

Credit Committee Quarterly Report: July – September 2011

Target Audience Credit Committee Members and BSC Parties

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Purpose of paper For information

ELEXON produces this report on the Credit Assessment Price (CAP) review process every 3 months for the Credit Committee. This particular report covers July to September 2011. The purpose of these reports is to assist the Credit Committee in its obligation to keep the CAP Review process under review.

In summary:

Summary

- A CAP review was triggered this Quarter. The Credit Committee agreed to increase CAP from £56/MWh to £59/MWh. The change was implemented on 12 October 2011.
- CAP overestimated outturn SBP throughout the Quarter.
- Another review this year seems unlikely.

1. Why we produce the Quarterly Report

ELEXON creates this report every 3 months to provide an overview of the performance of the CAP review process. We focus on the review process over the last Quarter (i.e. this report covers the months of July to September 2011). We assess the weekly trigger checks and the performance of CAP against outturn System Buy Price (SBP) and forward market prices.

The primary aims of these reports are to assist the Credit Committee:

- by indicating where a change in the trigger level may be necessary;
- in its task of keeping under review the suitability and availability of the forward price data and enabling the Committee, where appropriate, to recommend a change of provider(s) or additional provider(s) of forward price data to the Panel; and
- by providing a view on how well the methodology for reviewing CAP is working. The Committee can recommend a change to the standard methodology to the Panel if it believes it to be necessary or appropriate.



For more information, please contact

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As these reports are primarily for the Committee, there is no explanation in these reports of how the CAP review process works or what CAP is used for. Further information can be found on the Credit Committee web page:

<http://www.elexon.co.uk/bscpanelandcommittees/panelcommittees/CreditCommittee/default.aspx>

2. An overview of the CAP process from July to September 2011

A CAP review was triggered on 5 September 2011. The Credit Committee met on 14 September 2011 and agreed to increase the value of CAP from £56/MWh to £59/MWh. This change was implemented on 12 October 2011.

As part of the review that Credit Committee determined that the trigger level should remain as £6/MWh.

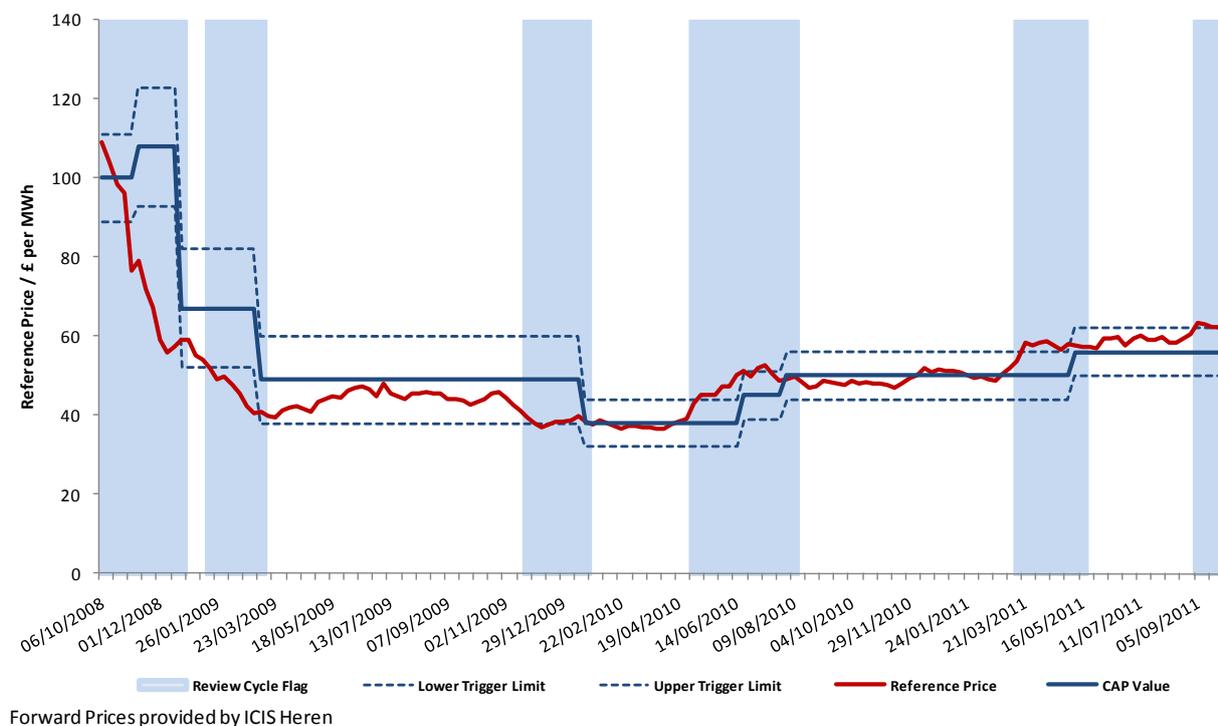
Cap Values and reviews in Q3 2011:

