ELEXON

Draft P444 Send Back Process

BSC Panel 342

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Summary **We [Elexon as BSCCo] invite the Panel to approve the P444 Send Back Process detailed in this paper. We will then execute the process on behalf of the Panel in order to address the P444 Send Back Direction from Ofgem ('the Authority').**

1. Introduction

1.1 This paper details our draft P444 Send Back Procedure and Timetable, which we invite the Panel to approve, prepared in response to Ofgem's P444 'Compensation for Virtual Lead Party actions in the Balancing Mechanism'[1] Send Back Direction, received on 8 September 2023.

1.2 We prepared the draft Send Back Process in accordance with BSC Section F 'Modification Procedures' 2.7A[2]. The Panel, having the considered this draft Send Back Process, may instruct us to make such changes to the draft Send Back Process as it believes necessary to address the Send Back Direction.

2. Background

2.1 Flexitricity raised P444 on 1 September 2022 to introduce compensation for Suppliers and Virtual Lead Parties (VLPs) for volumes adjusted by VLPs in the Balancing Mechanism (BM).

2.2 This Modification would amend BSC systems and processes to introduce a compensation mechanism (developed under Modification P415 'Facilitating access to wholesale markets for flexibility dispatched by Virtual Lead Parties'[3]) for Suppliers and VLPs when the National Grid Electricity System Operator (NGESO) dispatches a VLP Bid or Offer in the BM, to ensure a level playing field and enable correct incentives for flexibility.

2.3 The Proposer believes that implementing Supplier compensation in the BM would address a defect within the BSC introduced by Modification P344 'Project TERRE implementation into GB market arrangements' which Suppliers and VLPs are bearing the cost of.

2.4 The P444 Workgroup noted efficiencies to an aligned implementation with P415 but did not believe there is a dependency between this Modification and P415, i.e where P415 is not approved there is still a case for the approval of P444 and vice versa.

2.5 Under the P444 Proposed Solution, compensation costs are mutualised, with compensation paid at a price that approximates the Supplier's expected sourcing costs, obtained by using Ofgem's Price Cap Methodology (PCM). Under the P444 Alternative Solution, VLPs are liable to pay compensation costs for volumes adjusted by that VLP, with compensation paid at a price that approximates the Supplier's expected sourcing costs, again

[1] https://www.elexon.co.uk/mod-proposal/P444/
[2] https://bscdocs.elexon.co.uk/bsc/bsc-section-f-modification-procedures#section-f-2-2.7A
[3] https://www.elexon.co.uk/mod-proposal/p415/

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obtained by using Ofgem's published PCM. The different approach to 'who pays' is the only difference between the Proposed and Alternative Solutions.

2.6 The Proposer of P444 agreed to adopt an amended Proposed Solution on the basis that it enabled both a Proposed and Alternative solution to be brought before Ofgem to align with P415. They believed the Proposed Solution is a better option than the Alternative and that it is better than the current BSC arrangements.

2.7 The BSC Panel recommend that the P444 Alternative Solution should be approved and the Proposed Solution rejected, on the basis that the Alternative better facilitates Applicable BSC Objectives (b) and (c).

2.8 Against Objective (b)[4] the Proposer believes that the operation of the electricity system will be supported as a result of more efficient BM arrangements and greater participation in the BM under the Proposed Solution. A majority of members (5) believed that P444 is neutral against this objective, on the basis that VLPs already have access to the BM market under current arrangements.

2.9 For the Alternative Solution, 3 members voted that they believed this to be positive against Objective (b), for the same reasons as given for the Proposed but with several additional members believing the Alternative better supported this objective than the Proposed by more fairly allocating costs and clarifying who is responsible for paying them. Another split (3 members) felt that the Alternative solution would be overall detrimental to this objective and the current arrangements as a whole, due to encouraging less participation and creating a barrier to entry for VLPs due to the extra cost they would incur.

2.10 Against Objective (c)[5] the Proposer believed that greater volumes of available capacity in the BM will lead to greater competitive pressure and promote a level playing field for competition under the Proposed Solution. The rest of the Workgroup were split. 3 members voted that they believed the Proposed Solution to be overall neutral on (c), on the basis that VLPs already have access to the WM market and they couldn't identify a significant benefit that the Proposed Solution would bring to the current arrangements. Another split (3 members) felt that the Proposed Solution would be overall detrimental to this objective and the current arrangements as a whole, noting concerns over the impact the Proposed Solution could have on competition on the Supply side - by mutualising a risk that Suppliers can't manage, then putting the cost of that risk onto Suppliers to pay for competition. One of these members did not support any form of supplier compensation on the basis that they believed it would harm competition.

2.11 For the Alternative Solution, a Workgroup majority (5 members) believed that the Alternative Solution better facilitates the objective (c), for the same reasons given for the Proposed Solution but with several additional members believing the Alternative better supported this objective than the Proposed by creating a more level playing field. A minority (3 members) disagreed and felt the Alternative Solution is detrimental to this objective, on the basis that they believe it creates a barrier to existing VLPs.

3. Engagement with Ofgem prior to issue of Send Back Direction

3.1 Prior to issuing the Send Back, Ofgem engaged with Elexon and the P444 Proposer to request additional information on the impacts of P444 on the BM and additional context on the implications to current practices for participants in VLP activity following implementation of P344, which did not introduce a codified compensation mechanism.

