

**Proposed Revisions to the Balancing Services Adjustment Data
Methodology Statement**

**Incorporation of Revised Standing Reserve Weighting Factors and
Clarification of the Treatment of Supplemental Standing Reserve**

**A Report by National Grid
January 2007**

Overview

National Grid pays option fees for the availability of Standing Reserve (SR) and Supplemental Standing Reserve (SSR). The option costs are allocated to each Settlement Period according to the weighting factors derived from historical utilisation of the Standing Reserve. These costs feed into imbalance prices via the BSAD variable BPA.

The current Standing Reserve weighting factors correspond to the historical utilisation of Standing Reserve in 2002-03. Since then, the Standing Reserve utilisation pattern has continued to develop in line with changes in the market and the weighting factors could be changed to better reflect current utilisation patterns.

The current BSAD Methodology Statement describes how the weighting factors are applied to the Standing Reserve availability costs and how the weighted costs are used in the calculation BPA. However, it does not explicitly state how the availability fees associated with SSR are treated in the BPA.

Both of the points described above have become more material to the calculation of BPA due to the increased volume of SSR procured for this winter, 2006/07, compared to winter 2005/06. Therefore, National Grid is proposing to:

- Update the weighting factors applied to both SR and SSR to use the latest values, and
- Clarify the treatment of SSR within the calculation of BPA.

The changes proposed above are intended as an interim arrangement to cover the period up to the end of March 2007. National Grid will be bringing forward enduring proposals for the management of weighting factors in January 2007. National Grid believes that these interim improvements for the remainder of winter 2006/07 will improve the cost reflectivity of the System Buy Price (SBP).

Summary

This document has been prepared and submitted to the Authority in accordance with Standard Condition 16 of NGET's Transmission Licence. It reports upon the outcome of the recent consultation process undertaken by

National Grid with Industry Parties in relation to proposed changes to the BSAD Methodology Statement. The changes consulted upon covered:

- Update of the weighting factors applied to both SR and SSR to use the latest values, and;
- Clarification of the treatment of SSR within the calculation of BPA.

The consultation period was 28 days in accordance with Standard Condition 16 of NGET's Transmission Licence.

A change-marked copy of the current BSAD Methodology Statement version 4.0 is attached to this report in Appendix B. The changes contained in this Appendix reflect all of the changes that were consulted upon. Following industry consultation, National Grid has provided further clarity regarding the SSR volume in the BPA calculation, and a revised change-marked copy of the current BSAD Methodology Statement version 4.0 is attached to this report in Appendix D.

Following the consultation, National Grid recommends that the Authority approves the version of the BSAD Methodology Statement in Appendix D. If the Authority does not approve the proposed changes in Appendix D, National Grid recommends that the Authority approves the version of the BSAD Methodology Statement in Appendix B. Subject to the approval by the Authority, the proposed changes will become effective from 22nd January 2007.

Appendices

The attachments to this Report are detailed below:

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| Appendix A | Copy of the consultation document, published by National Grid on 11 December 2006. |
| Appendix B | Change marked version of the BSAD Methodology Statement with all amendments highlighted. |
| Appendix C | Copies of the responses received to the consultation. |
| Appendix D | Change marked version of the BSAD Methodology Statement with all amendments highlighted, including further clarification for inclusion of the SSR volume in the BPA calculation. |

Representations Received

Four responses to the consultation were received from:

Centrica
EDF Energy
RWE Trading
E.ON UK

Copies of the responses to the consultation are attached to this report and can be found in Appendix C.

Summary of Responses Received

All four respondents supported the proposed changes.

An overview of the responses received is contained in the following table.

Company	Supportive of proposed changes?	Comments
Centrica	Yes	<ul style="list-style-type: none"> • May have been more reasonable to make any changes during a period of lower price volatility than in mid-winter; • Use of two-year (rather than one-year) historical data may lead to a more accurate profile and may mitigate against an unrepresentative year; • Not clear whether 6 November 2006 is a 'typical' day from which general conclusions can be drawn.
EDF Energy	Yes	<ul style="list-style-type: none"> • In the longer term, removing weighting factors from the BSAD Methodology Statement would allow National Grid too much flexibility in the allocation of option fees, which should be subject to Ofgem/industry scrutiny; • Improve general market transparency via full disaggregation of BSAD data.
RWE Trading	Yes	<ul style="list-style-type: none"> • Proposed changes overdue, and it is disappointing that NGET did not take the opportunity to update the relevant utilisation periods through the annual review process; • The proposed weighting factor for Settlement Period 31 appears to be set to zero. RWE would expect an appropriate weighting factor in this Settlement Period if costs have been incurred.
E.ON UK	Yes	<ul style="list-style-type: none"> • Cautious of concluding too much from a single day's analysis; • Concerned if weighting factors change too frequently; need to strike a balance between stability and cost-reflectivity.

