

By email to: Leonardo.Costa@ofgem.gov.uk

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Dear Leonardo,

Derogation Request from Article 55 of the European Electricity Balancing Guideline

This letter constitutes a formal derogation request to the Authority, in accordance with Article 62 of the Commission Regulation (EU) 2017/2195 establishing a guideline on electricity balancing (EB GL).

As the third party assigned the EB GL Article 55 obligation to calculate imbalance prices in the manner specified in that Article, we are seeking derogation from the requirements of paragraphs 4 and 5 of Article 55.

We are requesting that the derogation period commences on the day of application of paragraphs 4 and 5 of Article 55 and continues until the earlier of:


- two years after such day of application; or
- the Authority approved implementation date of a Balancing and Settlement Code (BSC) Modification for the purpose of implementing the harmonised imbalance price proposals pursuant to EB GL Article 52.

We believe that receiving such derogation would allow ELEXON to more efficiently implement the full range of obligations deriving from the EB GL, providing savings in the region of £1.3 million to consumers.

Full details are given in the two appendices to this letter.

If the Authority determines that it requires further information to adopt a decision concerning this request, then please let us know and we shall endeavour to provide the requested information to you as quickly as possible so as not to unduly delay the Authority's decision.

Yours sincerely,



Mark Bygraves
Chief Executive

List of enclosures

Appendix 1: Formal request for derogation from EB GL Article 55

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APPENDIX 1: FORMAL REQUEST FOR DEROGATION FROM EB GL ARTICLE 55

1. Our ability to request a derogation

- 1.1 EB GL Article 13(5) states that “in the event that tasks and obligations are assigned to a third party by a Member State, or a regulatory authority, references to Transmission System Operators (TSOs) in this Regulation shall be understood as referring to the assigned entity in respect of the assigned tasks and obligations”.
- 1.2 ELEXON Limited has been assigned by the Department of Business, Energy and Industrial Strategy (BEIS) the tasks and obligations required by EB GL Article 55 (Imbalance Price).
- 1.3 EB GL Article 62 (2)(e) states that “A TSO may request a derogation from.....the implementation of the requirements pursuant to Articles 45, ...55, ...and 57.”
- 1.4 Therefore we believe that ELEXON Limited is enabled through assignment to request derogation from the Authority in respect of the requirements of Article 55.

2. Our request for a derogation from the requirements of Article 55

- 2.1 EB GL Article 62(4) requires that the request for derogation shall be filed with the relevant regulatory authority “at the latest six months prior to the day of application of the provisions from which the derogation is requested”.
- 2.2 Our request is for derogation to apply from the day on which Article 55 would otherwise apply which, pursuant to EB GL Article 65(2) would be one year after entry into force of the EB GL. This request is being submitted at least six months prior to this date, so we believe that this request complies with the Article 62(4) deadline.
- 2.3 EB GL Article 62(5) sets out a list of what a request for derogation must contain and we address each of these required points below.

3. The provisions from which a derogation is requested

- 3.1 EB GL Article 62(5)(a) requires that a derogation request must include the provisions from which a derogation is requested.
- 3.2 With this request we are seeking derogation from the requirements of EB GL Article 55 paragraphs 4(a), 4(b), 5(a) and 5(b).

4. The requested derogation period

- 4.1 EB GL Article 62(5)(b) requires that a derogation request must include the requested derogation period.
- 4.2 We are requesting that the derogation period commences on the day of application of paragraphs 4 and 5 of Article 55 and continues until the earlier of:
 - two years after such day of application; or
 - until the Authority approved implementation date of a BSC Modification for the purpose of implementing the harmonised imbalance price proposals pursuant to EB GL Article 52.
- 4.3 In requesting this we have taken note of the fact that under EB GL Article 65(9) the Authority cannot grant derogation from the requirements of Article 55 for a period of longer than two years.

4.4 However, we currently believe that both periods set out in paragraph 4.2 above will be approximately equal in time and equivalent to asking that the derogated provisions apply from three years after entry into force of the EB GL. See also Section 6 below.

5. The required detailed plan and timeline to ensure implementation of the derogated provisions after expiry of the derogation period

5.1 EB GL Article 62(5)(c) requires that a derogation request must include “a detailed plan and timeline specifying how to address and ensure the implementation of the concerned provisions of this Regulation after expiration of the derogation period”.

