

Proposed revisions to the Procurement Guidelines, Balancing Principles Statement and the Balancing Services Adjustment Data Methodology Statement

Incorporation of BM Start-up Service

**A Report by National Grid
September 2006**

Overview

As a result of conducting an industry wide reserve review, National Grid is progressing the replacement of the Warming and Hot Standby Service with a new Balancing Mechanism Start-up Service "BM Start-up Service". National Grid believes that the new service will have significant benefits in terms of the efficient and economic operation of the GB transmission system, promotion of competition, and transparency.

Changes to the Balancing Principles Statement (BPS) and the Procurement Guidelines (PGs) are required to enable us to establish a framework within which the new service can operate. In parallel, but separate to this consultation, we are developing the detailed contract terms that will sit within this established framework.

Changes to the Balancing Services Adjustment Data (BSAD) Methodology Statement are required to allow this new service to be appropriately reflected in imbalance prices via BSAD.

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 changes to the PGs, the BPS and the BSAD Methodology Statement. The changes consulted upon covered:

- 1) Incorporation of the new "BM Start-up Service" to replace the existing Warming and Hot Standby Service
- 2) Housekeeping changes.

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

Two change-marked copies of the PGs against the current version 6.0 (two options), one change-marked copy of the BPS against the current version 6.0 and one change-marked copy of the current BSAD Methodology Statement version 3.3 are attached to this report in Appendices A1 and A2, B and C

respectively. The changes contained in these Appendices reflect all of the changes that were consulted upon.

Following the consultation, National Grid recommends that the Authority approves the version of the PGs in Appendix A1, the BPS in Appendix B and the BSAD Methodology Statement in Appendix C, all of which would become effective from 1st November 2006.

Attachments

The attachments to this document are detailed below:

	Copy of the consultation document, published by National Grid on 1 August 2006;
Appendix A1	Change marked version of the PGs (option 1) with all recommended amendments highlighted;
Appendix A2	Change marked version of the PGs (option 2) with all amendments highlighted;
Appendix B	Change marked version of the BPS with all amendments highlighted;
Appendix C	Change marked version of the BSAD Methodology Statement with all amendments highlighted
Appendix D	Copy of the responses received to the consultation.

Representations Received

6 responses to the consultation were received from:

RWE Trading
E.ON UK
SAIC Ltd for the Scottish Power Group
Scottish and Southern Energy (also on behalf of Southern Electric, Keadby Generation Ltd, Medway Power Ltd and SSE Energy Supply Ltd)
International Power – Mitsui
Barclays Capital.

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

In order to give market participants a better understanding of how the proposed service would operate, National Grid published a first draft of the contractual terms in parallel with this consultation. Whilst the detailed contractual terms are outside of the scope of this consultation, we thank respondents for their comments and we will be seeking to issue a revised draft of the contract terms in due course.

Summary of Responses Received

Five of the six respondents supported making changes to the current Warming and Hot Standby Service, recognising some of the benefits outlined in the consultation document. Three Respondents supported the proposals outlined in the consultation (although some concerns were expressed on some aspects of the service design). One respondent indicated support only if certain aspects of the service design were changed and also changes were made to its treatment in BSAD. One respondent did not support the service as outlined in the consultation document, highlighting a number of areas of concern with the service design. One respondent did not specifically comment on the service design, but did not support the treatment of the service in the calculation of BSAD.

No respondents expressed support for the introduction of the Service without price data (option 2 – Appendix A2).

No respondents expressed any views on the proposed house keeping comments.

Two minor typographical errors have been identified in a worked example in the BSAD Statement, These errors do not alter the intended purpose of the worked example, nor are they likely to lead to misinterpretation of how the BM Start-Up Service is incorporated into BPA. Although these errors are minor, we would like the industry to have an opportunity to respond to any corrections. We therefore intend to propose these corrections at the next consultation of the BSAD Statement.