Date of Trigger Breach	Effective Dates	CAP Value actually implemented	CAP Value proposed in Consultation
21/03/2011	04/05/2011 to 11/10/2011	£56/MWh	£60/MWh
05/09/2011	12/10/2011 onwards	£59/MWh	£59/MWh

3. Detailed Analysis

A CAP review is triggered when the reference price (which is derived from forward prices provided by ICIS Heren) breaches a certain level above or below the current CAP value. Throughout the Quarter, CAP was set at £56/MWh, with a trigger level of +/-£6; i.e. a review would have been triggered if the reference price fell outside of a band £50/MWh - £62/MWh.

Graph 1: Reference Price and CAP

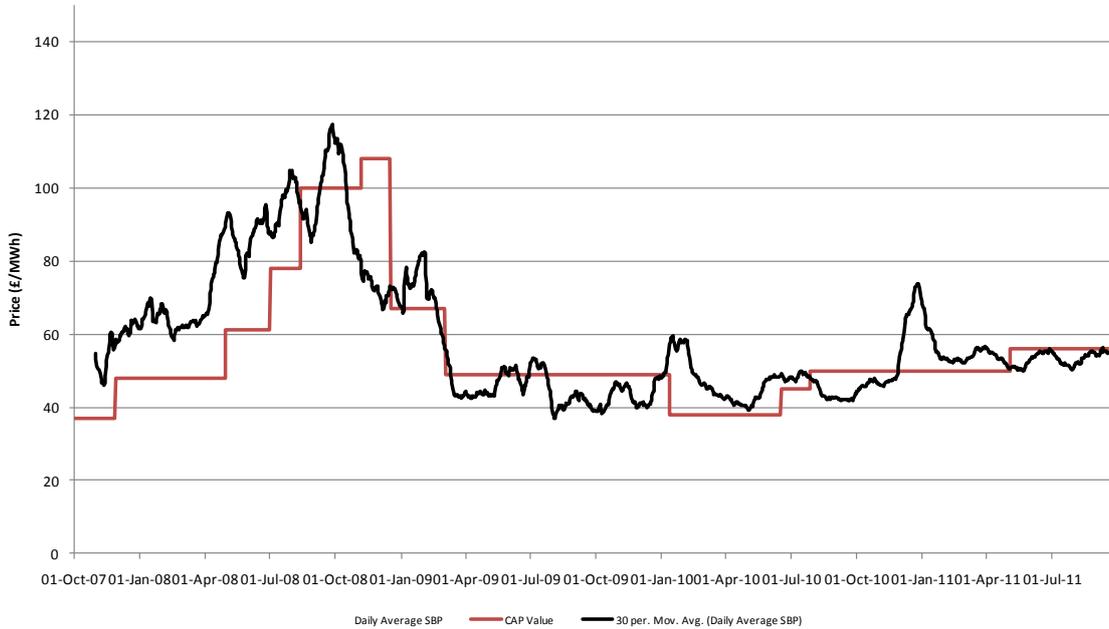


Graph 1 shows the variation in the reference price and the CAP value over the last 3 years (the process was started in October 2007). The graph also shows the upper and lower trigger levels, and the blue shaded areas indicate periods when the CAP value was under review.

