BSC Modification Proposal Form	At what stage is this document in the process?

P443

Mod Title: To Cap NGESO Interconnector Trades at the Value of Lost Load (VoLL)

01	Modification
02	Workgroup Report
03	Draft Modification Report
04	Final Modification Report

Purpose of Modification

To stop National Grid Electricity System Operator (NGESO) trading at a price that is above the Value of Lost Load (VoLL – currently £6,000/MWh) that represents the value to customers of unsupplied energy under the BSC.

Does this Modification impact any of the European Electricity Balancing Guideline (EBGL) Article 18 Terms and Conditions held within the BSC?

☒ Yes ☐ No

The Proposer recommends that this Modification should:

- not be a Self-Governance Modification Proposal
- be treated as urgent and progressed under a timetable agreed by the Authority

This Modification will be presented by the Proposer to the BSC Panel on *18 August 2022*. The Panel will consider the Proposer's recommendation and determine how best to progress the Modification.

High Impact:

Generators, Suppliers, Interconnector Users, Non Physical Traders, Customers and NGESO

Medium Impact:

Interconnector operators/owners

Low Impact:

Balancing and Settlement Code Company (BSCCo)

Contents

Timetable

The Proposer recommends the following urgent timetable:

Modification presented to Panel	18 August 2022
Submitted to Authority for decision on urgency	1WD following Panel meeting
Initial consideration by Workgroup	Week commencing 29 Aug 2022
One month urgent and EBGL consultation	12 September 2022 - 12 October 2022
Workgroup considers responses and finalises solution	Week commencing 17 Oct 2022
Draft Modification Report presented to Panel	25, 26 or 27 October 2022
Final Modification Report submitted to Authority	By 31 October 2022

Under the urgent procedure we would want the Workgroup to be able to raise an Alternative solution, for the Proposer to be able to withdraw their Proposal and for the standard Workgroup Terms of Reference to apply.

Any questions?

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1 Why Change?

What is the issue?

At the current time NGESO can trade at prices above the Value of Lost Load (VoLL – defined in BSC Section T 'Settlement and Trading Charges' 1.12). This adds to customers costs and sends a signal to the markets that customers are willing to buy power at any price. In a cost of living crisis the proposer does not believe that the British public are prepared to buy energy at any price and therefore a price cap before emergency actions seems a sensible safety net.

If NGESO has a price cap it will signal to the market that it will not simply buy through spiralling prices. Instead, it would cease to buy energy and start to use other energy management tools when offers to sell power are above VoLL. We would see these other actions as being:

- Issuing Capacity Market Warnings (CMW), to which interconnectors have an obligation to respond;
- Use Electricity Margin Notices (EMNs); and
- Start to manage demand, either via Demand Side Response (DSR) services or if necessary via load shedding.

In normal times, we would never expect to see prices reaching these levels. However, we have seen such prices (20/7/22), albeit that NGESO bought the energy for system reasons and not energy balancing reasons. The market rules need to reflect not only the needs of the industry parties, but also the needs of customers. By adding in a requirement on NGESO to not buy energy at any price, the rules will then better reflect the needs of customers and protect them from extraordinary prices. This modification will allow NGESO to consider the price beyond which customers are not willing to buy energy and instead expect the system operator to use other tools to manage the network.

NGESO will accept offers from interconnector parties in order to signal their desire for the interconnectors to either export less or to switch to importing into the GB market. The Proposer understands that if NGESO cannot buy energy (as a cap has been reached) and the interconnectors do not respond to a Capacity Market Warning, the first emergency action NGESO will take is to shut off the interconnectors. Therefore, the demand to supply third party countries would be impacted before the demands of GB customers go unmet. While the GB generally believes in markets, the proposer believes that there should be a price at which there is not an assumption that the GB customers are willing to go on buying.