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

Company	Q1 – Do you support BM Start-Up proposals plus price data	Q2 – Do you support BM Start-Up proposals without price information	Q3 - Other comments
International Power	Yes	No. (by implication of support in response to Q1)	<p>Supports changes and publication of price information. Improve transparency of Balancing actions. Allows Market Participants to assess impact of BM Start-up on cashout in advance of Gate Closure.</p> <p>Would like to see weekly price submissions published to enhance transparency and improve competition.</p> <p>Opposed to draft contract clause regarding 'free option' for bringing forward synchronisation at fixed prices</p> <p>Unclear in contract whether repayment of BMSU fees occurs if unit PNs on following a cancel during the committed period. If so seems unnecessarily restrictive compared to 4 hours with Warming.</p> <p>Suggests contract clause also contravenes the Grid Code which requires notification of changes to MEL to reflect the current state of plant.</p>
Barclays Capital	Yes	No - no grounds for any concerns over publication of pricing information.	<p>Price information is essential to help market understand likely evolution of imbalance prices. This understanding is critical to trading decisions and incentives to balance.</p> <p>Potential "double count" in the calculation of BPA – adding average cost per MWh of BMSU to average cost per MWh for other reserve option fees.</p>

			<p>Detail on non-delivery rules crucial – would have been useful to have a detailed description of rules. Concern that there is a potential incentive for Gens to “opt out” of the service if prevailing BM acceptances are more attractive.</p> <p>Hot standby should be included in the calculation of BPA.</p>
Scottish Power	Not stated	Not stated.	<p>Support principle of BM Start-Up Service.</p> <p>Support increasing participation to make market operate more effectively.</p> <p>Support increased flexibility of multiple start-up rates for different NDZ's to allow providers to more accurately represent their costs.</p> <p>Support firm warming payment – allows increased transparency in BM activity.</p> <p>Concerns over contradiction of Grid Code requirements in relation to notification of changes to MEL.</p>
Scottish and Southern	Yes –but only if all changes put forward by S & S are implemented.	Not Stated.	<p>S & S put forward four changes that must be incorporated before they could support the new service:</p> <ul style="list-style-type: none"> i) Proportioning payments - payment based on actual output achieved not unpaid if MEL is not achieved ii) Permitting offers – where plant has been warmed under BMSU but not chosen by National Grid. iii) change algebra – to employ a volume weighted average cost rather than a time weighted sum of average cost iv) no uplift in the BPA - for 3 reasons: <ul style="list-style-type: none"> a) BMSU should deliver margin (“system” service) rather than “energy” service b) BPA uplift should result in SBP that is greater than current arrangement c) the offer associated with the warmed BMU may be “tagged out” as a system acceptance yet the proposed BPA uplift will always be added on to the cash out price
RWE	Not stated	Not stated	<p>Do not support BMSU as an addition to BPA. Inappropriate to use the BPA as the mechanism for reflecting BM start up costs. Instead suggest need for specific parameter (BMU Start-Up Adjustor) to enable the cost of the service to be reflected in marginal cost of energy produced from that unit.</p> <p>Believes reserve or “margin” is a “system” service rather than an “energy” service. Energy market provides no value for “margin” so no justification for reflecting warming payment into cash out when the BMU is not synchronised. Under BMSU proposals BPA uplift incurred only for specified settlement periods and calculation linked to MEL thus could be higher or lower than current arrangements so difficult to argue that BPA arrangement more cost reflective than current arrangements.</p> <p>BM unit Offer may be “tagged out” for system reasons yet the BPA will always be added onto cash out price so inconsistent.</p> <p>More volatile cash out prices could be caused by the contract form rather than variations in the marginal cost of energy.</p> <p>BPA which is added to cash out prices irrespective of whether unit synchronised or not does not seem to provide signal of the marginal cost of energy.</p> <p>Market participants will need to understand BPA impact fully in order to price offers appropriately reflecting the marginal cost of energy.</p> <p>Perverse to impose a BPA uplift where a party has not delivered and is unavailable for technical or commercial reasons to deliver margin or energy.</p> <p>.Number of unintended consequences from BMSU proposals -</p> <ul style="list-style-type: none"> a) contract form appears to require fixing the offer price at the