The issues raised by the respondents can be broadly categorised as follows:

- Timing of consultation
- Historical data on reserve utilisation
- Analysis
- Other comments

National Grid's views on the issues raised by the respondents are provided below:

Timing of consultation

In its June 2006 consultation on the BM Start Up service, National Grid had stated that it would bring forward further proposals on the seasonal reserve procurement. National Grid had intended to revise the weighting factors and consult upon these as part of the proposals on the seasonal procurement of reserve. However, in early November 2006, it became apparent that a combination of the increased volume of SSR procured for the current (2006-07) winter and the use of 2002-03 weighting factors for the period 29 October

– 5 February had resulted in a material effect on the calculation of the BPA. Consequently, National Grid brought forward interim proposals to resolve this issue as soon as possible.

As stated in the December 2006 consultation, National Grid will bring forward enduring proposals for the management of the weighting factors before the end of January 2007.

Historical data on reserve utilisation

National Grid has updated the weighting factors using the 2005-06 data on historical utilisation of standing reserve. The main reason for using the previous year's data is to ensure that the resulting weighting factors are consistent with the current year's availability windows. This consistency ensures that the option fees are better reflected in appropriate settlement periods, thus resulting in a more cost-reflective BPA.

If the weighting factors are based on, say, the last two years' data, the resulting 'average' profiles may mitigate against an unrepresentative year, as has been pointed out by one respondent. However, National Grid believes that this could adversely affect the cost-reflectivity in the calculation of BPA. On balance, National Grid is of the view that it is more appropriate to use the most recent data from a single year, and that aggregating reserve utilisation across a season will be sufficient to smooth out any unrepresentative days.

One respondent commented that, despite procurement of SSR for Settlement Period 31 in the period 29 October – 5 February, the weighting factor appears to be set to zero and suggested that an appropriate weighting factor should be applied to the costs incurred in this Settlement Period. National Grid believes that this apparent discrepancy is due to the time lag between the setting of the forward-looking availability windows to which the option fees are allocated and the historical data from which the weighting factors are derived. In National Grid's view, the option fees can only be allocated precisely ex-post when both the option fees and the actual utilisation are known. However, ex-post cost allocation would adversely affect prompt pricing which would not be possible under an ex-post allocation methodology. National Grid therefore concludes that the current cost allocation approach, whilst not perfect, is an appropriate compromise between cost reflectivity and firm market signals.

Analysis

National Grid has carried out the analysis which demonstrates how the BPA calculation could be improved for the current winter, particularly for the period 29 October – 5 February. During this period, there is only one settlement period (SP 31) in each Working Day where there is an artificial impact on the BPA, and hence this impact could be demonstrated by analysing the data for any one Working Day in the period 29 October – 5 February. The analysis for 6 November 2006 could therefore be considered as representative of the Working Days in the period 29 October – 5 February.

In addition, National Grid carried out further analysis to demonstrate the effect of the revised weighting factors on the BPA profiles for the remainder of the

financial year (up to the end of March 2007). National Grid believes that the indicative BPA profiles resulting from this analysis would give the industry comfort with respect to the likely BPA values that would feed into the System Buy Prices.

Other Comments

Some respondents commented on the enduring proposals that National Grid is intending to bring forward following the interim changes proposed in this report. National Grid will take these comments into account in the development of enduring proposals.

Post Consultation Clarification of the Proposed Changes

In Part C of the BSAD Methodology Statement, the BPA equation correctly included the Supplemental Standing Reserve option fees in the numerator. However, the denominator did not include the volume of Supplemental Standing Reserve.

The above clarification is provided in the revised BSAD Methodology Statement in Appendix D.

Summary and Recommendation to the Authority

National Grid proposes to:

- a) Update the weighting factors applied to both SR and SSR to use the latest values, and;
- b) Clarify the treatment of SSR within the calculation of BPA such that the weighting factors are also applied to the SSR option fees.

National Grid believes that the proposed changes will better reflect the option fee costs in appropriate settlement periods and hence the resulting BPA will provide improved signals to the market via the system buy price.

Following the consultation, National Grid recommends that the Authority approves the version of the BSAD Methodology Statement in Appendix D. If the Authority does not approve the proposed changes in Appendix D, National Grid recommends that the Authority approves the version of the BSAD Methodology Statement in Appendix B. Subject to the approval by the Authority, the proposed changes will become effective from 22nd January 2007.

Appendix A

Consultation on the Proposed Revisions to the BSAD Methodology Statement

[Please see separate document]

Appendix B

Change marked version of the BSAD Methodology Statement with all amendments highlighted

[Please see separate document]

Appendix C

Copies of the Responses Received to the Consultation

[Please see separate document]

Appendix D

Change Marked Version of the BSAD Methodology Statement with all Amendments Highlighted, Including Further Clarification for Inclusion of the SSR Volume in the BPA Calculation

[Please see separate document]