It is also the case that the GB market participants are regulated by Ofgem. If parties selling power into the GB market from outside GB are thought to be in some way abusing their positions, for example taking advantage of a transmission constraint, exhibiting anti-competitive behaviour, etc. Ofgem can do nothing. As it can take no actions against such companies, the best way for Ofgem to fulfil its primary duty to customers is to take proactive action to protect them, for example by setting a price cap on their behalf.

Desired outcomes

Limit the exposure of all GB parties to extreme prices as a result of the tight margins across the European energy markets. Set a clear price at which point the market will expect NGESO to take other actions rather than buy energy at any price.

We do believe that a number of other things are needed from NGESO to go with such a price cap:

- A clear understanding about how the coal contracts will work so the market can consider if these are adding sufficient additional security for this winter. If the market does not believe they are

sufficient, or their use economic, we may need to tweak the rules, add additional services, etc. before the winter; and

- Publish a hierarchy of actions that they will take if they can (i.e. if it is not emergency actions that they are taking as quickly as possible). The market understands the difference between a CMW and EMN, but then will NGESO limit interconnector flows before demand disconnections, etc.? Again the better the transparency and understanding the more efficient the response in any emergency will be.

In drafting this modification proposal it has become apparent that there is actually little formal regulation of interconnector trading. Not only does Ofgem have no regulatory powers in third party countries, but NGESO does not used Bid Offer Acceptances (BOAs) for interconnector trades. Instead it has constructed its own auction process, that sits outside the industry codes, under the C16 Licence Condition statements. This is neither transparent nor subject to open governance. Further, System Operator (SO) to SO transactions appear to be transacted at prices that are unrelated to the cost of energy in either market at the point it is traded. While this modification does not address all of these issues, with the significant volumes of energy now flowing through interconnectors, we would urge the Department for Business, Energy & Industrial Strategy (BEIS) and Ofgem to address the wider regulatory framework.

The Proposer is not wedded to using the BSC as a means to cap prices. In fact, including the cap in the C16 Balancing Principles Statement would seem the logical place. However, amending the C16 statement is not something an industry party can formally propose, it is unlikely to happen in the timescales needed to address this issue, and would not have the advantages of an open Modification process that allows for discussion at an industry Workgroup. Further, we understand that NGESO can use the outcome of any BSC Modification process to feed into C16 Statement amendments, if deemed appropriate. Therefore, at the current time we can see no other manner to address this defect, other than a BSC Modification.

2 Solution

Proposed Solution

Our preferred option is to alter BSC Section Q 'Balancing Mechanism Activities' to add in a new paragraph as follows:

6.3.2D For any Balancing Services Adjustment Action [provided using an Interconnector] and with a positive Balancing Services Adjustment Volume, the Balancing Services Adjustment Cost cannot be greater than VoLL * Balancing Services Adjustment Volume

While this is the solution drafted, there is an issue that would benefit from further consideration:

Should this cap just apply to interconnector trades? The Proposer believes it should be because all GB generators/traders/suppliers are regulated by Ofgem and can be investigated if prices are believed to no longer be cost reflective and/or go beyond scarcity pricing. The Proposer is also keen that customers who offer DSR are free to do so at a price that will reflect their own VoLL. For some industries that may be higher than £6,000/MWh.

The solution will require NGESO to cap its offers to Interconnector Users to no more than VoLL, as defined in the BSC. These trades are included in the Balancing Services Adjustment Data (BSAD) file, which is sent from NGESO to Elexon. Elexon process the BSAD file for the purposes of Settlement and reporting.

Another consideration is whether Elexon should validate that NGESO has done this (i.e. that BSAD data received from NGESO does not include Interconnector actions priced at higher than VoLL). In principle this would probably be desirable, but it may require changes to Settlement systems, and the Proposer would not want implementation of the Modification to be delayed while waiting for such changes to be made.