			<p>price prevailing in the settlement period when the service is called.– could artificially increase the costs for operating the system in the event that units were required and accepted in the settlement period when the unit is instructed</p> <p>b) fixing the MEL and other parameters increases risks to providers and may increase cost and reduce availability of plant to offer the service</p> <p>c) contract form risks restricting the ability of the plant to provide additional capacity in the event that a unit defaults under contract terms</p>
E.ON	No (although do support publication of price information)	No	<p>Support new service in principle but oppose new service as outlined in consultation.</p> <p>Proposals go far beyond what is required and as requested by the industry. Proposals would allow National Grid unacceptable degree of influence over participant's operational flexibility and pricing in BM for little or no compensation in return.</p> <p>Support change for generator to be paid whether the generator is called or not but warming service not the same as provision of standing reserve so inappropriate to restrict Offer price and other technical parameters when warmed. Inconsistent stance by National Grid in context of P194 and BMSU – in P194 NG argued that Generators were failing to react to market conditions by repricing in BM toward marginal acceptance. BMSU proposals will restrict generators' ability to do just that.</p> <p>Also make point that proposals could contravene the Grid Code on notification of changes to MEL.</p> <p>Some concern over timing of when prices would apply from and would prefer no pricing gate. Concern over restricting one value of t_{ntss} per unit</p> <p>Draft contract suggests NG would have a free option over advancing a pre existing synchronisation. Inconsistent with rationale for service and undermines other services.</p> <p>Support opening up service to plant with different technology.</p> <p>Support three warming prices dependant on current state of plant and NDZ time.</p> <p>Support provision of more information on warming instructions but thought NG were going to do this anyway.</p>

These issues can be broadly categorised as follows:

- Design of BM Start-up Service (both in principle and comments on the contractual terms for the BM Start-up Service)
- Treatment of BM Start-up Service in Cashout

National Grid's views on the issues raised in each of these areas is provided below.

Design of the BM Start-up Service

Locking in First Offer Price

The concept of structuring a service with two payment elements, one of which is a pre-agreed utilisation price, is common in the provision of Balancing Services (including services utilised through the acceptance of Balancing Mechanism Offers e.g. Standing Reserve). As a firm fee is being paid in

return for being able to synchronise a unit within BM timescales, National Grid believes it is entirely appropriate to have certainty over the total cost of synchronising that unit.

If a requirement to use BM Start-up arises, National Grid will make an economic assessment of the plant available to it to determine the cheapest way of meeting the requirement. This includes an assessment of the firm payments made under the BM Start-up contract + the cost of the synchronising Offer to bring the generator to its SEL using the 'indicative' submitted first BM Offer price(s) for the future settlement period(s) where the requirement exists. If the Generator is allowed to subsequently increase the first Offer price after National Grid has committed to a BM Start-up instruction, then this would undermine its entire assessment, leading to potential inefficiencies in despatch. Additionally it could be argued that allowing synchronisation costs to increase after the BM Start-up commitment is made could be open to manipulation as alternative options of meeting the requirement may have expired leaving National Grid unable to cancel the BM Start-up instruction and switch to a different provider.

In anticipation of a possible BM Start-up Instruction, the generator is free to vary the price of its first Offer pair, which will enable the unit to be synchronised at SEL (Stable Export Limit), enabling it to reflect anticipated market conditions for the actual period of time when the plant may be synchronised. We note that this pricing decision will occur a number of hours in advance, however we do not believe this is unreasonable as this principle is well established in other services where utilisation prices are agreed much further in advance of service utilisation (up to a year in the case of Standing Reserve). It is National Grid's view that the benefits of locking in synchronisation costs far outweigh any additional costs that may be associated with a generator committing to a synchronisation cost a number of hours in advance.

The proposal is therefore that on receipt of a BM Start-up Instruction that the generator should not be allowed to increase the Offer price, relating to the synchronisation energy upon which National Grid has based its assessment of whether to use that Generator or not. For the avoidance of doubt, in all circumstances the Generator is free to vary its other Offer prices (i.e. those applying for the additional generation above SEL) up to Gate Closure to reflect prevailing market conditions and compete on an equal basis with other BM Participants.