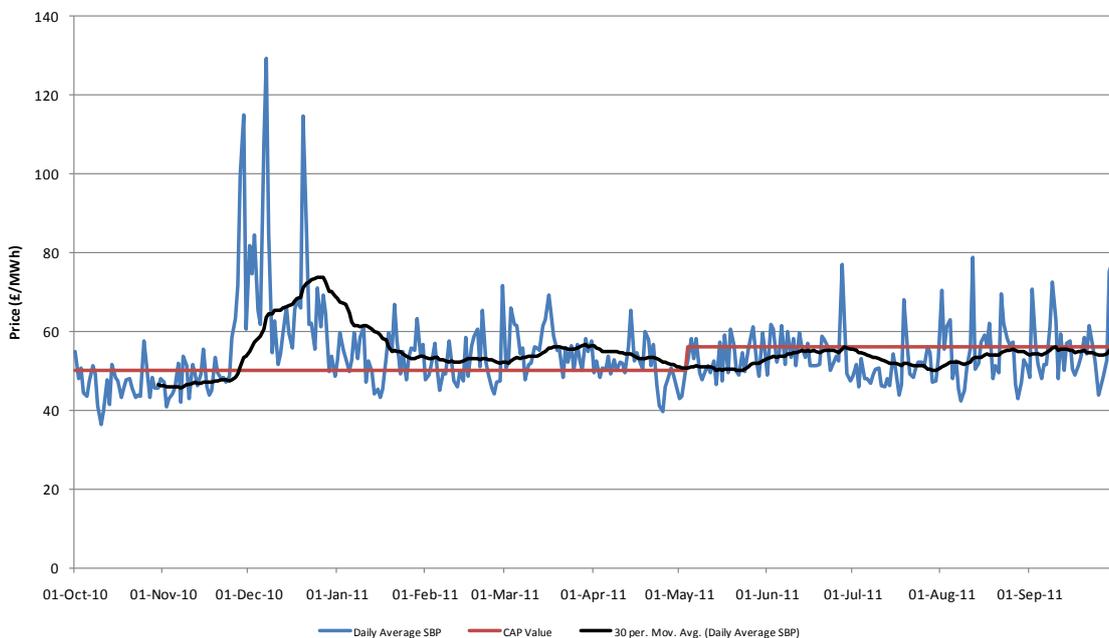
The graph shows that throughout the Quarter the reference price was higher than CAP, and a steady increase throughout August resulted in the review being triggered. The average reference price over the Quarter was £60.41. At the time of writing, the reference price has dropped and is currently around the level of the new CAP value.

In Graphs 2 and 2a you can see the relationship between CAP and daily average SBP. We believe that this is the real measure of how good the current CAP review process is at predicting outturn SBP. Graph 2 shows the period from October 2007 to date, while Graph 2a shows the data for the last 12 months only. To provide clarity over the longer time period in Graph 2, we have removed the daily average SBP but kept the 30 day moving average of daily SBPs.

