
P462 Workgroup Meeting 2 Summary

Summary

1. Meeting Objectives

The Chair welcomed attendees and presented the meeting objectives:

- Understanding of the routes to resolve the issue, why the BSC Modification route was chosen and understanding of impacts of other routes; and
- Covering Wider Impacts for P462 and how to address them as part of the Assessment Procedure.

2. Action review

- 2.1 The Lead Analyst reviewed the Actions from the previous Workgroup meeting. The two main actions for Workgroup meeting 2 are Action 1 and Action 4.
- 2.2 Action 2 will be addressed at a later Workgroup. Some analysis for the carbon impact as per Action 3 is available in the slide pack on slide 26, however, this is to be also be covered in a later Workgroup. Action 5 is being monitored until REMA is published by DESNZ. Action 6 is yet to be resolved and there has been ongoing work behind Action 7 and this will be covered in a later meeting.
- 2.3 Regarding Action 7 (how P462 interacts with government policy) a DESNZ representative provided an update to the Workgroup. They noted that the government are concerned by Balancing costs which have been high in recent years. These issues could be addressed via REMA, however, DESNZ believe it is important in principle that they do not stop work addressing rising Balancing costs in the short term and support Modification Proposal being assessed via a Workgroup. The release date of the second REMA consultation was still unknown [post-meeting note: it was issued on 12 March 2024].

3. Why a BSC Modification

The Issue

- 3.1 NGESO covered Slide 8 where they provided a recap on the issue identified where the Bid Price order is not aligned with the incremental cost to the consumer of the transactions.
- 3.2 A Workgroup member queried, whether the Workgroup were going to debate the issue rather than being taken as written, because there is counter argument to be made regarding the whole point of subsidising the units is to promote out of merit. For example, biomass unit running an expensive fuel may well be running out of merit, but that's the intention presumed from the government policy to do that.
- 3.3 A Workgroup member sought clarity on whether there was bunching of Bid Prices? Also, queried if this Modification is trying to incentivise units to operate in the BM?
- 3.4 NGESO clarified that there is a clustering behaviour as the competitive pressure leads to an undercutting of ROC units. It doesn't mean however if P462 is implemented it would stop clustering behaviour.
- 3.5 NGESO clarified that the aim is to create a market structure where units, irrespective of their subsidy are able to consider a profit and cost methodology for their Bid pricing that is aligned with the wider market and aligned between subsidy types. This is so they can compete and allow consumer costs savings through competition in the Bid Stack.
- 3.6 Another Workgroup member noted, since the Mod is about facilitating competition, is this Ofgem's responsibility. They agreed there is an issue but they did not understand why it is the BSC's job to resolve the issue. They also do not know what the specific BSC defect is, as it appears to be a tertiary level issue (stemming from the subsidy).

