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26 June 2002

The National Grid Company, BSC Signatories and
Other Interested Parties

Our Ref: MP No P28

Dear Colleague,

Modification to the Balancing and Settlement Code ("BSC") - Decision and Direction in relation to Modification Proposal P28: "Review of Governance and Modification Procedures"

The Gas and Electricity Markets Authority (the "Authority")¹ has carefully considered the issues raised in the Modification Report² in respect of Modification Proposal P28: "Review of Governance and Modification Procedures".

The Balancing and Settlement Code Panel (the "Panel") recommended to the Authority that

- (i) The proposed Modification P28 be rejected; and
- (ii) The Alternative Modification Proposal P28 as developed by the Modification Group and defined in the Modification Report be made and implemented ten working days after the date of the Authority's determination

The Authority has decided to direct a modification to the BSC.

This letter explains the background to the Modification Proposal and sets out the Authority's reasons for its decision. In addition, the letter contains a direction to The National Grid Company plc ("NGC") to modify the Balancing and Settlement Code ("BSC") as set out in the Alternative Modification Proposal P28.

This letter constitutes the notice by the Authority under section 49A Electricity Act 1989 in relation to the direction.

¹ Ofgem is the Office of the Authority. The terms "Ofgem" and "the Authority" are used interchangeably in this letter.

² ELEXON document reference P28 MR Final, Version No. 1, dated 24 January 2002

Background

Section F of the BSC describes the procedures to be followed for considering and enacting any proposed modifications to the BSC. Some Parties to the Code have considered that changes to these procedures would facilitate the achievement of the Applicable BSC Objectives³ C3 (3) (c) and C3 (3) (d).

Accordingly, the following three Modification Proposals were submitted with a view to facilitating the achievement of said objectives:

P21: Review of Modification Group and Panel Procedures
(Proposed by Amerada Hess Gas Ltd., submitted on 20 June 2001)

P23: Review of the Imbalance Settlement Group
(Proposed by Dynegy, submitted on 22 June 2001)

P24: Review of the Modification Procedures
(Proposed by Dynegy, submitted on 22 June 2001)

Due to the similar nature of these Modifications, the Initial Written Assessment ("IWA")⁴ of these Modification Proposals indicated that they would be best progressed as an amalgamated Modification Proposal, P28. The Panel agreed to submit the amalgamated Modification Proposal P28 to the Definition Procedure.

The Modification Proposal

Modification Proposal P28 seeks to modify the BSC so as to improve governance of the BSC arrangements, specifically in relation to the operation of the Panel, Panel Committees, Modification Groups and Modification Procedures. The exact detail of the proposed changes is provided in the Modification Report, but can be summarised as follows:

a) Panel

- i) All non-confidential Panel business to be held in open session
- ii) Any Panel Member to be able to invite comment from the floor

b) Panel Committees

- i) The Imbalance Settlement Group and the Supplier Volume Allocation Group to operate in the same way to the Panel in terms of non-confidential business being held in open session and members being able to invite comment from the floor.

c) Modification Groups

- i) Standing Groups to deal with Modifications in general areas
- ii) Standing Groups to consider issues in advance of specific Modification Proposals being raised

³ The Applicable BSC Objectives, as contained in Condition C3 (3) of National Grid Company's Transmission Licence, are:

- a) the efficient discharge by the licensee of the obligations imposed upon it by this licence;
- b) the efficient, economic and co-ordinated operation by the licensee of the licensee's transmission system;
- c) promoting effective competition in the generation and supply of electricity, and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity;
- d) promoting efficiency in the implementation and administration of the balancing and settlement arrangements.