Plant Dynamics

Some respondents have expressed concern at the proposal to 'lock in' certain plant dynamics when the service is instructed. As described above, when making its assessment whether to instruct a unit to provide BM Start-up, National Grid needs certainty regarding the cost of synchronising the unit which will be defined by the parameters SEL and MNZT as well as the relevant BM Offer price. National Grid also needs to know the MW of 'headroom' that will be available once the unit has synchronised (as this is the amount of reserve being created) in order to make an economic choice between services offered. Additionally, to bring BM Start-up in line with other

services that attract firm fees, we believe it is appropriate to be able to measure the service that is being delivered by checking certain technical parameters. For the avoidance of doubt, the data 'requirements' are not intended to replace or amend Grid Code obligations regarding data submissions – simply that these data submissions will be used to measure whether the service has (or is) being delivered.

A number of respondents raised concerns over the draft contractual requirements relating to MEL (Maximum Export Limit) and the interaction with Grid Code requirements. BC2.5.3.2 of the Grid Code requires that revisions to Export Limits be notified to National Grid without delay as soon as any change becomes apparent. Following a BM Start-up instruction, the intention of the contract is to make checks on MEL to establish whether the service has been delivered. The checks will use the declaration and any revisions to MEL made in accordance with the Grid Code provisions as an indication of the continuing availability of the unit to provide the service. If a unit fails whilst providing BM Start-up (i.e. before it has synchronised) the generator has an obligation to revise MEL to zero (or some other value) in line with the Grid Code requirements. Such a redeclaration may indicate that the generator is unable to provide the BM Start-up service and therefore may trigger the BM Start-up non-delivery provisions. In circumstances where the unit provides BM Start-up, synchronises via a BM Offer Acceptance, and then fails, the unit will have delivered BM Start-up and will therefore receive BM Start-up payments (but clearly may be subject to the non-delivery rules in the BSC in relation to delivery of BOAs).

The draft contractual terms will be reviewed and amended as appropriate to ensure the intentions behind these provisions are clear.

National Grid recognises that there may be a variety of technical issues that may arise in the start-up and operation of a BMU. It is not National Grid's intention to deem that the service has not been delivered where legitimate variations in the service delivery occur due to technical reasons and this issue will be given further consideration in the development of a second draft of the contract terms. However, some checks and measures will be required to ensure that if the service is not delivered broadly in line with what was indicated by the generator when the service was instructed, then payments received by the generator are repaid via a non-delivery mechanism.

Advancing Synchronisations

Some respondents raised concerns regarding the contractual provisions relating to advancing synchronisations. The BM Start-up service makes provisions for advancing a pre-existing synchronisation (indicated by a PN) where a BOA cannot be used as the notice required is outside of BM timescales. It is not proposed to make any BM Start-up payments as the costs of the start up of the unit have already been sunk in the PN. Provision of this service would be remunerated via the BOA (once the BM window for issuing the BOA has been reached) and it is not National Grid's intention to put in place any restrictions on price or technical parameters as no firm fee is being paid. This issue will be clarified in the second draft contract terms.

Provisions following the cease of a BM Start-up Instruction

Some respondents expressed concern regarding provisions in the draft contract for repayments of BM Start-up fees to be made if the Generator PNs itself on during a defined period following a cancelled BM Start-up instruction. The BM Start-up Service is intended to be used to access Generation that would otherwise not have run, and therefore the purpose of these provisions is to cover two potential concerns:

1. As the decision to use the BM Start-up service is based upon indicative non-firm information submitted by generators, there is the potential to create a perverse incentive in relation to PN submissions – i.e. National Grid cannot know whether a BMU intends to run and is withholding a PN in order to receive a BM Start-up instruction, or is genuinely not intending to run.
2. If a Generator is able to sell energy into the market (or run to cover its own position) for less than it otherwise would have done, as a result of receiving a payment following a cancelled BM Start-up instruction, this may be seen as a cross subsidy between BSUoS payers and the counterparty buying the cheaper energy. This may lead to (and perpetuate) a situation where the market does not purchase longer notice marginal plant ahead of the day in the anticipation that it will be subsidised on the day.

