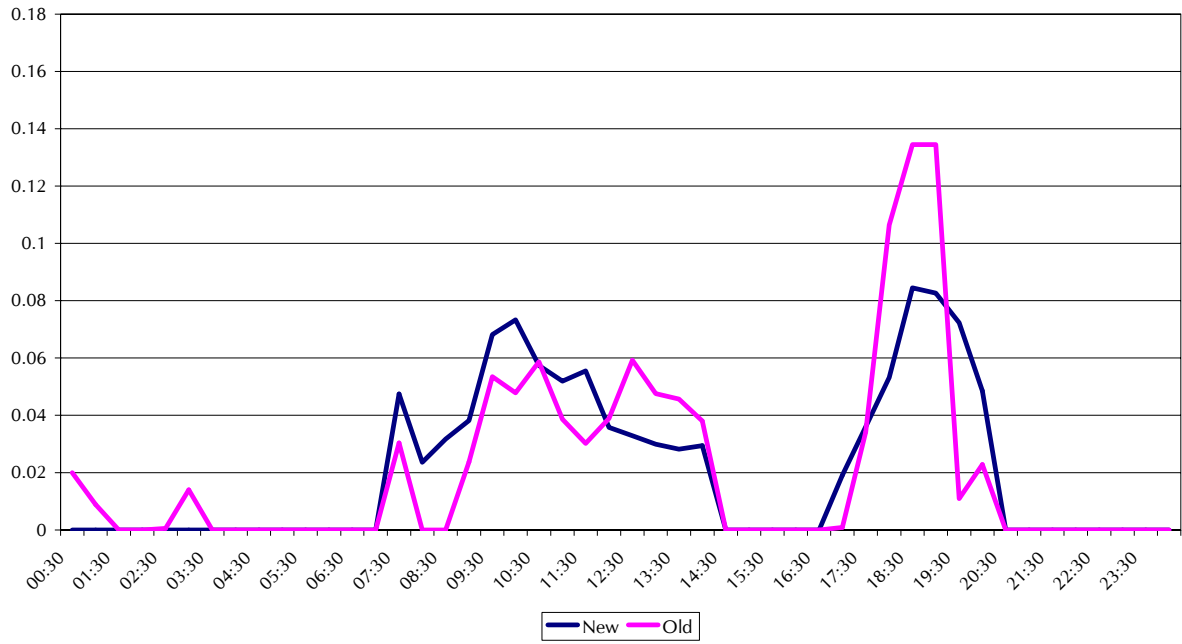
**25 Oct - 2 Feb**



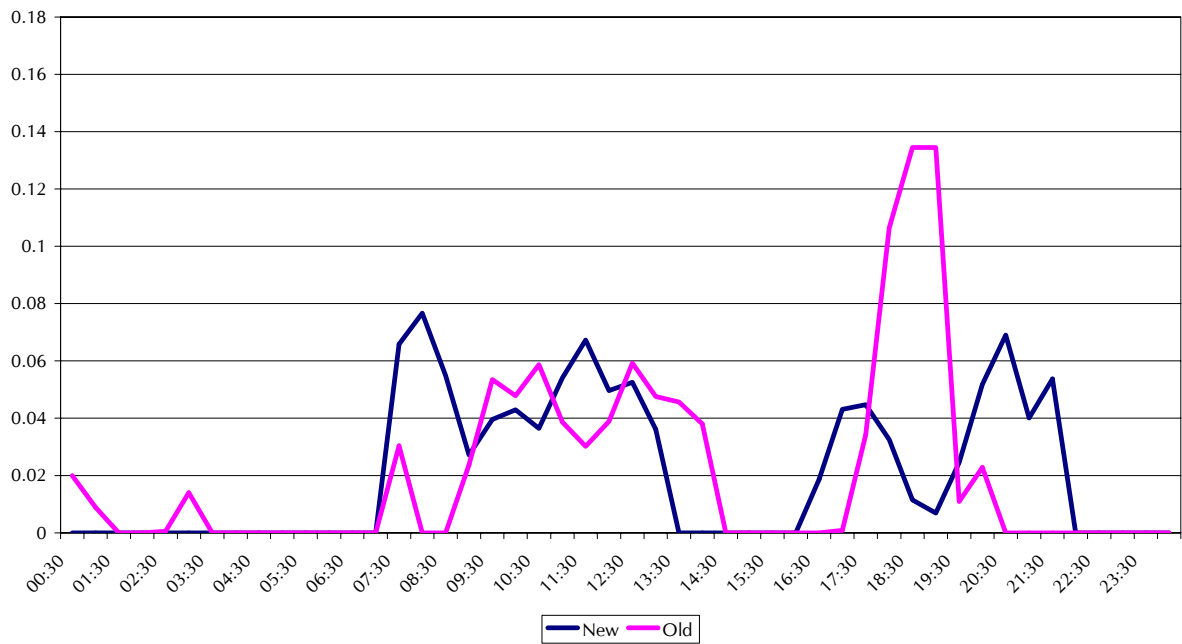
**2 Feb - 5 Feb**



5 Feb - 25 Mar



25 Mar - 1 Apr



25 Mar - 1 Apr WD