Benefits

Given the tight margins across the European energy markets, there is a risk this winter that each market will try to outbid each other in order to secure power. This leads to spiralling prices that go beyond the reasonable definition of "scarcity pricing" and instead could create excessive profits for a few parties at the expense of customers. There has to be a price at which point customers would reasonably say that they do not wish to buy power, instead accepting some rationing. In the electricity markets this value is referred to as VoLL (Value of Lost Load). Under the BSC Ofgem set VoLL at £6,000/MWh to give a price to go into Settlement to compensate customer if they are cut off. The Proposer recognises that VoLL is different for different customers at different times of day, different times of year, etc, and in the Capacity Market (CM) assessment was suggested by BEIS to be £17,000/MWh. However, as this is a change to the BSC we have used the VoLL used in the BSC so as to not create additional confusion. The modification therefore proposes that NGESO should not be allowed to buy electricity beyond £6,000/MWh and should instead use other system tools to keep the lights on or instigate load shedding.

This change will reflect the VoLL into the traded market to the benefit of customers. It will also protect any short parties (Supplier or Generators) from excessive prices, which will reduce the likelihood of them going out of business and creating additional structural problems within the GB energy market this winter.

Further, the interconnectors are part of the Capacity Market and have been paid by customers for holding an obligation to deliver power in a system Stress Event. At the point that NGESO is no longer able to buy power, it will be able to consider the interconnectors as demand within their margin calculations and if necessary issue a Capacity Market Warning (CMW). This signal should bring any additional generation to

the market, get CM DSR providers to turn down, and the interconnectors to import. Customers having paid for this insurance policy may this year need to use it.

We note that there are already a number of price caps, implemented in different ways, across the European energy sector. While we generally do not favour such market interventions, these are extraordinary times and Ofgem should be mindful of their primary legislative duty to protect GB customers. Ofgem and BEIS should both agree that there is a price at which customers are generally unwilling to pay, and this needs to be reflected in market arrangements.

Finally, Ofgem has significant power to investigate parties they believe are acting in an anti-competitive manner within the GB market. However, it has no power over some parties in third party countries. By setting VoLL Ofgem has tried to reflect average customer price limits and stopping parties in other countries trying to supply at prices above the level of VoLL will directly protect customers.

3 Relevant Objectives

Impact of the Modification on the Relevant Objectives:	
Relevant Objective	Identified impact
a) The efficient discharge by the Transmission Company of the obligations imposed upon it by the Transmission Licence	Neutral
(b) The efficient, economic and co-ordinated operation of the National Electricity Transmission System	**Positive**
(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	**Positive**
(d) Promoting efficiency in the implementation of the balancing and settlement arrangements	Neutral
(e) Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency [for the Co-operation of Energy Regulators]	Neutral
(f) Implementing and administrating the arrangements for the operation of contracts for difference and arrangements that facilitate the operation of a capacity market pursuant to EMR legislation	**Positive**
(g) Compliance with the Transmission Losses Principle	Neutral

This change is positive in relation to the following relevant objectives:

(b) It requires that NGESO does not simply buy through all offers to meet demand at a price above the VoLL set out in the BSC. NGESO has no direct incentive to consider price in this way and it would be more efficient if it did. We recognise there may then come a point when using emergency powers to reduce interconnector flows, load shedding, etc., becomes necessary, but NGESO also has tools like the Capacity Market and it can use.

(c) As well as protecting customers, such a price cap will also protect Generators and Suppliers who are short in any period. There are considerable concerns about the number of Supplier defaults we have seen and in a tight market we will not want Generators to suffer extreme losses either. Therefore, offering some protection to excessive prices is likely to protect these businesses to the benefit of customers.

(f) It will be to the benefit of customers who have paid CM parties that if electricity supplies are short, and prices above the level customers are willing to pay, then the system operator can use a CMW to signal energy need, instead of NGESO buying through the interconnector offers. All the CM parties, including interconnectors, should then respond to CMW, based on the money they have already been paid.

