

Credit Committee Quarterly Report: April to June 2010

Date Published: 5 July 2010

Overview or Purpose of Document:

ELEXON produces this report on the Credit Assessment Price (CAP) review process every 3 months for the Credit Committee. This particular report covers April to June 2010. The purpose of these reports is to assist the Credit Committee in its obligation to keep the CAP Review process under review.

In summary:

- Two CAP reviews were triggered during the Quarter resulting in a change of CAP from £38/MWh to £45/MWh implemented on 17 June; and a future change due to be implemented on 28 July to £50/MWh.
- CAP has been a reasonable proxy for outturn SBP at the beginning and at the end of the Quarter. During April and the latter half of June CAP was £2-£3/MWh below average outturn SBP. However, in the middle period, SBP rose during May before the CAP rise to £45/MWh could be implemented, so in May and early June the match was not as good (£9-£10/MWh below average outturn SBP).
- The upward change to CAP (£45/MWh from 17 June) has predicted outturn SBP for the latter half of June well. On prices to date it was an appropriate change in CAP.

Target Audience:

Credit Committee Members and BSC Parties

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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 April, May and June 2010). 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.

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. If you are reading this report out of interest and want to know about this background, there are documents that cover this on the Credit Committee web pages, which you can find at:

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

2 An overview of the CAP review process from April to June 2010

The CAP trigger breached twice in this Quarter following a marked upward trend in the reference price from the end of April.

On 10 May 2010, the upper CAP trigger level of £44/MWh was breached when the reference price reached £45.03/MWh. This initiated a CAP review and industry consultation. As a result the Credit Committee met on 19 May and agreed to raise CAP to £45/MWh. This change was effective from 17 June 2010.

The second trigger event occurred at the earliest possible date it could following the May review. On 21 June 2010, the new upper CAP trigger level of £51/MWh was breached as the reference price reached £51.31/MWh. The Credit Committee met on 30 June and after considering the consultation responses agreed to raise CAP to £50/MWh to be effective from 28 July 2010.

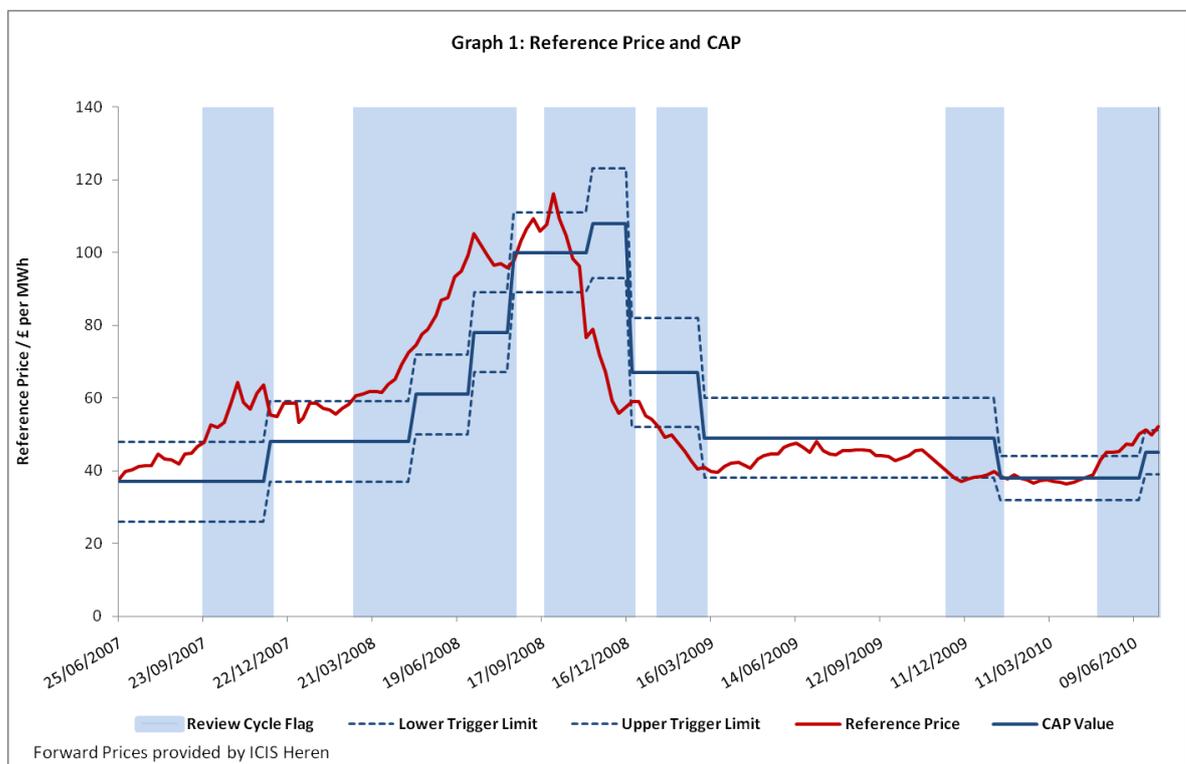
The Credit Committee agreed to leave the trigger level unchanged at £6/MWh throughout.