3.2 Elexon clarified that the P344 Workgroup believed that Suppliers should be compensated for the energy sourcing cost of Bid Offer Acceptances (BOA)s taken by their customers through VLPs, but did not codify any arrangements for making that happen. In the absence of codified arrangements it is the responsibility of Suppliers to make bilateral arrangements with their customer.

3.3 Elexon were unable to report the extent to which Suppliers have made bilateral arrangements with customers, as it does not have visibility over what compensation (if any) has been agreed between customers and Suppliers. If Suppliers and customers do not wish to reveal the contracts that they have in place, Elexon do not have the authority to mandate the sharing of this information, although Ofgem could employ its statutory powers to require Suppliers and other licenced entities to provide this information.

3.4 Given this, Elexon do not believe it will be straightforward to establish a baseline for P444, as parties are unlikely to share commercial information with us or a third party on our behalf.

[4] Objective (b) - The efficient, economic and co-ordinated operation of the National Electricity Transmission System
[5] Objective (c) - Promoting efficiency in the implementation of the balancing and settlement arrangements

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3.5 Elexon noted that the P444 Alternative Solution is effectively codifying a mechanism for Supplier compensation and, as such not fundamentally changing the P344 principles or the economics of VLPs bidding in to the BM. The P444 Proposer reiterated that their intention behind proposing the Modification was to remove friction in the P344 arrangements and hence removing a potential barrier to VLPs accessing the BM. The P444 Proposed Solution (by socialising the compensation) would allow VLPs – unlike other BM participants – to bid in without accounting for energy costs.

4. Ofgem Send Back Direction

4.1 Ofgem sent P444 back to the Panel on 8 September 2023, as it was unable to form an opinion on whether or not P444 should be approved. Ofgem believes it has not been provided with sufficient evidence to evaluate the impact of P444's effects on industry and other stakeholders.

4.2 Ofgem direct that additional steps are undertaken to revise the FMR to include:

- impact analysis with quantitative and qualitative evidence which fully explains and demonstrates the impact on industry of implementing either compensation method through the BSC Modification P444 against the status quo.
- how the implementation of this Modification would positively and/or negatively impact the applicable BSC Objectives.

4.3 After revising the Final Modification Report (FMR) accordingly, the BSC Panel are asked to resubmit P444 to Ofgem for decision as soon as reasonably practicable.

5. Proposed Send Back Procedure

5.1 The approved P444 implementation approach was to implement P444 in the standard November 2024 BSC Release. This aligns with the current plan for implementation of P415 and unlocks efficiencies associated with applying Supplier compensation to both the BM and Wholesale market in the same BSC Release, assuming approval of both Modifications.

5.2 However, Elexon believe the Panel should reconsider the viability of implementing P444 to the same timescale as P415 given the expected time needed to reasonably develop requirements, conduct, analyse and present quantitative and qualitative impact analysis.

5.3 Elexon invite the Panel to agree that the P444 Workgroup should be reinstated to agree the requirements for any further analysis, assist in developing those requirements to the required level and consider the results ahead of any additions to a revised FMR.

5.4 Elexon believe that the P444 Workgroup should additionally consider how the implementation of P444 would positively and/or negatively impact the applicable BSC Objectives, once further analysis has been completed and results shared.

5.5 Ahead of agreement on the scope of further work, it is challenging to confidently assess how long Elexon would need to ensure the above activities are completed, particularly given the request for quantitative and qualitative impact analysis that may require the procurement of a third party to undertake.

5.6 Furthermore, as material changes could be made to the revised FMR, the Panel may wish to direct that this is issued for industry consultation ahead of being passed back to Ofgem.

5.7 Elexon ultimately wish to progress the Send Back as efficiently as possible, but are mindful of the time needed to conduct requirement gathering and analysis for P444 and the need to effectively and robustly answer the questions highlighted by Ofgem.

5.8 Elexon propose to return to the BSC Panel on a regular basis to provide further updates at appropriate moments. The Panel may wish to consider and feed back on the requirements for further analysis (as with the P415 CBA) and Elexon are happy to return as needed outside of any regular updates.

5.9 The moving parts and need to agree scope and duration of further work make setting a definitive timetable challenging, so Elexon propose a 'long stop' provisional timetable that assumes maximum time needed, while aiming to bring this back as soon as is suitable. In order to resubmit the P444 FMR to the BSC Panel, we propose the following timetable and procedure over a course of 9 months:

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Event	Date
P444 Workgroup meetings to consider scope for P444 further quantitative and qualitative analysis and develop requirements. Elexon to prepare for potential third party procurement, if needed.	As needed throughout September, October and November
Update to BSC Panel on discussions and recommended scope for further analysis	9 November 2023
If needed, Elexon to begin procurement activities for third party service providers	November 2023
Conduct quantitative and qualitative impact analysis	TBC dependent on agreed scope of further analysis, assuming an upper limit of 3 – 6 months, starting in either December or January 2024
Workgroup to consider results of further analysis and provide final views on assessment against the Applicable BSC Objectives.	Following completion of further analysis, provisionally tabled for March 2024
Industry consultation	March/April 2024
Present revised Draft Modification Report to Panel	Following completion of further analysis and additional steps recommended by the Panel (e.g industry consultation), provisionally targeting May 2024
Resubmit Final Modification Report to Authority	Within 3 Working Days of final presentation to the Panel

5.10 Should the agreed scope and extent of further analysis be possible to progress in a shorter timescale than the above, Elexon will return to the Panel to make them aware of changing timescales.

6. Recommendations

6.1 We invite you to :

a) **APPROVE** this draft P444 Send Back Process

Attachments

Attachment A – P444 Send Back Direction

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