



Credit Committee Quarterly Report: January – March 2012

Target Audience	Credit Committee Members and BSC Parties
Date Published	5 July 2012
Purpose of paper	<p>ELEXON produces this report on the Credit Assessment Price (CAP) review process every 3 months for the Credit Committee. This particular report covers January to March 2012.</p> <p>The purpose of these reports is to assist the Credit Committee in its obligation to keep the CAP Review process under review.</p>
Summary	<p>In summary:</p> <ul style="list-style-type: none"> • A change in CAP from £59/MWh to £51/MWh was implemented on 10 January 2012. • A review was triggered immediately following the implementation of the new CAP value. The Credit Committee agreed to decrease CAP to £46/MWh, effective from 23 February 2012. • CAP underestimated outturn SBP throughout most of the Quarter.

1. Why we produce the Quarterly Report

- 1.1 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 January to March 2012). We assess the weekly trigger checks and the performance of CAP against outturn System Buy Price (SBP) and forward market prices.
- 1.2 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.

- 1.3 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/group/credit-committee-cc/>

2. An overview of the CAP process from January to March 2012

- 2.1 A new CAP value of £46/MWh was implemented on 10 January 2012 following a review in December 2011.

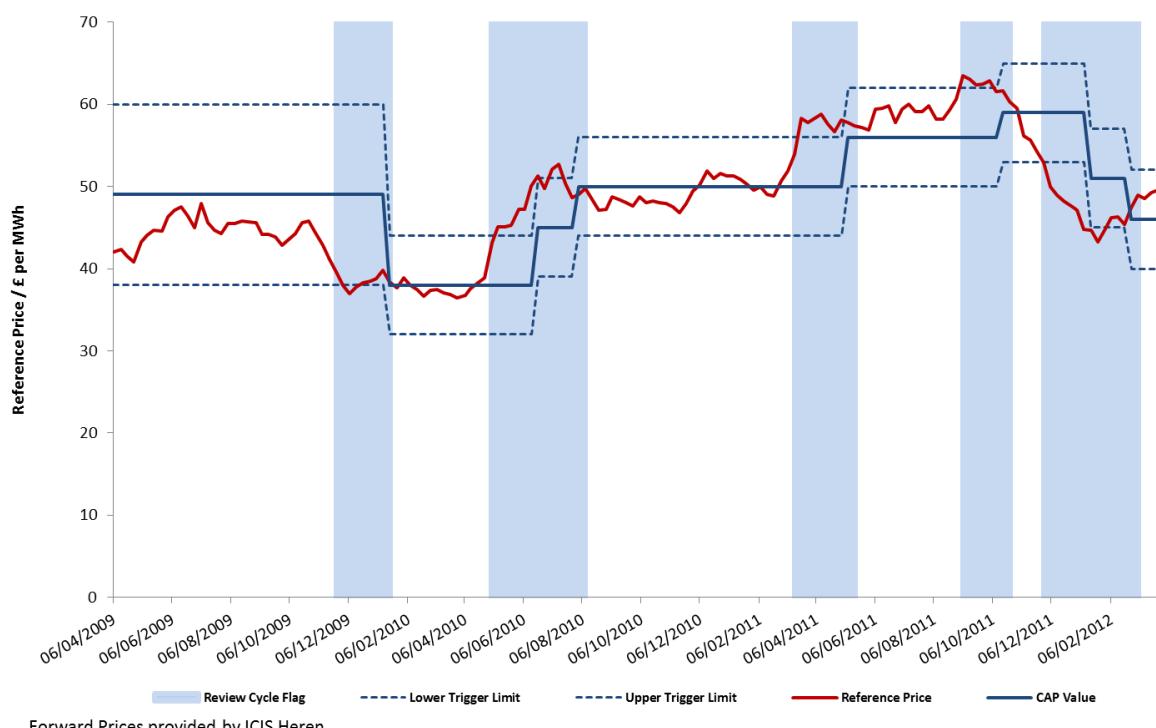
- 2.2 Another review was triggered immediately after the new value was implemented, on 16 January 2012. The Credit Committee met on 26 January 2012 and agreed to further reduce CAP to £46/MWh. The new value was implemented on 23 February 2012.
- 2.3 CAP values and reviews in Q1 2012:

