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| Modification proposal: | Balancing and Settlement Code (BSC) P268: Clarify the P/C status process for exempt BM units | | |
| Decision: | The Authority ¹ directs that the Alternative Modification P268A be made, and that Modification P268 be rejected. ² | | |
| Target audience: | National Grid Electricity Transmission Plc (NGET), Parties to the BSC and other interested parties | | |
| Date of publication: | 19 th September 2011 | Implementation Date: | 23 rd February 2012 |

Background to the modification proposal

The Production/Consumption (P/C) flag determines to which of a Lead Party's energy accounts a Balancing Mechanism (BM) Unit's Metered Volumes are allocated. The P/C Status for most BM Units is determined by the sum of the Relevant Capacities of all the BM Units in its Trading Unit.³ This means that the P/C Status of a BM Unit can change at any time following a change to the composition of its Trading Unit and/or the Relevant Capacity values of any of the BM Units in the Trading Unit (dynamic determination).

The rules are different for Exempt Export BM Units (licence-exempt generators such as wind farms under 50MW). Unlike other BM Units, the Lead Party for an Exempt Export BM Unit can choose to fix its P/C Status as either Production or Consumption. This Status will remain the same unless the Lead Party specifies otherwise, and will not be affected by whether other BM Units join or leave its associated Trading Unit. If the Lead Party does not do this (either by choice, or by omission) the default rule is that the P/C Status will be dynamically determined by the sum of the Relevant Capacities of all the BM Units in its Trading Site, in the same way that the P/C Status of other BM Units is set.

Approved BSC Modification P100⁴ introduced these rules in 2003. Before the introduction of P100, only Exempt Export BM Units that were not in a Trading Unit with any other BM Units could independently elect the BM Unit's P/C Status. If no election of P/C Status was made, the default rule was that the BM Unit's P/C Status would be determined by its Relevant Capacity. P100 extended this ability, as well as the dynamic default rule, to Exempt Export BM Units in Trading Units with other BM Units.

Proposer's concerns with the current arrangements

Due to the dynamic nature of the default rule, the P/C Status of an Exempt Export BM Unit may be changed without the Lead Party's explicit instruction or agreement. If a Lead Party is unaware of the changes to its P/C Status, this could result in unintended Imbalance Charges arising, as its Contract Notifications and Metered Volumes would not be aligned to the same Energy Account.

The BSC also states that an Exempt Export BM Unit's election of P/C Status shall not become effective until at least 28 calendar days have passed, although it is not clear why the existing 28-day notice period is necessary.

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

² This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

³ The Relevant Capacity of a BM Unit and of a Trading Unit is dependent on its Generation Capacity (GC) or Demand Capacity (DC) values. The sum of the GC and DC values of every BM Unit in a Trading Unit determines the Relevant Capacity of the BM Unit and of its associated Trading Unit.

⁴ Details regarding P100 'Extension of Demand-side Trading Units in order to increase the competitiveness of the market for embedded benefit' appear on Elexon's website: <http://www.elexon.co.uk/Pages/P100.aspx>.

The Modification Proposal

BSC modification P268 was raised by Statkraft in January 2011. In the proposer's view, the BSC is unclear about the treatment of an Exempt Export BM Unit which had previously been another type of BM Unit and had already had an existing P/C Status. An inconsistency between the provisions in the BSC and in detailed BSC Procedures (BSCPs), specifically, the Central Registration Agent (CRA) Service Descriptions, was also highlighted. The inconsistency in the CRA Service Descriptions is thought to have arisen with the introduction of P100.

P268 proposes that all Exempt Export BM Units would be required to elect a P/C Status which is either Production or Consumption. The P/C Status of Exempt Export BM Units would no longer be determined dynamically, removing the current default rule. ELEXON and the CRA would have an obligation to ensure that each Exempt Export BM Unit has an elected P/C Status.

P268 would not change an Exempt Export BM Unit's ability to subsequently elect a different P/C Status. However, it would change the minimum notice period required before a P/C Status election becomes effective, reducing it from 28 calendar days to two Working Days.

P268 would apply retrospectively from 1 March 2010 although the solution would be implemented prospectively. In the proposer's view, this would allow it to recover Imbalance Charges it incurred as a result of a particular set of circumstances and which were the subject of a subsequent Trading Dispute (DA375) which was not upheld. Retrospective application of the solution would allow an Exempt Export BM Unit to elect its P/C Status, leading to the recalculation of Imbalance Charges for all BSC parties in the interim between 1 March 2010 and the P268 implementation date.