- 3.7 NGESO agreed that the principal consumer benefit is that you are improving competition. However, another benefit is taking transactions in the incremental consumer cost order instead of taking those transactions affected by subsidy recovery value.
- 3.8 Elexon noted that the one of the aims of the Mod is to get Generators to price their Bids based on their costs [excluding subsidy 'losses'] therefore removing clustering effects and having more of a graduation of Bid prices. However, Elexon noted that there will still be some clustering effects as any economical rational agent would try and bid in at what they expect the clearing price to be – unless forced to by the TCLC.
- 3.9 NGESO agreed to an extent, they stated that currently the point of clustering is impacted by subsidies, rather than just profit and cost recovery.
- 3.10 NGESO presented slide 9 on The Issue 'Defining terms'. NGESO covered 4 theoretical units, Unit A, Unit B, Unit C and Unit A2.
- Unit A has its Bid price split into two components: its subsidy expectation and its 'profit and cost recovery'. The profit and cost recovery should be the marginal consumer price, therefore, the Bid price with the subsidy recovery does not align with the Bid price submitted by the unit. Unit A has the lowest profit and cost recovery however the highest subsidy, therefore their Bid price is the highest. The increase in Bid price is not an incremental cost to the consumer, it's a cost that has already been incurred as a result of the subsidy regime that they are within.
 - Unit B similarly has two components but has a smaller subsidy expectation and a lower Bid price, however is able to achieve a much higher profit and cost recovery even though its Bid price is cheaper.
 - Unit C does not hold any subsidy and it is able to marginally outcompete unit B with its Bid price being all profit and cost recovery.
 - Unit A2 assumes a unit with a 'variable' subsidy amount, as the subsidy expectation could go negative and in this case it is able outcompete Unit C. The repayment obligation to LCCC is dependent actual output, therefore the repayment obligation disappears and the subsidy expectation being negative so the profit and cost recovery component being much high.
- 3.11 One Workgroup member, stated they had difficulty understanding the NGESO diagrams and requested worked examples with indicative numbers to help understand the issue. NGESO agreed to provide additional Worked examples in future sessions to aid understanding.
- 3.12 One Workgroup member, queried where existing legislation and regulations comes into play as they want to understand where the issue sits in terms of the BSC and BSC guidance. The behaviour with Bid prices is what was envisaged and was being legislated for when the subsidies were introduced. Also, what would this change affect other than just the BSC? NGESO noted that this is one to take away and to expand further as part of the Workgroup and is related to Action 5.
- 3.13 One Workgroup member queried why units in the examples would not be considered in breach of the TCLC? The wording in the TCLC in effect is about not submitting excessive Bids into the BM and not making excessive profit through the BM.
- 3.14 NGESO explained that the TCLC only applies during a constraint period, whereas the stack presented in the slides can appear at any point in time, i.e., does not need to specifically driven by a constraint to see subsidy recovery in Bid prices. Therefore, there's already a time boundary requirement on why it is a TCLC issue or not. Secondly, TCLC only applies to excessive benefits, therefore doesn't state a unit shouldn't receive a profit or recover the lost subsidy. Things such as opportunity cost on storage are reasons why you may end up with a low Bid price whilst being fully compliant with the TCLC.
- 3.15 One of the core reasons NGESO take units at the bottom of the Bid stack (even below 0) is for constraint purposes. The units that are priced negatively that don't hold a subsidy are not inherently in breach of TCLC either, it would not be fair as they have profit and cost recovery and the Bid prices is the way to reflect them. A wind unit, for example, may have a very low bid price and would be fully compliant with TCLC because of very high subsidy expectation and would expect to recovery that subsidy amount as part of its Bid pricing. Ultimately, the TCLC does have an interaction, but do not believe the issue to be covered under the TCLC directly.
- 3.16 One Workgroup member stated that it is fully legitimate for subsidised units to chase the subsidy costs. NGESO agreed and noted that the solution for this modification is that units should be 'kept whole' for any subsidy that they would expect as part of their Bid price.

- 3.17 One Workgroup member suggested that it would be complex to implement P462 from an operational standpoint. The Workgroup member noted that LCCC would need some revenue to cover the service of replaying the subsidy revenue. They would need to account for the different subsidies each unit would have e.g., ROC or CfD, and whether it is negative or positive. They queried if any analysis about the implementation and operational aspect has been done and whether this would be in the CBA.
- 3.18 NGESO explained that the CBA is part of the scope of the Workgroup and would seek Workgroup feedback on what to include. NGESO do not believe LCCC are expected to change anything under P462 as the solution would be through the Balancing and Settlement process. Elexon provided their understanding that it's the BSC Settlement process that would make that sort of separate payment of the subsidy expectation slightly separate to the Bid price. Therefore, there is some complexity as the settlement process would need to know which units have got which support mechanisms. It could be more complex with BM units that have a mix of subsidy regimes. Any complexity and costs will need to be assessed as part of this modification proposal process. Elexon initially believe that central implementation costs would be quite low in comparison to the benefits quoted in the proposal, assuming the Workgroup confirm those benefits as correct.
- 3.19 One Workgroup member asked how the proposer is defining the marginal consumer benefit. NGESO explained that this is something which they aim to do with the Workgroup.
- 3.20 There were a couple of queries from a Workgroup member. Firstly on whether a requirement is needed for bidders to not include considerations of the subsidy, or is the assumption that bidders know they'll receive it regardless, such that behaviour follows? Secondly, how would a unit know if they were going to receive the subsidy payment, regardless if they're on or off? NGESO stated that, the units shouldn't reflect the subsidy in their Bid price, the expectation being that the market is rational, i.e., the competition between units would prevent them from driving a double benefit of their subsidy through their Bid prices. Secondly, it does not change from the current format, for normal operations it is not expected that units would price in a way that would lead to them being curtailed first in the bid stack anyway.
- 3.21 Elexon elaborated further that P462's solution is relying on competition to ensure subsidy holding units do not continue to put their subsidy expectation into their Bid prices. Regarding the TCLC, it would purely stop a unit bidding in a way that allowed it to recover its subsidy twice.
- 3.22 NGESO covered slide 10, where they explained at a high level how the mapping of cash flows work.
- 3.23 One Workgroup member stated they understood it from the CfD point of view but would like NGESO to demonstrate a similar exercise for other subsidies such as ROCs and REGOs. Another Workgroup member queried if the subsidy would go through BSUoS, NGESO confirmed in the initial proposal it would still be in BSUoS. NGESO will share more cash flow maps that they can share in the following Workgroup(s).