The arguments are finely balanced as it could be also be argued that cashout prices, coupled with the uncertainty as to whether a BM start-up instruction will be cancelled or run to term, provide adequate incentives to avoid the first potential perversity. On the second point, it could be argued that there are efficiencies to be gained by allowing the unit to make use of the preparations to run that may have been made and sell into the market at a more competitive price than would otherwise have been the case if BM Start-up payments had to be repaid.

This will be considered further in the development of the contract terms.

Treatment of BM Start-up Service in Cashout

Inclusion of BM Start-up costs in cashout

National Grid believes that firm fees associated with the option or availability of Balancing Services procured for energy balancing reasons should be included in the calculation of energy imbalance prices to ensure that these costs are reflected onto participants that are in energy imbalance. National Grid disagrees with respondents who suggest that the BM Start-up Service is a 'system' service and therefore should not be included in the calculation of imbalance prices. The BM Start-up service is a reserve service which delivers the availability of additional capacity to the system to enable the System Operator to balance generation and demand. In this respect BM Start-up is no different to Standing Reserve, the 'unsynchronised' availability of which

meets part of National Grid's reserve requirement and enables it to energy balance. Therefore National Grid's view is that it is appropriate to target costs associated with the BM Start-up Service into energy imbalance prices to reflect these costs onto participants that are in imbalance.

The Buy Price Price Adjustment (BPA) / Sell Price Price Adjustment (SPA) component of BSAD is the mechanism to ensure that such Balancing Services costs are appropriately targeted into System Buy Price/System Sell Price respectively. Contrary to one respondent's view, the BPA mechanism is not specifically designed around Standing Reserve and currently includes three types of Balancing Services which relate to energy balancing services. These are standing reserve option fees, forward contract option fees, and firm regulating reserve option fees. When BPA/SPA mechanism was established on 25th September 2001 by the Approval of BSC Modification Proposal P8, the Authority recognised that option fees associated with any energy balancing service should be included in the calculation of imbalance prices:

"Ofgem considers that option fees should be included in the calculation of energy imbalance prices. All the costs of Electricity balancing services purchased or sold should be appropriately targeted to energy imbalance prices and therefore to those participants who are in Electricity imbalance. This includes both the option and utilisation fees of reserve services contracted by NGC prior to purchases in the Balancing Mechanism. Ofgem believes that there is strong economic rationale for signalling the total costs of reserve costs (i.e. including option fees) through energy imbalance prices."

For these reasons, National Grid believes that it is entirely appropriate to include the costs of BM Start-up in the calculation of BPA.

Impact on Cashout Prices

Concerns have been expressed regarding the effects (i.e. increased or decreased imbalance prices) associated with changing from the Warming service to the BM Start-up service. Specifically that the Warming service 'rolls up' all the costs of procuring energy from a BMU via a BOA into the periods governed by the dynamics of the unit (MNZT), whereas BM Start-up will reflect costs only into specified settlement periods (unrelated to MNZT) which may result in higher or lower imbalance prices which may be no more cost reflective than the current arrangements. It is National Grid's view that it is more cost reflective to allocate BM Start-up costs into the settlement periods that drove the requirement, than to allocate them into periods associated (and constrained) by the dynamics of the plant delivering the service. Additionally, the amount of reserve delivered to the system is not the minimum running point SEL, but rather the Maximum Export Limit (MEL) as the SO has the option of accepting further Offers on the unit (up to MEL) once the unit is synchronised. Therefore it is appropriate to reflect this amount of reserve into the BPA calculation.