Graph 2 Daily Average System Buy Price and CAP



Graph 2a: Daily Average System Buy Price and CAP



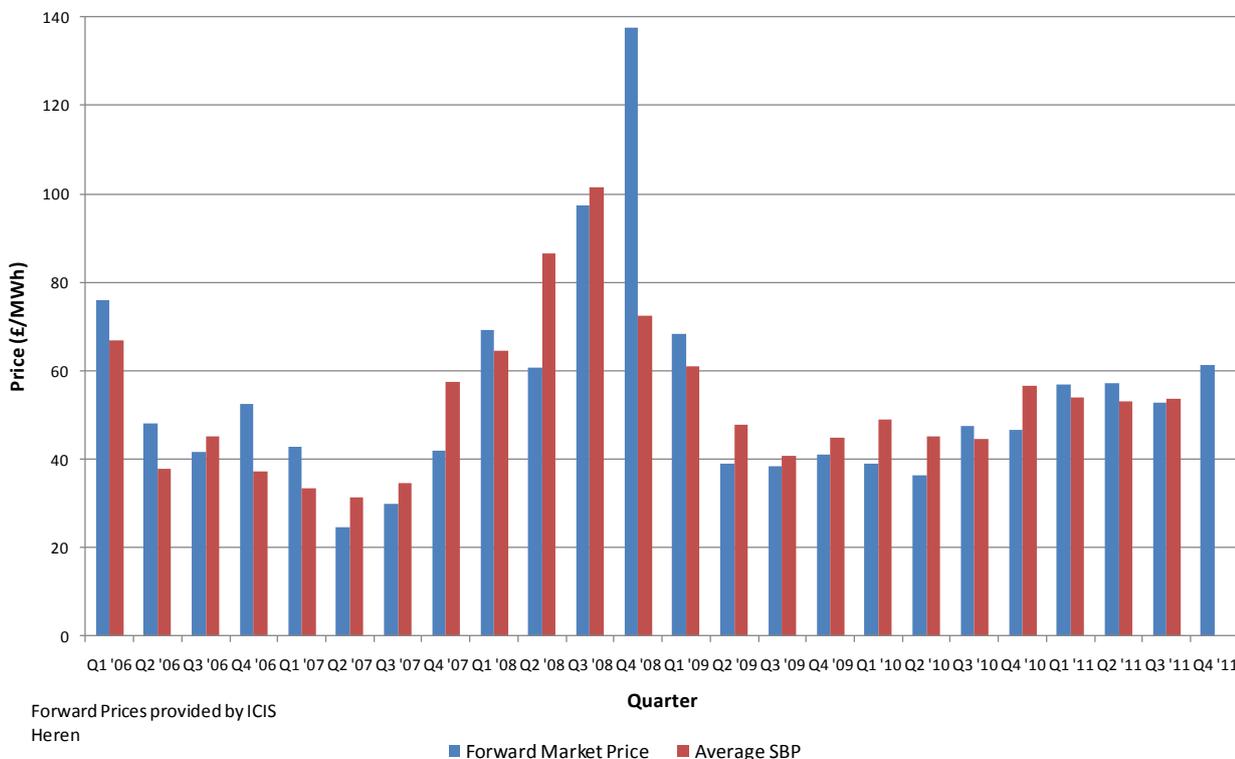
The graphs show that for the majority of the Quarter, SBP was below CAP. At the time of the review being triggered, SBP was at a similar level to the £56/MWh CAP value. Overall, the average SBP for the quarter was £53.70.



	July 2011	August 2011	September 2011
Average Outturn SBP	£50.36	£54.84	£55.97
Average Outturn SBP - CAP	-£5.64	-£1.16	-£0.03

Graph 3 shows the average outturn System Buy Price (SBP) over each Quarter against the forward price for that Quarter. We have based this forward price on the last available forward market price before the Quarter actually began. This is another measure of how good the CAP review process is overall. This is because if the forward price does not predict outturn future SBP movements well, then with our current methodology, CAP will not reflect future SBP well either. Of course, we should make the point that forward prices are not necessarily used by the markets as predictors of SBP, but we have previously found that they are generally a good basis for this purpose, as can be seen over the years in Graph 3. Hence they have proved a good basis for use in the CAP review process.

Graph 3: Average Outturn SBP against Quarterly Forward Market Prices



In the last Quarter, although a slight underestimate, the forward price for the Quarter was very similar to the overall average SBP.

4. Looking Forward

The reference price has been dropping steadily since the breach at the beginning of September. At the time of writing the reference price is £59.53, which is very close to the current CAP value of £59/MWh. In November and December, the reference price will begin to incorporate Q2 2012 price. The current Q2 price is £54.90. Therefore unless a drastic change occurs in the prices, a further review this Quarter should not occur.

5. Conclusions

- A CAP review was triggered this Quarter. The Credit Committee agreed to increase CAP from £56/MWh to £59/MWh. The change was implemented on 12 October 2011.
- CAP overestimated outturn SBP throughout the Quarter.
- Another review this year seems unlikely.