Why a BSC Modification

- 3.24 NGESO then presented slide 11, the two key criteria for choosing a solution was based on impact and ease of delivery. The shortlisted options were firstly, option 1, a BSC Mod (P462) to explicitly pay for any lost subsidy values outside of the direct Bid price. Secondly option 2, a change to the CfD contract. Thirdly, option 3, sending a request to units to not include subsidies in their Bid price. Fourthly, option 4, NGESO take account of the subsidy payment/repayment in addition to the submitted BM price when accepting bids. NGESO concluded that option 1 (BSC Change) would be the most impactful and would be delivered in a shorter timescale than option 2 (change in CfD contract) and option 4 (NGESO accounting for subsidy when accepting bids).
- 3.25 NGESO noted that for option 2 (change in CfD contract) may only impact future CfD contracts, as opposed to current RO and CfD generators, this would result in £90million per year of cost savings for consumers up to 2030, plus could only start taking affect between 2026/2027. Option 1 (BSC Change) however, would impact all subsidy holding units and would result in £160million of cost savings per year up to 2030 and could come into effect in 2025 if approved.
- 3.26 One Workgroup member questioned why it was a BSC Modification Workgroup's responsibility to decide on £160million worth of subsidies being diverted. They understand that DESNZ may want a quicker fix for Balancing Costs to be lower, however, the role as a BSC Workgroup member is to be a technical expert and to feedback on governance of BM and imbalanced processes, not LCCC processes. They requested that it is explained as to why it is the BSC's responsibility. They reiterated feedback from the first Workgroup meeting that P462 could have been an issue group to help address where the solution should sit.

- 3.27 NGESO noted that a Panel member had requested NGESO withdraw the Modification and raise an Issue group. NGESO kept it as a modification due to the quoted consumer impact and additional delay of implementation if it were to be raised as an Issue.
- 3.28 Elexon noted that in a broad sense this is an issue about the interaction between the BM and certain policies that could be solved by changing the design of the BM. Therefore, the defect in the BM is the way it's currently designed, the information that goes to National Grid does not allow them to dispatch units in consumer cost order. Since NGESO have identified an issue and gone down the BSC route of fixing the BM via a modification proposal then that's an appropriate route to pursue.
- 3.29 One Workgroup member queried regarding option 2 (change in CfD contracts), currently the contracts say if you generate renewable energy you get paid a subsidy and if you don't, you don't get paid the subsidy which is the reason that the Bid price includes the lost subsidy element in it. Is the contract mod proposing, even if you don't get paid, your generation will pay you the subsidy? They stated that they could not envisage any contract holders objecting to the government proposing a mod that would pay more money. NGESO stated that they will take this question away and respond to this.
- 3.30 Another Workgroup member, queried the £160million quoted by NGESO, which was based on 2023 prices. They noted that 2023 was a quite exceptional time in terms of market prices and volatility. They also felt that the wording so far is quite CfD focused and it feels important to include RO units, especially due to the different way the supplier charges and consumer charges work.
- 3.31 NGESO stated they had looked at other years and that this is a persistent issue irrespective of the specific market prices. They noted that specifically the CfD component is larger when the day ahead price was persistently above the strike price of CfD assets. The £160m/year specially relates to the forward-looking benefit that was presented previously, however, different scenario analysis has been done.
- 3.32 An Ofgem representative clarified that their view is P462 aims to address a distortion in the market that is created by an interaction between the subsidy arrangements and the design of the BM. They see this as a distinct issue from TCLC as the TCLC targets behaviours of some generators during constraint periods and would not intervene in the distortion of this market design issue. Therefore, they do not see why this could not be discussed as a BSC modification proposal.
- 3.33 One Workgroup member noted that there are number of wider considerations that should be taken into account as this Modification could have far reaching consequences. Another Workgroup member agreed and stated that there is a potential showstopper with the impact on the wholesale market. For example, a wind generator looking to buy off their generation when the system is long would still need to recover their lost subsidy through the wholesale market. So they would bid at very negative level and know that cash out is going to exclude that subsidy, so they are going to wait and go long. This results in a lot more balancing on the system.
- 3.34 One workgroup member asked about the CBA and requested that the Workgroup is involved in some of the detailed parameters and development. Elexon confirmed that the CBA would be informed by the Workgroup, so it would be a joint process, an action will be to start addressing the CBA.