In relation to general concerns regarding increases in SBP, National Grid believes that better targeting BM Start-up costs only into those settlement periods where the requirement for reserve exists should provide more cost reflective imbalance prices (whether they be higher or lower) in all periods compared with the current arrangements. As noted by some respondents, by

providing appropriate information provision as to what these costs and periods of requirement are (as proposed in the consultation), market participants should be in a better position to make economic contracting decisions ahead of Gate Closure.

Treatment of non-delivery of BM Start-up in BPA

The purpose of publishing indicative imbalance prices on the BMRS (“prompt pricing”) is to allow market participants to react to imbalance prices as they evolve. Currently the calculation of imbalance prices is based upon the instruction of Balancing Services rather than those actually delivered. National Grid’s proposal is to treat the BM Start-up consistent with all other Balancing Services (including BOAs) in this respect. The consequences of recalculating BPA post event to reconcile against the receipt of non-delivery repayments would be to undermine the purpose of prompt pricing and any decisions made by market participants in reacting to the prices they see. Thus the proposal for BM Start-up is entirely consistent with the general basis for calculating imbalance prices and there is no justification for making a special case of BM Start-up.

National Grid notes the comments made regarding participants who may choose to ‘opt out’ of providing BM Start-up in favour of being accepted in the BM at much higher prices. Whilst we accept that this would be an undesirable outcome, the BM is inherently a parallel but separate mechanism to many of the commercial balancing services that National Grid procures and ultimately the choice to participate sits with the provider. Reliability of service delivery is always a factor that contributes to the decision to instruct a service from a provider, and we believe that this, coupled with the risks that participants would face, is disincentive enough to prevent this behaviour from occurring in practice.

BPA Algebra

As described in the consultation, the BM start-up service differs from existing reserve services in that multiple BM Start-ups may be instructed and cancelled to meet a varying magnitude of requirement for a future period. To take this into account, individual instructions cannot be considered and averaged in isolation (as is the case for Standing Reserve) as this could result in different solutions that meet identical requirements (at the same cost) creating differing BPA values. Hence it is necessary to take account of the amount of reserve being created by looking at each point in the lead-times associated with BM Start-up instructions.

One respondent (SSE) states that it believes National Grid intends to calculate a time weighted sum of the average cost rather than a volume weighted average cost. We agree that the methodology may be better described in this way, although this does not affect the proposed methodology or the intention behind it.

The respondent suggests that the formula would be more reliably calculated as the result of (i) the total of BM start up cost divided by (ii) the average of the BM start up volume. The respondent submitted a worked example to

demonstrate this point. It is unclear from the response how, and over what, the average of the BM Start-up Volume is proposed to be calculated, and appears to also be time weighted. If we have understood the respondent's proposal correctly, it would create the concept of a single average 'block' of volume through the lead-times which we do not believe as closely represents the way that BM Start-up costs are incurred as National Grid's proposed methodology. Therefore National Grid continues to believe its proposed algebra provides the most consistent and representative methodology for reflecting BM Start-up costs into the calculation of BPA.

Treatment of existing services and BM Start-up in BPA

Standing Reserve is procured well in advance against a pre-determined Short-term Operating Reserve Requirement (STORR), which varies by season and day type, and is derived from observed short-term variations in demand, generation losses, shortfalls and gains from approx. 4 hours ahead to real time. For any given settlement period a simple volume weighted average can be calculated as the volume of reserve in the period is fixed. In contrast to Standing Reserve, BM Start-up would be used on-the-day to ensure the overall plant position can meet demand + STORR at 4 hours ahead. Hence the shortfall that BM Start-up may be used to meet is not fixed or predetermined as it is a differential that varies with the market's position and uncertainties in longer lead times. As a consequence of the changing volume requirement for a given set of settlement periods, the BM Start-up component of BPA is not best represented by a single cost over a single volume. Moreover, as BM Start-up is procured on a different basis to Standing Reserve and covering requirements that the market can feasibly cover itself, National Grid believes the proposed methodology is an appropriate and cost reflective way of signalling the costs of BM Start-up in cashout. This methodology coupled with the transparency relating to the BM Start-up service will provide a strong within-day market signal that additional energy is required for certain settlement periods to enable the System Operator to balance the system given the market's position and conditions on that day.