Date of Trigger Breach	Effective Dates	CAP Value actually implemented	CAP Value proposed in Consultation
05/09/2011	12/10/2011 to 09/01/2012	£59/MWh	£59/MWh
28/11/2011	10/01/2012 to 22/02/2012	£51/MWh	£52/MWh
16/01/2012	23/02/2012 onwards	£46/MWh	£47/MWh

3. Detailed Analysis

- 3.1 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. From 10 January 2012, CAP was set at £46/MWh, with a trigger level of +/-£6; i.e. a review would have been triggered if the reference price fell outside of a band £40/MWh - £52/MWh.

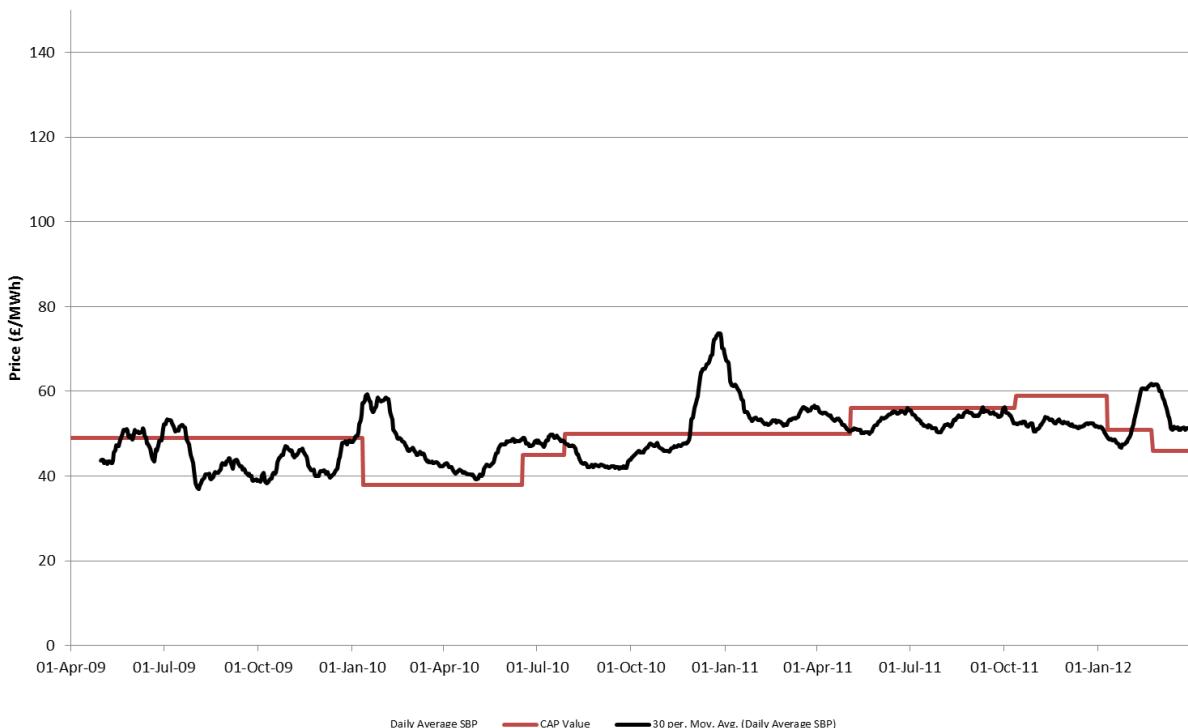
Graph 1: Reference Price and CAP

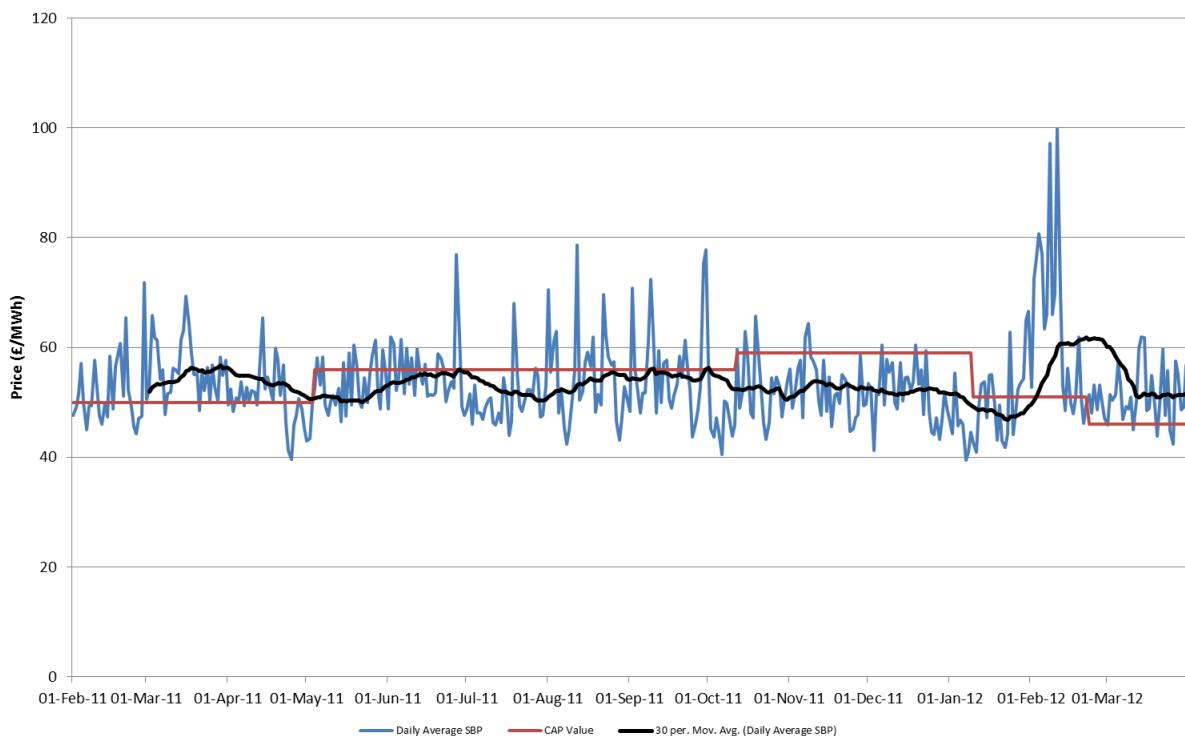




- 3.2 Graph 1 shows the variation in the reference price and the CAP value over the last 3 years (the process was started in October 2007). The graph also shows the upper and lower trigger levels, and the blue shaded areas indicate periods when the CAP value was under review.
- 3.3 On 16 January 2012, following the implementation of the new value, the reference price was £44.65, so another review was triggered.
- 3.4 The graph shows that the reference price then began to increase, and continued to do so across the Quarter from £44.81/MWh at the time of the new CAP value being implemented to £49.55/MWh at the end of the Quarter. At the time of writing, the price remains around this level.
- 3.5 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 last three years, 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