⁴ ELEXON document reference IWA021/023/024, issued 26 June 2001

- iii) Self-selection to be introduced so therefore no core-membership, no requirement of impartiality and no indemnity for standing and Modification Groups
- iv) ELEXON to be responsible to the Panel for the delivery of Modification reports.

d) Modification Procedures

- i) Definition and Assessment procedure to be conflated into one evaluation procedure.
- ii) Only one mandatory consultation
- iii) Panel recommendation to be made only after consultation responses have been received
- iv) Re-consultation to be mandated if material changes arise for a Pending Modification
- v) Panel to be able to bring forward Implementation Dates

At its meeting of the 23 August 2001, the Panel directed that an Assessment Procedure should be undertaken, and that as part of this procedure, the following specific activities should be pursued:

- A consultation should take place with interested parties
- Views on the proposals should be obtained the Panel
- Consideration should be given to the development of an Alternative Modification

A consultation document⁵ was issued in response to the first of these points, and two subsequent interim reports were submitted to the Panel. Ofgem provided their provisional thinking in a letter to the Chairman of the BSC Panel, dated 13 November 2001. The Assessment Report included details of both the original and Alternative Modification Proposal which was developed and both proposals were detailed on pages 10 & 11 of said Assessment Report.

The Alternative Modification Proposal addresses the same operational areas as the original Modification Proposal, but is less prescriptive in its approach. It can be summarised as follows:

a) Transparency of operation of the Panel, Panel Committees and Modification Groups

- i) All non-confidential (Panel and Committee) business to be held in open session, where practical. The default position and presumption would be that a meeting would be in open session and it would be for the Chairman, on grounds of practicality or confidentiality to decide otherwise. The Trading Disputes Committee and the Performance Assurance Board will remain entirely confidential.
- ii) All Modification Group business to be held in open session by default subject to confidentiality/practicality, as per Panel/Committees above.

b) Constitution and operation of Modification Groups

- i) The Panel may establish standing Modification Groups.
- ii) Standing Modification Groups will be able to consider issues ahead of there being any formal Modification Proposal. The terms of Reference will prescribe the scope for these discussions and the time span for the operation of the group. The standing Modification Group Chairman will exercise discretion in considering whether new issues are within its scope. Routine reporting to the Panel will enable review of such business to be undertaken.
- iii) Modification Groups to continue to be comprised of a core membership of industry experts, acting in an impartial manner. Members will continue to be indemnified by the Balancing and Settlement Code Company ("BSCCo").

⁵ ELEXON document reference CON 28, issued 12 September 2001

c) Improving the efficiency of Modification Procedures

- i) If late material matters emerge at the Report Stage, the Panel will have the discretion to permit a re-consultation and a commensurate extension to the Report Phase. The Panel's ability to extend the Report Phase will be subject to the Authority consent.
- ii) The Panel may apply to the Authority to bring forward the proposed Implementation date of an Approved Modification. Any such application will be preceded by consultation with parties to assess the impact of the revised date.

The Panel considered the P28 Assessment Report on 13 December 2001. The Panel directed that Modification Proposal P28 be submitted to the Report Phase, with a recommendation that the Alternative Proposal be approved. ELEXON published a draft Modification Report⁶ on 19 December 2001, which invited respondents' views.

Respondents' views

In total, ELEXON received eight responses to the consultation on the draft Modification Report for Modification Proposal P28. Of the responses, three expressed support for the original Modification Proposal and four supported the Alternative Modification Proposal. (Of the supporters of the Alternative Proposal, one was subject to clarification of their understanding of an issue arising) The remaining one response expressed general support for modification of the current process, without stating which Proposal they preferred.

Those in favour of the original Proposal considered that the Alternative Proposal did not address all of the issues raised by original proposal. They were concerned about a perceived diminution in the role they intended that standing Modification Groups play in the process. They also considered that the Panel should not proffer recommendations in advance of all consultation responses being received because the Panel's recommendation may unduly influence those consultation responses. It should be noted that the three supporters of the original Proposal explicitly expressed a preference for the Alternative Proposal over maintenance of the status quo. The respondents' views are given in Annex 1 of the Modification Report for Modification Proposal P28.

Panel's recommendation

The Panel met on 17 January 2002 and considered the draft Modification Report for Modification Proposal P28, the views of the Modification Group and the consultation responses received.

The Panel recommended that the Authority should reject the Proposed Modification P28, but accept the Alternative Modification P28, which should be implemented within ten working days of the Authority's determination.

The Panel noted that approval of Alternative Modification Proposal P28 might lead to an inconsistency with the Transmission Licence unless a condition of the Licence was modified. Under the then existing drafting of the Licence, reference is made to implementation dates being extended only⁷; by implication, the bringing forward of such dates is precluded.