5.2 Our compliance with the EB GL is planned via the BSC Modification process. Our detailed plan and timeline is set out in the Proposed Progression Timetable below.

Proposed Progression Timetable	
Event	Date
EB GL Entry into Force (EIF)	18 Dec 17
TSO make Article 52 proposal for harmonisation of imbalance settlement (EIF+1 year)	Dec 18
National Regulatory Authorities’ (NRAs) approval assumed EIF + 18 months	Jun 19
BSC Modification for Articles 52 and 55 raised (EIF +18 months)	Jun 19
Present Initial Written Assessment to Panel	10 Jul 19
Workgroup Meetings (4 months) <ul style="list-style-type: none"> Phase 1: Article 55 requirements Phase 2: Article 52 requirements 	29 Jul 19 – 30 Nov 19
Assessment Procedure Consultation (15 WD)	2 Dec 19 – 20 Dec 19
Workgroup Meeting	W/B 13 Jan 20
Present Assessment Report to Panel	13 Feb 20 ¹
Report Phase Consultation (15 WD)	17 Feb 20 – 6 Mar 20
Present Draft Modification Report to Panel	12 Mar 20
Issue Final Modification Report to Authority	13 Mar 20
Awaiting Authority Decision (25 WD)	16 Mar – 17 Apr
System design and development (6 months)	May 20 – Oct 20

¹ This is an assumed date. The timetable for 2020 is not available, and is subject to Panel approval by the BSC Change process.

Proposed Progression Timetable	
Event	Date
BSC Modification for Article 52 and 55 implemented in November 2020 BSC Systems Release	4 Nov 20
Article 52 and 55 implementation deadline (EIF +3 years)	18 Dec 20

- 5.3 Key milestones in the timeline: EB GL EIF; Article 52 proposal for harmonisation of imbalance settlement (EIF+1 year); NRAs' approval assumed EIF +18 months; BSC Modification for Articles 52 and 55 raised (EIF +18 months); BSC Modifications implemented on or before Article 52 and 55 implementation deadline (EIF +3 years).
- 5.4 However, in summary, we would seek for a BSC Modification proposal to be raised in mid-2019 to ensure that the BSC is compliant with the provisions of the EB GL by the end of the derogation period, if granted.

6. Assessment of the consequences of the requested derogation on adjacent markets

- 6.1 EB GL Article 62(5)(d) requires that a derogation request must include "an assessment of the consequences of requested derogation on adjacent markets".
- 6.2 EB GL Article 52(4) states that "the proposal pursuant to paragraph 2 shall provide an implementation date no later than eighteen months after approval by all regulatory authorities in accordance with Article 5(2)".
- 6.3 Under, what we believe to be, reasonable assumptions as to timings for TSOs to make the proposal (one year) and for regulatory authorities to approve it (six months), we would expect that the implementation of the approved harmonisation of imbalance price would then take place approximately three years after entry into force of the EB GL.
- 6.4 Given that such harmonisation will not take place until approximately three years after entry into force, there will be no harmonisation before that time and therefore any non-compliances with Article 55 will not, in our view, have any significant impacts on adjacent markets, in particular trades with those markets.
- 6.5 Indeed the requirements of Article 55 if derogated as requested would apply from the same point in time as the wider harmonisation changes. We consider this in more detail in section 7 below.
- 6.6 Further, our best estimates² of the current compliance position for Great Britain (GB) would historically place the GB imbalance price in breach for approximately 0.02% of Settlement Periods, with a maximum deviation of £6.82/MW and an average deviation of £2.88/MW. Therefore, notwithstanding the above, if there were any consequences of this derogation from non-compliance with Article 55 they would only affect a tiny proportion of Settlement Periods and with a low materiality.