The Alternative Modification Proposal

During the assessment of P268, an alternative modification (P268A) was developed by the Workgroup. The solution is identical to the proposed modification except for the retrospective application element. The alternative would apply prospectively from the proposed implementation date.

BSC Panel⁵ recommendation

At their meeting on 11 August 2011 the Panel voted by a majority to recommend that the proposed Modification P268 should not be made, and that the alternative Modification P268A should be made.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 17 August 2011. The Authority has taken into account the responses to ELEXON's⁶ consultation which are attached to the FMR⁷. The Authority has concluded that:

1. implementation of the **original Modification will not** better facilitate the achievement of the Applicable Objectives of the BSC;

⁵ The BSC Panel is established and constituted pursuant to and in accordance with Section B of the BSC.

⁶ The role and powers, functions and responsibilities of ELEXON are set out in Section C of the BSC.

⁷ BSC modification proposals, modification reports and representations can be viewed on the ELEXON website at www.elexon.co.uk

2. implementation of the **alternative Modification P268A** will better facilitate the relevant objectives of the BSC⁸;
3. directing that **alternative Modification P268A** be made is consistent with the Authority's principal objective and statutory duties⁹.

Reasons for the Authority's decision

We agree with the views of the Panel and the majority of respondents that alternative Modification P268A will better facilitate BSC objectives (c) and (d). We do not consider that the other objectives are relevant. The benefits of this Modification lie primarily in better facilitating objective (d). The benefits against objective (c) are largely due to the improvements in efficiency arising under objective (d).

We do not consider that retrospective application of the modification better facilitates either BSC objectives (c) or (d). We set out our views on retrospection below.

Objective (c) 'The promotion of effective competition in the generation and supply of electricity'

We note the proposer's view that the proposed Modification would promote competition by providing a level playing field for new entrants who are less familiar with BSC processes. The proposer states that these parties are disproportionately impacted by the risks and uncertainty caused by any inconsistency or ambiguity in the BSC rules.

We note that the Workgroup and a majority of the Panel took the opposite view, namely, that the complexity and disruption that retrospective application of the solution would cause would outweigh any benefits that prospective implementation could bring. Instead, the alternative Modification would better facilitate BSC objective (c) by making the rules clearer and simpler, assisting both existing and new BSC parties.

We agree that the alternative Modification would better promote effective competition by simplifying and clarifying the BSC rules for Exempt Export BM Units. This clarity may have a particularly positive impact on new and smaller parties who should still seek to develop a full understanding of the rules to participate in the trading arrangements. The retrospective element of the proposed Modification would undermine any benefits that the solution would otherwise deliver.

Objective (d) 'The promotion of efficiency in the implementation and administration of the balancing and settlement arrangements'

By mandating that an Exempt Export BM Unit elects its P/C Status, and by removing the option for an Exempt Export BM Unit's P/C Status to be dynamically determined, no Exempt BM Unit will have a P/C Status that its Lead Party has not explicitly chosen. The Panel, the Workgroup and the majority of the respondents agreed with these elements of the solution. The Workgroup also stated that this approach would remove any risk of confusion and deliver the intention of P268. One respondent disagreed with the removal of a dynamically determined P/C Status for Exempt Export BM Units, stating that BM Units can already manage the risk of imbalance by exercising the current option to 'fix' their P/C Status. However, we note that the Workgroup found no evidence that an Exempt Export BM Unit would want to have a dynamically-determined Status. We agree with the majority of the respondents that this solution best achieves P268's intention.

⁸ As set out in Standard Condition C3(3) of NGET's Transmission Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=15853

⁹ The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Electricity Act 1989 as amended.

We note that the Workgroup could not identify any reason why the minimum notice period for a P/C Status election is currently 28 days. The Workgroup stated that to achieve the intention of P268, there must not be any gap between the effective dates of a BM Unit's Exempt Export Status and its first P/C Status election. We agree that reducing the minimum notice period to two Working Days would better achieve the intention of the modification and provide a more efficient outcome.