Interaction between BPA and "tagged" BM Offers

Two respondents noted that a BM Offer Acceptance may be "tagged" out of the imbalance price calculation, but the BM Start-up fees would still feed into the calculation of BPA. National Grid believes that against the current background for calculating imbalance prices this is an appropriate outcome. There are rules within the BSC to determine whether the energy delivered to the system, either as a result of synchronising a unit or accepting further Offers on it, was resolving the Net Imbalance Volume and therefore whether those costs should influence the imbalance price. The costs of having the options available to energy balance are separate to this and as described above, we believe it is appropriate to also reflect these costs onto participants in imbalance when the market is short. The proposed treatment of BM Start-up in this respect is the same as Standing Reserve, where option fees will influence BPA, and therefore the imbalance price, irrespective of whether the reserve is utilised and whether any utilisation is "tagged" out by the tagging rules contained within the BSC.

Exclusion of Hot Standby Costs from Cashout

The costs of holding a unit in Hot Standby are over and above the costs of bringing a unit to a point where it is able to synchronise. As no extra MW of reserve are being created by holding a unit in Hot Standby, National Grid does not believe it is appropriate to include these costs in the calculation of BPA. We do not believe Hot Standby displaces other reserve costs as presumed by one respondent.

Summary and Recommendation to the Authority

The development of the Warming and Hot Standby Service into the BM Start-up Service is one of the outcomes from National Grid's Reserve Review process set out more fully in the consultation. National Grid believes that the proposed BM Start-up Service has a number of advantages and improvements over the existing Warming and Hot Standby Service and these are summarised below:

- The BM Start-up Service will be open to all BMUs with lead-times that prevent them from starting-up within BM timescales, regardless of fuel type. This will promote increased participation in the provision of BM Start-up, which may lead to an increase in competition.
- The remuneration structure will be closer aligned with other reserve services. A firm Start-up fee will be paid regardless of whether a unit is cancelled or proceeds to synchronisation, allowing the provider to price start-up costs and incremental energy costs separately. This will allow providers to compete in the BM on a more equal basis and also allow for the costs of reserve to be treated more consistently within cashout. We believe this will have overall benefits in terms of promoting efficiency and competition in the wholesale electricity market.
- The pricing arrangements for BM Start-up fees will be more flexible to allow providers to reflect potentially different costs for starting up units which are in different states of readiness. This will promote cost reflectivity and increased efficiency in the provision and despatch of the service. This will also be enhanced by allowing providers to revise BM Start-up prices more frequently.
- Locking in synchronisation costs (as submitted by the provider for the periods where the unit may be required to run) will give National Grid certainty in its assessment and enable it to make the most economic despatch decisions, whilst allowing providers freedom to vary additional energy prices right up until Gate Closure to promote competition in the BM.
- Targeting BM Start-up costs into the calculation of BPA in settlement periods which drove the requirement will provide more cost reflective imbalance prices (whether they be higher or lower than now) and better target the costs of energy balancing onto participants in imbalance.
- The proposed level of transparency associated with the service will allow all Market Participants to better understand when a service is being used, what the costs are, and how those costs may influence cashout prices in advance thereby putting them in a better position to make economic contracting decisions ahead of Gate Closure.

The consultation responses highlighted a number of issues related to the draft contract terms which were published by National Grid in parallel with the consultation. Whilst the detailed contract terms are outside of the scope of the consultation, National Grid will be reviewing them in light of comments received and will work with providers to address concerns raised.

Having reviewed the issues raised by participants, both in the context of establishing a framework within which this service can fit and also appropriately reflecting the service in cash out prices, we believe, on balance, that the original proposals represent the best way forward.

Furthermore we believe that the publication of service price information, as proposed in option 1 of the proposed PGs changes, is appropriate.

Therefore National Grid recommends that the Authority approve the version of the Procurement Guidelines in appendix A1, the Balancing Principles Statement in Appendix B and the BSAD Methodology Statement in Appendix C, all of which would become effective from 1st November 2006.