² As described in Appendix 2

7. Assessment of the possible risks for the integration of balancing markets across Europe caused by the requested derogation

- 7.1 EB GL Article 62(5)(e) requires that a derogation request must include “an assessment of the possible risks for the integration of balancing markets across Europe caused by the requested derogation”.
- 7.2 The proposed derogation is for a delay to the interim changes to imbalance price, required by Article 55 one year after entry into force. These interim changes would, without the derogation, be required before full harmonisation is required by Article 52, or likely to be achieved. We estimate full harmonisation will be achieved approximately two years later based on the requirements of Article 52.
- 7.3 The changes being derogated are to the imbalance price, and not directly to the balancing markets themselves. In theory, different formulations of imbalance price in different parts of the European Union (EU) could impact the ordering of bids in the common merit order lists. This depends on the extent to which Balancing Service Providers believe they need to take account of any imbalance price exposure in their bids. However because full harmonisation of imbalance price formulations will not be achieved until the end of, or after, the requested derogation period, we anticipate the effects of the derogation, if granted, on the integration of balancing markets across Europe will not be significant.
- 7.4 The harmonisation required by Article 52 is not enabled or lessened in any particular way by any work to achieve compliance with Article 55. Article 52 requires the harmonisation of the main components used for the calculation of the imbalance price for all imbalances pursuant to Article 55. Compliance with Article 55 could be achieved in such a way as to make no progress towards the harmonisation of these components. We do not know how these components may be harmonised in the future.
- 7.5 The future integration of balancing markets is a driving factor for requesting this derogation, as the requirement will likely revisit and supersede any work carried out towards ensuring compliance with Article 55. We believe that the future requirement for integration places significant risk of wasted and/or duplicated effort and the more efficient outcome would be deferral of this compliance work until harmonisation is required.
- 7.6 The impact of the changes currently believed to be necessary to be compliant with Article 55 will have a very low materiality, but at high cost. We believe the materiality of those changes to be so low as to not contribute towards harmonisation.
- 7.7 Work on the implementation of the Trans-European Replacement Reserve Exchange (Project TERRE) and Manually Activated Reserves Initiative (MARI) will continue as planned regardless of the decision on this derogation. We believe these projects are critical for the integration of balancing markets across Europe.

8. Reasoned and further information in support of the derogation request

- 8.1 EB GL Article 62(3) requires that “the derogation process shall be transparent, non-discriminatory, non-biased, well-documented and based upon a reasoned request”.
- 8.2 To support the latter two points of being “well-documented” and “based upon a reasoned request”, we set out our detailed reasons for the derogation request in the following sections.

9. Is the BSC already compliant with EB GL Article 55?

- 9.1 We are aware that there could be different interpretations of how Article 55 can be applied in the GB electricity market context.
- 9.2 However based on the interpretation of Article 55 by the P360 Workgroup it is our belief that the current BSC (as at the date of this request) is not fully compliant with the requirements of EB GL Article 55. We look at this in detail, paragraph by paragraph below.

Articles 55(1) and 55(3)

- 9.3 Paragraphs (1) and (3) of EB GL Article 55 both require that the TSO calculates the imbalance price. Paragraph (1) sets the sign convention to be used.
- 9.4 ELEXON has been assigned the task and obligation of calculating the imbalance price pursuant to Article 55, and the sign convention matches the current one in the BSC. So we see no current need for derogation of these paragraphs and have not requested any.

Articles 55(4)(b) and 55(5)(b)

- 9.5 Paragraph (2) of EB GL Article 55 requires that the rules “shall include a definition of the value of avoided activation of balancing energy from frequency restoration reserves or replacement reserves”.
- 9.6 Paragraphs (4)(b) and (5)(b) rely on this value when there are no activations of balancing energy in either direction, so the BSC cannot currently be compliant with these two paragraphs either given that this value is as yet undefined.
- 9.7 It is the belief of the BSC Modification P360 ‘Making the BSC’s imbalance price compliant with the European Balancing Guideline’ Workgroup that the BSC would become compliant if the value is set to equal the Market Index Price as currently defined in the BSC.

Articles 55(4)(a) and 55(5)(a)

- 9.8 We recognise that there are different potential interpretations of the requirements set out in these paragraphs when applied in the GB BSC context some of which could lead to the conclusion that the current BSC is compliant. However:
- this is not our view and we believe that the current BSC is not compliant with these EB GL requirements for the reasons given in our analysis, set out in Appendix 2 below; and
 - we believe that the most appropriate way to test the correct interpretation of the EB GL in this case is to raise a BSC Modification proposal as was done in September 2017. Should the Modification Working Group and/or BSC Panel conclude that the current BSC is compliant and the Authority agree, then the Modification solution would not address these paragraphs, but at the current time we are of the view that the BSC is not compliant with Articles 55(4)(a) and 55(5)(a).
 - We believe that a definitive view on compliance is extremely challenging given a number of dependencies and uncertainties, not least the definition of which products and services fall within the categories of frequency restoration reserves (FRR) and replacement reserves (RR). Our understanding is that this does not need to be finalised until August 2018, according to the System Operator Guidelines. A change in the assumed product mapping at such time would create significant risk of non-compliance despite best possible efforts.