We also note that changes to BSCP15, BSCP31 and the CRA Service Description were developed alongside the proposed BSC legal text. Although we do not approve changes to BSC subsidiary documents, we do consider it important that there is consistency between the BSC and these documents. BSC parties should use the appropriate change process to make changes to BSCPs to remove inconsistencies.

We agree with those respondents who believe that these changes clarify and simplify the process for determining the P/C Status for Exempt Export BM Units. This approach avoids uncertainty, placing a direct responsibility on BSC parties to ensure that the correct P/C Status applies, and would reduce the likelihood of Export Exempt BM Units being exposed to unforeseen Imbalance Charges. This approach would promote efficient administration in the balancing and settlement arrangements. We consider that reducing the minimum notice period for a P/C Status elected change to two Working Days will also increase the efficiency of the process.

Retrospective application of the solution

We consider that retrospective implementation of modifications should generally be avoided as they undermine market confidence. However, we have recently set out a number of circumstances in which they may be justified¹⁰. If the resulting loss or consequence is material, Ofgem may consider whether a retrospective change is appropriate where:

- the fault or error occasioning the loss was directly attributable to central arrangements;
- there were combinations of circumstances that could not have been reasonably foreseen; or
- the possibility of a retrospective action had been clearly flagged to the participants in advance, allowing the detail and process of the change to be finalised with retrospective effect.

We note the proposer's views supporting retrospective application of the proposed Modification, namely:

- that the proposer suffered a significant financial loss because of circumstances that it believes are attributable to central BSC arrangements;
- that the circumstances that gave rise to the loss could not have been reasonably foreseen.

We also note that two Panel members considered that the CRA Service Description constitutes a part of the central BSC arrangements and that one Panel member also considered that the circumstances giving rise to the proposer's loss were not reasonably foreseeable. However, the Workgroup that assessed P268 and a majority of Panel members took a contrary view regarding whether the CRA Service Description does constitute part of the central BSC arrangements.

¹⁰ Ofgem's guidance on urgency criteria sets out our views on retrospective code changes and can be found at: <http://www.ofgem.gov.uk/Licensing/IndCodes/Governance/Documents1/Ofgem%20Guidance%20on%20Code%20Modification%20Urgency%20Criteria.pdf>.

The Workgroup and a majority of the Panel also considered that the proposer's loss is due to its own error and that it is inappropriate to correct a party's mistake through a retrospective rule change. It was noted that in the event of any inconsistency between the BSC and a BSC subsidiary document, the BSC takes precedence¹¹. In the Workgroup's view, retrospective implementation may send the wrong message to BSC parties about the need to fully understand the detailed rules in the BSC and subsidiary documents and actively monitor their trading positions.

The Workgroup also considered that retrospective application had not been clearly flagged in advance as retrospective application would apply from before the date the proposed Modification was raised.

It is important that parties take responsibility for understanding the rules of the market in which they operate. In our view, although the CRA Service Description does form part of the central BSC arrangements, BSC parties should take account of the central BSC arrangements as a whole, and seek clarification if there is inconsistency or a risk of confusion. In our view, P268 should not be retrospectively applied for the following reasons:

- As we have previously stated, retrospectively implemented modifications create uncertainty and undermine market confidence;
- The BSC states that the text of the Code should take precedence over BSC subsidiary documents in the event of any inconsistencies; and
- The inconsistency that the proposer originally sought to address was in a BSC subsidiary document. The rules in the BSC were clear and the proposer should have taken account of the BSC rules in preference to the rules in the subsidiary document. Changes to subsidiary documents should be addressed by means of a Change Request rather than a BSC modification.

We therefore consider it inappropriate to retrospectively apply the proposed solution in this case.

We consider that the proposed solution would promote efficiency in the implementation and administration of the balancing and settlement arrangements, but only if it is applied prospectively, through the alternative Modification, and not retrospectively. The benefits of prospective implementation are improved clarity and simplicity of the arrangements. These benefits would be undermined by the disruption and uncertainty that retrospection would introduce.

Decision notice

In accordance with Standard Condition C3 of NGET's Transmission Licence, the Authority, hereby directs that Alternative Modification proposal BSC P268A '*Clarify the P/C status process for exempt BM Units*' be made. We agree with the proposed implementation date of 23 February 2012.

Colin Sausman

Partner, Smarter Markets

Signed on behalf of the Authority and authorised for that purpose

¹¹ BSC Section H1.5