CAP values and reviews during the Quarter:

Date of Trigger Breach	Effective Dates	CAP Value actually implemented	CAP Value proposed in Consultation
30/11/2009	12/01/2010 to 16/06/2010	£38/MWh	£38/MWh
10/05/2010	17/06/2010 to 27/07/2010	£45/MWh	£45/MWh
21/06/2010	28/07/2010 onwards	£50/MWh	£51/MWh

3 A more detailed analysis

A CAP review triggers if the Reference Price (which is derived from forward prices currently provided by ICIS Heren) breaches a band of current CAP +/- trigger level. So while CAP was set at £38/MWh, a CAP review would be triggered if the Reference Price reached £38/MWh +/- £6/MWh, i.e. below £32/MWh or above £44/MWh. From 17 June 2010 when CAP was reset to £45/MWh, the limits became £39/MWh and £51/MWh. From 28 July 2010 when CAP will be further increased to £50/MWh, the new trigger limits will become £56/MWh and £44/MWh.

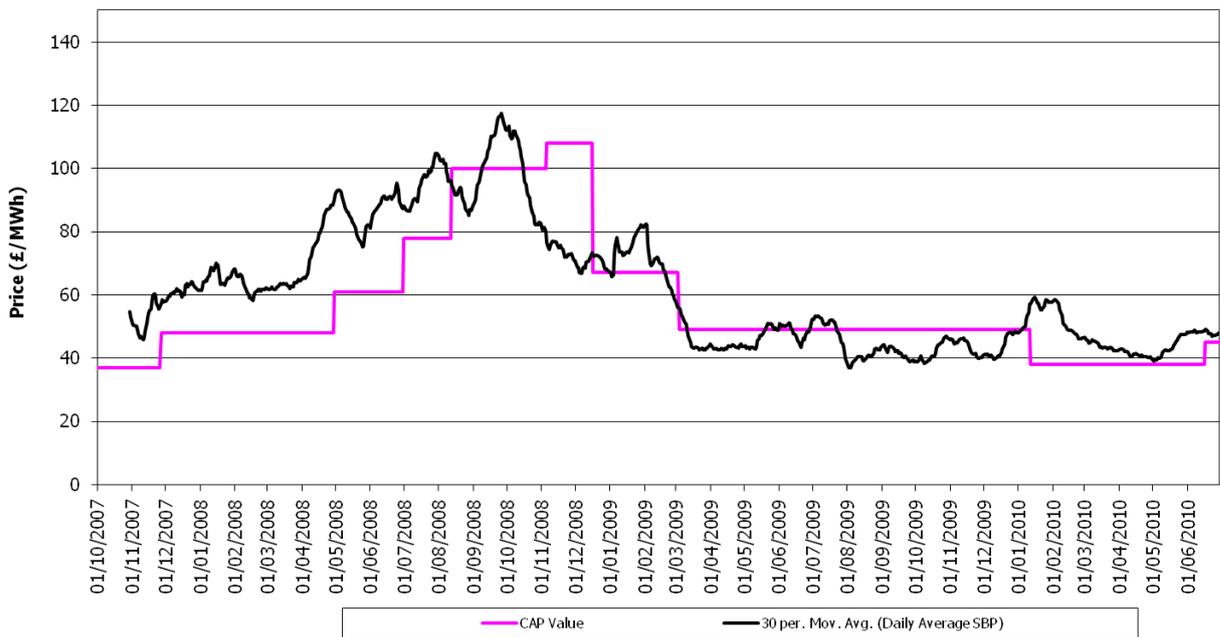


In Graph 1 you can see how the Reference Price has varied and what the CAP value has been set at over time. The new CAP review process was introduced in October 2007. On the graph you can also see the upper and lower limits of the trigger level and the shaded areas indicate periods where the value of CAP was under review.