Article 55(6)

9.9 Article 55(6) requires the imbalance price is calculated according to at least one of the rules ('principles') in 4(a), 4(b), 5(a) or 5(b) where both positive and negative RR has been activated.

9.10 We believe that the wording 'at least' implies more than one of these rules can be used, facilitating the implementation of dual imbalance pricing where relevant.

9.11 As Net Imbalance Volume (NIV) tagging is taken to be system management (as it is currently defined) rather than balancing energy, there is no situation where positive and negative balancing energy is activated in the same Settlement Period.

9.12 Therefore, the P360 Workgroup believe that the BSC is compliant with Article 55(6).

10. Additional Information in support of the requirements of EB GL Article 62(8)

10.1 EB GL Article 62(8) requires the relevant regulatory authority to consider the following aspects in assessing this request for derogation. While clearly this is for the Authority to determine, we believe it would be helpful to you to set out our thoughts on these aspects.

11. Difficulties related to the implementation of the concerned provisions

11.1 EB GL Article 63(8)(a) requires the Authority, when assessing a derogation request such as this, to consider "the difficulties related to the implementation of the concerned provision or provisions".

11.2 National Grid raised BSC Modification P360 'Making the BSC's imbalance price compliant with the European Balancing Guideline' in September 2017 to ensure, subject to the Authority's approval, BSC compliance with EB GL Article 55 within the legal deadline.

11.3 While the P360 is progressed on a best endeavours basis to achieve compliance prior to the deadline, given the complexities of the potential solution and the time required to implement it, it was noted that there is a significant risk to implementation in time for compliance. Even on a best endeavours basis we believe it is unlikely we will achieve compliance by the deadline.

11.4 The timescales required to implement a solution in time for the compliance deadline have not allowed for any contingency, nor have they considered the time and expertise requirements of the service providers utilised for the delivery of other European Harmonisation obligations and projects (particularly P344 'Project TERRE implementation into GB market arrangements'). This was highlighted when P360 was raised.

12. Risks and implications of the concerned provisions in terms of operational security

12.1 EB GL Article 63(8)(b) requires the Authority, when assessing a derogation request such as this, to consider "the risks and implications of the concerned provision or provisions, in terms of operational security".

12.2 In response, ELEXON does not foresee any risks and implications, in terms of operational security, of derogating the concerned Article 55 provisions.

13. Actions taken to facilitate the implementation of the concerned provisions

13.1 EB GL Article 63(8)(c) requires the Authority, when assessing a derogation request such as this, to consider "the actions taken to facilitate the implementation of the concerned provision or provisions".

13.2 The actions taken to date are described in section 11 above.

13.3 We have taken these actions on a best endeavours basis in order to achieve compliance as soon as possible. We have maintained throughout that the provision of derogation constitutes the most efficient outcome. However, in order to minimise the risk and duration of any non-compliance in the event derogation is not forthcoming we have proceeded on the basis described.

14. Impacts of non-implementation on non-discrimination and competition with other European market participants

14.1 EB GL Article 63(8)(d) requires the Authority, when assessing a derogation request such as this, to consider “the impacts of non-implementation of the concerned provision or provisions, in terms of non-discrimination and competition with other European market participants, in particular as regards demand response and renewable energy sources”.

14.2 As previously noted above, this derogation, if granted, will not delay or impact the cross European harmonisation of imbalance prices required by Article 52 of the EB GL. Therefore it will not discriminate against other European market participants, in the sense that other European market participants may be participating in many European markets all of whose imbalance price formulations may differ from the eventual EU harmonisation requirements.

14.3 The BSC does not distinguish, and the BSC Panel and ELEXON are required by BSC paragraphs B1.2.1(c) and C1.3.1 respectively to give effect to the BSC “without undue discrimination”, between Parties or classes of Party.