4. Wider Impacts

- 4.1 The Lead Analyst presented the wider impacts on slide 15 to gather further feedback from the Workgroup.
- 4.2 One workgroup member requested that the impacts were more explicit in what they mean. They stated for Flexibility and storage impacts, P462 would undermine signals for both and the wider impact being investor certainty in retrospect. They also queried if there is an EU compliance aspect to consider, for example, the clean energy package stipulates that there should be priority dispatch for renewable assets installed before a certain date.
- 4.3 Another workgroup member commented on 4,5 and 6 (Flexibility) asking if you're removing some of the costs to be recovered from generation bids, does that distort competition with demand turn up where there are no additional costs? Plus, who might themselves be out of merit, even though they are in the right place in terms of consumer costs? Are they competing on a fair and equal basis when some of the costs of curtailing generation are inverted? Another Workgroup member agreed that more clarity on Flexibility would be useful and the implications of non-subsidised generators bidding in as well.
- 4.4 Another Workgroup member asked about implications for the Co-located assets and hybrid metering that's possibly falling into CfD Allocation Round 7.

- 4.5 The Lead Analyst noted that Workgroup feedback and queries have been captured as part of the Wider Impacts to P462.

Actions

No.	Workgroup raised	Action	Owner	Due by	Status
1.	WG1	To consider ToR (m) 'Is the BSC an appropriate route to amend the issue identified in P462?' in more detail at WG2. NGESO to show other routes considered prior to raising P462. Along with their impacts. To allow Workgroup feedback on these other solutions to the issue identified as part of P462.	NGESO/Workgroup	WG2	Closed
2.	WG1	NGESO to provide a detailed list of the assumptions in the analysis presented at WG1.	NGESO	WG3	Open
3.	WG1	NGESO to present back an issues case illustrating the carbon impact of the proposal and what percentage of transactions might displace conventional units in the same settlement period (as opposed the renewable generators with support mechanisms). To consider this has a Wider Impact as per ToR (e).	NGESO	TBC	Open
4.	WG1	Review of the Wider Impacts as per ToR (e). This includes suggestions raised prior to the Workgroup. Along with issues raised from WG1. WG1 Issues raised: • Impacts on Wind curtailment • Impacts on Storage • Impacts on Flexibility markets • Impacts on the interaction between the Wholesale market and Balancing Mechanism • Potential Carbon impact (as per Action 3) • Interaction with TCLC (as per action 6)	NGESO/Workgroup	WG2	Closed
5.	WG1	To review the potential REMA impacts once the consultation is published by DESNZ	NGESO/Workgroup	TBC – After the REMA consultation is published	Open
6.	WG1	Consider if the issue identified is covered as part of TCLC.	NGESO/Workgroup	WG2	Open (Agree to close WG3)
7.	WG1	Elexon to engage with DESNZ on how P462 interacts with government policy.	Elexon	TBC	Open

8.	WG2	Present proposed Cost Benefit Analysis process to the Workgroup	Elexon	WG3	Open
9.	WG2	NGESO to present further analysis on specifically RO and REGO impacts	NGESO	WG3	Open