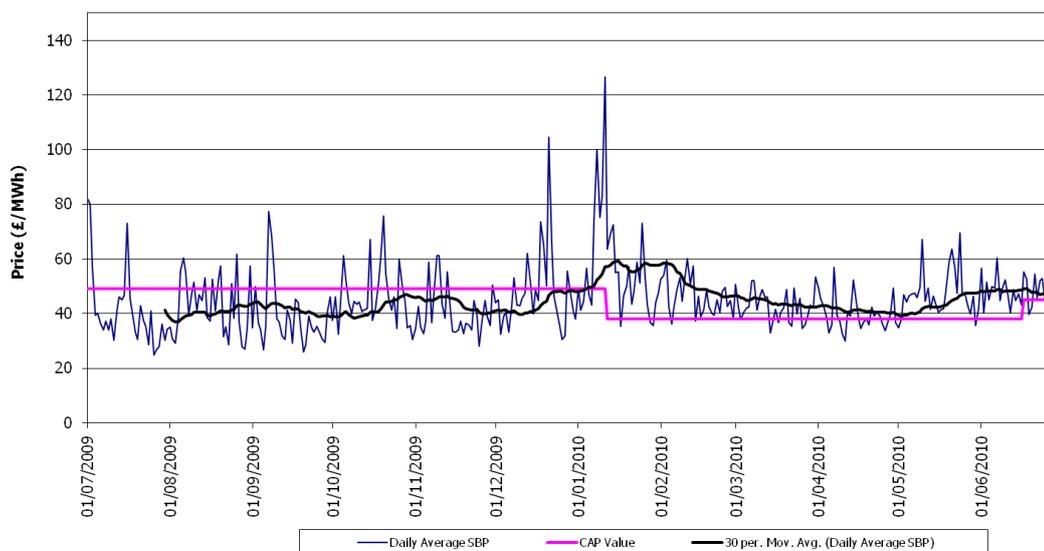
During this last Quarter, initially the Reference Price continued the flat price trend of the previous Quarter averaging about £38/MWh. But, from the beginning of May onwards, there was a pronounced upward trend in the Reference Price that, with slight exceptions, continued throughout the rest of Quarter. The highest price of the Quarter was on 21 June 2010 at £51.31/MWh. It fell slightly the following week to £49.81/MWh, which was the last price of the Quarter. But, at the time of writing after the end of the Quarter, it has risen again to £52.06/MWh on 5 July.

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 30 day moving average and CAP



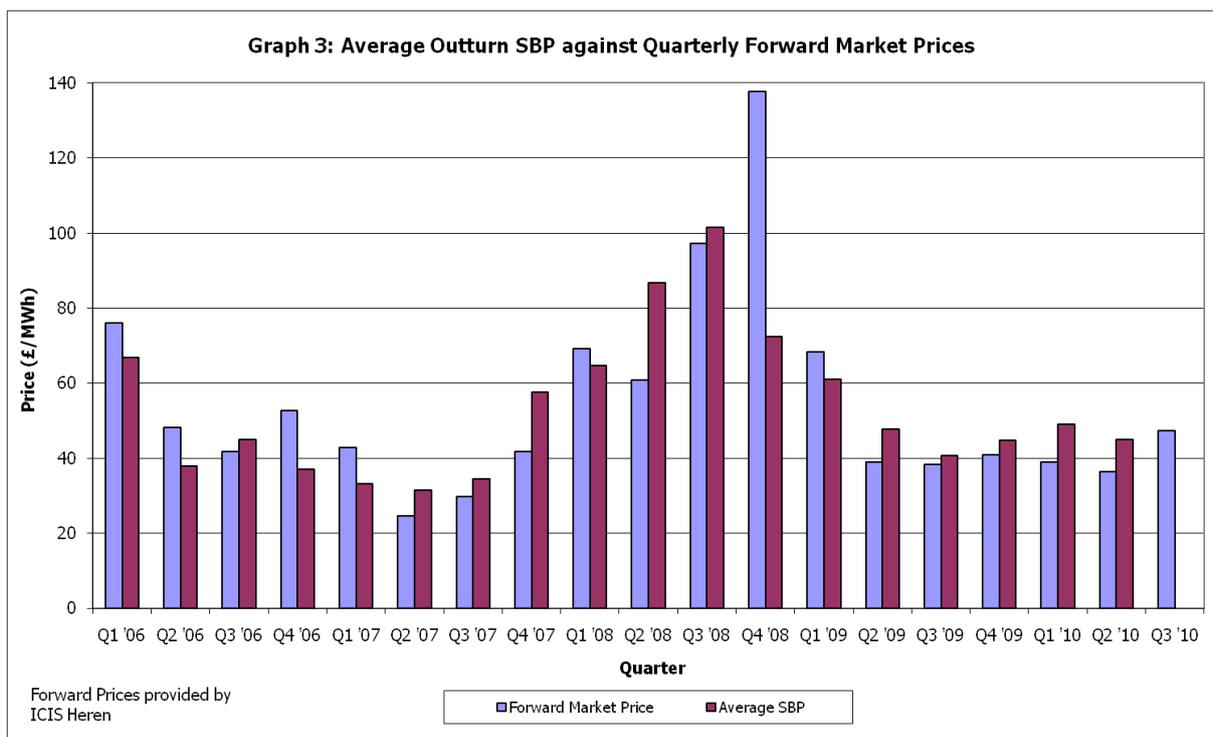
Graph 2a: Daily average System Buy Price and CAP over the last 12 months