14.4 As a result, the imbalance price applies equally to all market participants, European or otherwise, regardless of whether or not it is calculated in accordance with the principles of Article 55.

14.5 Based on our current interpretation of the compliance position, the imbalance price would have been non-compliant with Article 55 for six Settlement Periods in a 20 month period. This means that even in the event any individual non-compliance did impact on non-discrimination and competition, they would occur very infrequently.

14.6 The BSC does not discriminate between:

- BSC Parties based in GB and BSC Parties based elsewhere in Europe;
- Demand Response and other Balancing Services settled within the scope of the BSC (currently Bid/Offer Acceptances in the GB Balancing Mechanism); or
- Renewable and non-Renewable energy sources provided by BSC Parties.

14.7 In summary we do not expect any impacts of a delayed implementation of the requirements of Article 55 paragraphs 4 and 5 to have any impacts on non-discrimination and competition with other European market participants, in particular as regards demand response and renewable energy sources.

15. Impacts on overall economic efficiency and smart grid infrastructure

15.1 EB GL Article 63(8)(e) requires the Authority, when assessing a derogation request such as this, to consider “the impacts on overall economic efficiency and smart grid infrastructure”.

15.2 We believe that the current BSC is not compliant with Article 55 paragraphs 4 and 5. Included within the analysis of this non-compliance set out in Appendix 2 below, is our assessment of the materiality of this non-compliance based on historic data. This analysis may aid the Authority’s consideration of the impact of the derogation, if granted, on overall economic efficiency during the derogated period.

- 15.3 We do not foresee any impact between a delay to the changes in imbalance price calculation required by EB GL Article 55 and smart grid infrastructure.
- 15.4 The cost to design, build and implement a solution to ensure compliance with Article 55 paragraphs 4(a) and 5(a) is anticipated to be in the region of £1.3 million, based on the cost of previous similar changes. The EB GL requires further harmonisation in the two years following that implementation. The work required for further harmonisation is likely to impact on the same calculations as would be impacted by reaching compliance within the Article 55 compliance deadline. This would result in double charging for consumers.
- 15.5 We believe that given the high likelihood of further changes being required as part of harmonisation, the most efficient outcome is for derogation of the Article 55 requirements until the deadline for harmonisation.

16. Impacts on other scheduling areas and on market integration

- 16.1 EB GL Article 63(8)(f) requires the Authority, when assessing a derogation request such as this, to consider "the impacts on other scheduling areas and overall consequences on the European market integration process".
- 16.2 Harmonisation of the calculation of imbalance prices is not formally required until considered and approved pursuant to EB GL Article 52 and, as previously noted, we do not expect the requested derogation to delay this harmonisation in GB. Indeed the derogation is intended to allow for a single comprehensive change to the imbalance price to meet the requirements of both Articles 52 and 55 simultaneously.
- 16.3 Therefore, we expect no impacts from this derogation, if granted, on other scheduling areas and no adverse consequences for the European market integration process.

APPENDIX 2: ELEXON'S ANALYSIS OF BSC COMPLIANCE WITH THE EB GL ARTICLES 55(4), (5) AND (6)

We have analysed the System (imbalance) Price over 29,711 Settlement Periods for the period 6 November 2015 to 16 July 2017.

The live System Price, and the System Price calculated under the (approved but yet to be implemented) future November 2018 rules were assessed against weighted average thresholds taken from Article 55 of the EB GL.

The thresholds calculated were based on the interpretation of the requirements of Article 55 by the P360 Workgroup. There is no scenario that we have assessed that has 100% compliance with Article 55 for either the live or November 2018 System Price.

Assumptions

Article 55 gives thresholds for allowed values of Imbalance Prices. These thresholds are calculated from the value of (or value of avoided) FRR and RR.

How FRR and RR are to be translated into quantities that are measurable in the GB System Price calculation has not yet been defined. However, Article 55 specifies that these thresholds must be based on activated balancing energy. This excludes any energy used for system management cannot feed into the thresholds.