The licence condition was modified on June 24 2002 after all interested parties had been consulted.

⁶ ELEXON document reference MR28, Version No. 0.1, issued 19 December 2001

⁷ Electricity Transmission License: Standard Conditions, September 2001, Condition C3 (4)

Ofgem's view

Ofgem considers, having had regard to its statutory duties, that of the two Modifications proposed, the Alternative Modification Proposal P28 would better facilitate the achievement of the Applicable BSC Objectives.

The major issues identified by the proposals are transparency of operation of the Panel, Panel Committees and Modification Groups; the constitution and operation of Modification Groups; and improving the efficiency of Modification Procedures.

Transparency of operation of the Panel, Panel Committees and Modification Groups

It is Ofgem's view that transparency and openness are of paramount importance when considering the operation of bodies involved in the process of enacting the procedures of the BSC. However, this must be balanced against the needs to maintain commercial confidentiality where appropriate, and to progress the work of the Panel, Panel Committees and Modification Groups within time and resource constraints. Ofgem considers that the transparency of operation advocated by the Alternative Modification Proposal can only help to improve industry participants' understanding of issues, and therefore promote competition and efficiency in line with the Applicable BSC Objective C3 (3) (c).

Constitution and operation of Modification Groups

Ofgem considers that the use of standing Modification Groups to consider issues in general areas may facilitate the achievement of improved operational efficiency of the Modification Groups, as it may allow increased understanding of issues pertinent to the subject areas under consideration and increased participation by standing Modification Group members. The ability of Standing Groups to consider issues prior to those issues being formally raised as Modification Proposals may bring about efficiency improvements by promoting forward thinking. It will also promote the development of better-defined proposals. However, it is important that this ability is not used to prejudice the right of a party to raise a Modification Proposal, notwithstanding the initial views of the standing Modification Group. Ofgem expects that the Panel should exercise control over the terms of reference and the life span of the standing Modification Groups. Ofgem considers that the Panel will be mindful of their efficiency objectives when setting the terms of reference and the time-scales to apply.

Ofgem considers that a core membership of experts acting in an impartial manner is the most efficient means to bring about evaluation of proposals according to whether they achieve the Applicable BSC Objectives. Ofgem therefore favours the Alternative Modification Proposal, rather than the intent of the original Modification Proposal to introduce self-selection of Modification Group members.

Improving the efficiency of Modification Procedures

Ofgem considers that a separate Definition phase is vital for clarifying the scope of issues to be considered in the Assessment phase, thereby contributing to the longer-term efficiency of each Modification Proposal under evaluation. Ofgem also considers that the Panel making preliminary recommendation prior to final consultation should not adversely influence the responses of those consulted upon. Ofgem considers that the original Modification Proposal is not likely to facilitate the achievement of Applicable BSC Objectives in either of these regards.

Ofgem agrees that where late material changes arise during the Modification Proposal Report Phase, the Panel should have the discretionary ability to re-consult with the interested parties,

subject to the Authority's approval. Ofgem also believes that the ability to bring proposed implementation dates of Approved Modifications forward in time facilitates achievement of efficiency in the implementation and administration of the balancing and settlement arrangements.

The Authority's decision

The Authority has therefore decided to direct that the Alternative Modification Proposal P28 should be made and implemented.

Direction under Condition C3 (5) (a) of NGC's Transmission Licence

Having regard to the above, the Authority, in accordance with Condition C3 (5) (a) of the licence to transmit electricity granted to NGC under Section 6 of the Electricity Act 1989 as amended (the "Transmission Licence"), hereby directs NGC to modify the BSC as set out in the Alternative Modification resulting from Modification Report.

The Modification is to take effect ten working days after this decision to approve the Modification Report.

In accordance with Condition C3 (5) (b) of NGC's Transmission Licence, NGC shall modify the BSC in accordance with this direction of the Authority.

If you have any questions, please contact me on the above number.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'DEU', is positioned above the printed name and title of the signatory.

David Edward

Head of Electricity Code Development

Signed on behalf of the Authority and authorised for that purpose by the Authority