4 Potential Impacts

Impacts on Core Industry Documents

Impacted Core Industry Documents			
☐Ancillary Services Document	☐Connection and Use of System Code	☐Data Transfer Services Agreement	☐Use of Interconnector Agreement
☐Retail Energy Code	☐ Transmission License	☐System Operator Transmission Owner Code	☐Supplemental Agreements
☐Distribution Code	☐Grid Code	☒ Other (C16 statements)	

Our proposed legal text documents the price cap in the BSC, and ensures that NGESO cannot submit prices exceeding that cap into Settlement. But for completeness corresponding changes should also be made to relevant C16 statements e.g. the Balancing Principles Statement.

Impacts on BSC Systems

Impacted Systems				
☐CRA	☐CDCA	☐PARMS	☐SAA	☐BMRS
☐EAC/AA	☐FAA	☐TAAMT	☐NHHDA	☐SVAA
☐ECVAA	☐ECVAA Web Service	☐Elexon Portal	☐Other (Please specify)	☒ None

No impact on BSC Systems expected, as the cap will be applied by NGESO and feed through via the existing BSAD file, with no changes to the file structure or format required (content only).

Impacts on BSC Parties

Impacted Parties			
☒Supplier	☒Interconnector User	☒Non Physical Trader	☒Generator
☐Licensed Distribution System Operator	☒National Electricity Transmission System Operator	☐Virtual Lead Party	☒Other (interconnector owners and operators)

This change will most directly impact Interconnector Users and NGESO, as it will limit the price at which NGESO accepts offers from Interconnectors Users for purposes of balancing the system. There will be less direct (but still potentially significant) impacts on those parties that fund NGESO's balancing activities (e.g. Suppliers, Generators and Non Physical Traders) and ultimately customers.

Impacts on consumers and the environment

Impact of the Modification on consumer benefit areas:	
Consumer benefit area	Identified impact
Improved safety and reliability *Will this change mean that the energy system can operate more safely and reliably now and in the future in a way that benefits end consumers?* This should not change system reliability as the balancing tools will all still exist.	Neutral
Lower bills than would otherwise be the case *Will this change lower consumers' bills by controlling, reducing, and optimising spend, for example on balancing and operating the system?* *If possible, this section should include any quantifiable benefits.* This will stop NGESO accepting excessive prices and that will ultimately put a cap on the prices in the wholesale market to the benefit of customers.	**Positive**
Reduced environmental damage *Will this proposal support:* • *new providers and technologies?* • *a move to hydrogen or lower greenhouse gases?* • *the journey toward statutory net-zero targets?* • *decarbonisation?* No impact identified.	Neutral
Improved quality of service *Will this change improve the quality of service for some or all end consumers. Improved service quality ultimately benefits the end consumer due to interactions in the value chains across the industry being more seamless, efficient and effective.* No impact identified.	Neutral
Benefits for society as a whole *Are there any other identified changes to society, such as jobs or the economy.* The UK is suffering a cost of living crisis. Any small changes we can make to put some downward pressure on energy prices will benefit the economy as whole. While we would not expect this price cap to kick in very often (and hopefully not at all), it will be important in sending a signal to the neighbouring electricity markets that GB customers will not simply pay any price to keep the lights on.	**Positive**

Legal Text Changes

Our preferred option is to alter Section Q, of the BSC to add in the following requirement:

6.3.2D For any Balancing Services Adjustment Action [provided using an Interconnector] and with a Balancing Services Adjustment Volume greater than zero, the Balancing Services Adjustment Cost cannot be greater than VoLL * Balancing Services Adjustment Volume

5 Governance

Self-Governance

☒ **Not Self-Governance –** A Modification that, if implemented:	
☐ materially impacts the Code's governance or modification procedures	☒ materially impacts sustainable development, safety or security of supply, or management of market or network emergencies
☒ materially impacts competition	☒ materially impacts existing or future electricity consumers
☒ materially impacts the operation of national electricity Transmission System	☒ is likely to discriminate between different classes of Parties
☒ involves any amendments to the EBGL Article 18 Terms and Conditions related to Balancing; except to the extent required to correct an error or as a result of a factual change	
☐ **Self-Governance –** A Modification that, if implemented:	
Does not materially impact on any of the Self-Governance criteria provided above	

This modification is expected to amend provisions of the BSC that constitute EBGL Article 18 balancing terms and conditions. As such, it must be issued for a one month EBGL consultation and be submitted to Ofgem to decision.