Information that currently exists within the pricing calculation includes the following list. We have added rationale as to whether we consider each item RR, FRR or other and whether it constitutes activated balancing energy or system management:

- Balancing Action Details
 - Price and Volume
 - Bids and Offers
 - BOAs meet the requirements for FRR products therefore are considered to be FRR and activated balancing energy, unless modified in some way by flags or tags, and therefore contribute to thresholds.
 - Balancing Service Adjustment Data (BSAD)
 - ELEXON considers that the majority of BSAD data components comprise of RR or FRR or neither and is mainly activated balancing energy, unless modified in some way (e.g. SO flag). There are some BSAD products which are not RR or FRR and therefore should not contribute to the threshold. ELEXON does not hold the data at a disaggregated level.
 - System Operator (SO) Flag
 - This flag is applied to Bids and Offers when the product has been used for system management instead of energy balancing. SO Flagged BOAs are therefore not energy balancing and do not contribute to thresholds.
 - Continuous Acceptance Duration Limit (CADL) Flag
 - This flag is applied to Bids and Offers where the acceptance duration is less than 15 minutes. These actions are flagged as the energy imbalance position is determined over a full imbalance Settlement Period but CADL flagged actions

contribute for less than half of that period. We therefore believe these are system management actions.

- Short Term Operating Reserve (STOR) Flag
 - STOR products are considered to be RR unless modified in some way by flags or tags.
- Stage 1 flagged actions
 - Stage 1 flagged actions are flagged according to one of the categories above and should be treated consistently
- Stage 2 flagged actions
 - Stage 2 flagged actions are flagged according to one of the categories above and should be treated consistently
- Repriced flagged actions
 - Actions which are flagged can be repriced and re-enter the bid-offer stack, if they are within the merit order of accepted BOAs. These actions are treated as energy balancing as they would have been taken for energy balancing reasons if they weren't taken for system management reasons.
- Arbitrage tagged volumes
 - Arbitrage tagged volumes are actions which make no net contribution to energy balancing as the net energy contribution is always 0. We therefore believe these are system management actions.
- De-Minimis Acceptance Threshold (DMAT) tagged volumes
 - DMAT tagged volumes are volumes deemed too small to materially contribute to Settlement. The original rationale was to address system rounding errors. We therefore believe these are system management actions.
- Net Imbalance Volume (NIV) tagged volumes
 - NIV tagging aims to determine whether the system was long or short energy over an imbalance Settlement Period and therefore whether the System Buy Price (SBP) or System Sell Price (SSP) should be used. This is to facilitate a single imbalance price. The aim of NIV tagging is to remove actions which did not contribute to energy balancing over the Settlement Period, and we therefore believe these are system management actions.
- Price Average Reference (PAR) tagged volumes
 - PAR tagging aims to ensure the most expensive energy balancing actions feed into the imbalance price calculation, ensuring it is a sufficient incentive for parties to remain balance. We therefore believe these are energy balancing actions unless modified.
- Replacement Price Market Index Price (MIP)
- Reserve Scarcity Price (RSP)
 - Replacement Price, Market Index Price and Reserve Scarcity Price are all used as prices for existing actions, and therefore do not impact on whether an action is considered energy balancing or system management.

In addition to the above list, TERRE and MARI will introduce RR and FRR products into the imbalance price and will also contribute to the thresholds.

To calculate the Article 55 required threshold for each Settlement Period, a weighted average is determined for the actions that meet the FRR and RR criteria above.

Defaulting price

Where no activation of balancing energy has occurred in either direction, to comply with the thresholds in detailed in EB GL Article 55 paragraphs 4(b) and 5(b), a single Imbalance Price must equal the value of the avoided activation of balancing energy from FRR or RR. The current price used for defaulting scenarios is the MIP.

The MIP reflects the price of wholesale electricity in GB for delivery in respect of the Settlement Period in the short term market. The rationale behind using the MIP is that the MIP is the price parties could expect to pay had they traded their imbalance volumes in advance of the Settlement Period. This does not necessarily imply it is the value of avoided activation from FRR and RR so this will need to be confirmed or alternative formulation for the value of avoided activation defined in the BSC.

Non-Compliance

A Workgroup was raised to determine ELEXON's compliance position. The elements above have been agreed by the workgroup.

In the best-estimate non-compliance scenario, six Settlement Periods are affected. This represents 0.02% of the Settlement Periods in the sample. The largest difference in outturn and threshold prices is £6.82, with the average absolute price difference across the six Settlement Periods is £2.88.