You can see that CAP matched daily outturn SBP reasonably well in April 2010. However, from May onwards outturn SBP rose before reaching a plateau in June. The upwards CAP change to £45/MWh from 17 June was a much better match to outturn SBP.

	April 2010	May 2010	June 2010 (to 16 June)	June 2010 (from 17 June)
Average Outturn SBP	£40.09/MWh	£47.24/MWh	£48.09/MWh	£47.73/MWh
Average Outturn SBP - CAP	£2.09/MWh	£9.24/MWh	£10.09/MWh	£2.73/MWh

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.



For the second Quarter of 2010, you can see that the last forward price was again below the outturn SBP, continuing a pattern we have seen over the last five Quarters. However, this gives a slightly misleading impression as the value of CAP set under the review process has not consistently undershot outturn SBP (Graph 2) over the same period. For example in much of the second half of 2009, CAP was slightly above the 30-day moving average of daily SBP. The difference between Graphs 2 and 3 is down to the fact that Graph 3 takes a snapshot view on the last day of each Quarter, whereas CAP can be reset at any time by the review process triggering.

3.1 Effect of Modification P217

ELEXON has monitored the impact of pricing modification P217, implemented on 5 November 2009. Reports are now included as routine in the monthly Trading Operations Report.

The evidence from this monitoring is that P217 can impact the prices in individual half hours but has no significant impact on the level of average daily prices. So there is still no reason to suggest that the current CAP review process needs to be revised as a result.

4 Looking Forward

4.1 Will there be another CAP Review soon?

After the future change in CAP on 28 July 2010 a review would trigger if the Reference Price rose above £56/MWh or dropped below £44/MWh.

With each change of month in the coming Quarter, we include less of the fourth Quarter of 2010 forward prices and more of the first Quarter of 2011 prices in calculating the Reference Price.

In July, the Reference Price is purely based on fourth Quarter prices and by October the Reference Price will be based purely on first Quarter 2011 prices. At the time of writing, based on current

levels for Quarterly forward price, it is likely that October will see the peak Reference Price of 2010 before they drop back through the inclusion of Spring then Summer 2011 prices.

On 5 July 2010 the latest Reference Price is standing at £52.06/MWh made up solely of fourth Quarter of 2010 prices. The first Quarter of 2011 price is £53.47/MWh. So neither of the Quarterly prices is currently sufficient to breach the £56/MWh trigger level. However, it is also unclear whether the rising trend of prices that started at the beginning of May will continue.

5 Conclusions

- Two CAP reviews were triggered during the Quarter resulting in a change of CAP from £38/MWh to £45/MWh implemented on 17 June; and a future change due to be implemented on 28 July to £50/MWh.
- CAP has been a reasonable proxy for outturn SBP at the beginning and at the end of the Quarter. During April and the latter half of June CAP was £2-£3/MWh below average outturn SBP. However, in the middle period, SBP rose during May before the CAP rise to £45/MWh could be implemented, so in May and early June the match was not as good (£9-£10/MWh below average outturn SBP).
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