Further, where the cap kicks in, it is likely to have a material impact on competition, to stop anti-competitive behaviours, the operation of the Transmission System, management of network emergencies and consumers as it will cap the price at which NEGSO is able to purchase power over Interconnectors. As the solution is proposed to only target Interconnector Users, it could also be considered to discriminate, although the Proposer believes this is due discrimination in order to protect GB consumers. Therefore, this modification should be submitted to Ofgem for decision and should not be a Self-Governance Modification Proposal.

Progression route

☐ **Submit to assessment by a Workgroup** –:A Modification Proposal which:	
does not meet any criteria to progress via any other route	
☐ **Direct to Report Phase** – A Modification Proposal whose solution is typically:	
☐ of a minor or inconsequential nature	☐ deemed self-evident
☐ **Fast Track Self-Governance** – A Modification Proposal which meets the Self-Governance Criteria and:	
is required to correct an error in the Code as a result of a factual change including but not limited to:	
☐ updating names or addresses listed in the Code	☐ correcting minor typographical errors
☐ correcting formatting and consistency errors, such as paragraph numbering	☐ updating out of date references to other documents or paragraphs

☒ **Urgent –** A Modification Proposal which is linked to an imminent issue or current issue that if not urgently addressed may cause:	
☒ a significant commercial impact on Parties, Consumers or stakeholder(s)	☐ a Party to be in breach of any relevant legal requirements
☐ a significant impact on the safety and security of the electricity and/or gas systems	

In seeking urgency, we are mindful of Ofgem's Urgency Criteria.

In our view, the unprecedented cost of living crisis has led to exceptional risk of extremely high prices that could not be reasonably be in line with what customers are willing to pay, given the VoLL. It is "a current issue that if not urgently addressed" will have "a significant commercial impact on parties, consumers or other stakeholder(s)" and could give rise to "a significant impact on the safety and security of the electricity and/or gas systems".

The 'significant commercial impact' arises for Customers, Suppliers and Generators as they could be exposed to extraordinary costs if NGESO is prepared to buy energy at any price. These parties face a significant commercial impact from this current issue.

The 'significant commercial impact' on customers is most keenly seen on industrial customers who are exposed to rising wholesale energy costs and many of whom compete in international markets. In some of those markets' energy prices are being capped. For them anything that reduces prices must be helping their competitive position in their own markets. Further lowering costs to sectors such as food manufacturing will also help to marginally ease the inflationary pressure the whole economy is witnessing.

For domestic customers, while their prices are capped, that cap rightly reflects the actual cost of supply. If the market can signal that excessive prices will not be accepted, the chances are that the price cap will be at a lower level than could otherwise have been the case.

For Generators or Suppliers who find themselves short, for example due to a sudden change in the weather, a plant trip, etc., it is also important that their risk of significant imbalance charges can be managed. There should be no need for NGESO to take actions that are markedly above the price of electricity in interconnected markets just to try get interconnector parties to change the interconnectors' flow direction. It will not be in customers' interests if such actions then create secondary impacts, for example pushing companies out of business.

Does this modification impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

We do not believe this impacts any open SCRs and request it is treated as a SCR Exempt Modification Proposal.

Does this Modification impact any of the EBGL Article 18 Terms and Conditions held within the BSC?

It is proposed to amend BSC Section Q 6.3, which is considered part of the EBGL arrangements (as mapped in 'BSC Section F 'Modification Procedures' Annex F-2). More generally, the amendment would be considered within the scope of the EBGL arrangements. This Modification does therefore trigger the EBGL change process.

Implementation approach

Given the urgent nature of this issue, this proposal should be implemented at the earliest opportunity. We request it is implemented 2 Working Days after Ofgem approval.