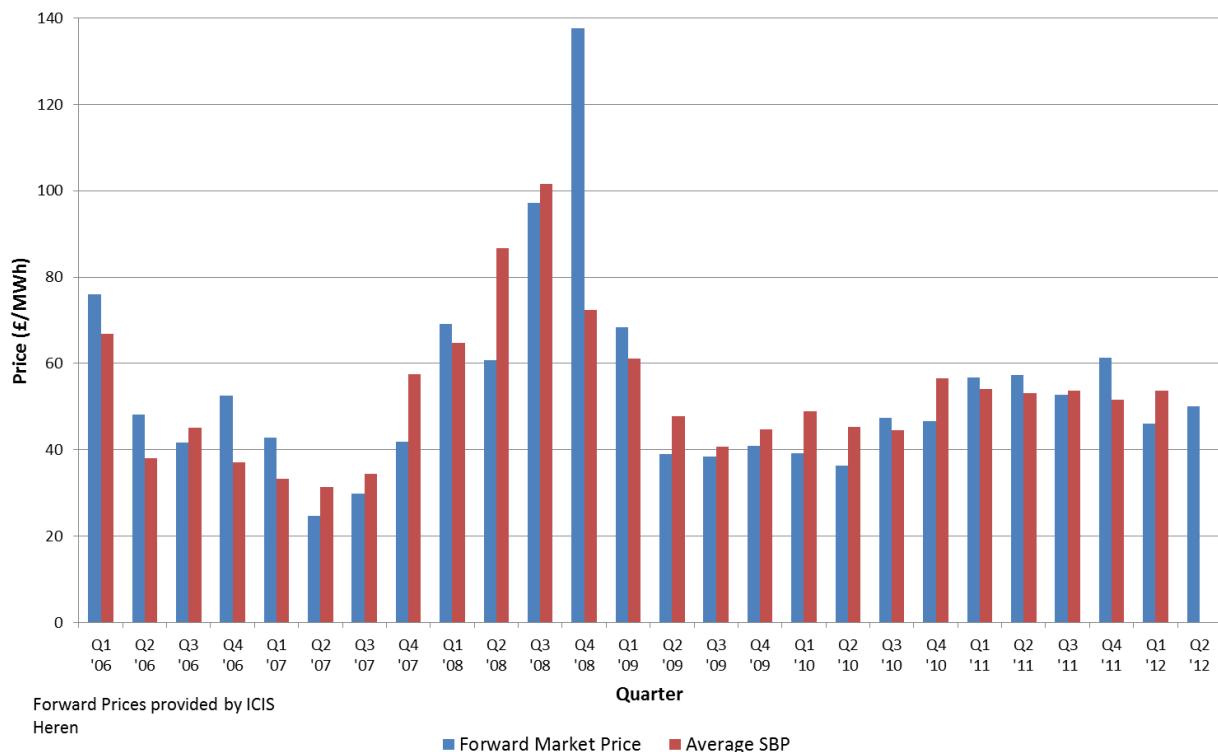
Graph 2: Daily Average System Buy Price and CAP

- 3.6 The graphs show that the £51/MWh CAP value implemented on 10 January was initially an over-estimate of SBP, and therefore the reduction following the trigger event was appropriate. However, immediately following the Credit Committee's meeting, a very cold period of weather caused a large spike in SBP during February. Following the cold period, prices returned to a more stable level, averaging £51.51 across March. The overall average for the Quarter was £53.64.

	January 2012	February 2012	March 2012
Average Outturn SBP	£49.18	£60.62	£51.51
Average Outturn SBP - CAP	-£1.82*	£9.62*	£5.51

*£51/MWh value

- 3.7 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

- 3.8 The forward price was an under-estimate of the average SBP for the Quarter. As previously mentioned, this was mainly due to a spike in SBP caused by cold weather in late January – early February.

4. Looking Forward

- 4.1 Throughout most of Q2, the reference price is based on a mix of Q3 and Q4 2012 prices. During the Quarter, Q4 prices dropped so that they were a similar level to Q3, and therefore no reviews were triggered.

5. Conclusions

- A change in CAP from £59/MWh to £51/MWh was implemented on 10 January 2012.
- A review was triggered immediately following the implementation of the new CAP value. The Credit Committee agreed to decrease CAP to £46/MWh, effective from 23 February 2012.
- CAP underestimated outturn SBP throughout most of the Quarter.

For more information, please contact:

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