



Direct Dial: 020-7901 7355

22 December 2003

The National Grid Company, BSC Signatories and
Other Interested Parties

Our Ref: MP No P127

Dear Colleague,

Modification to the Balancing and Settlement Code (“BSC”) - Decision and Direction in relation to Modification Proposal P127: “Optional De-registration by Insolvent Party”

The Gas and Electricity Markets Authority (the “Authority”)¹ has carefully considered the issues raised in the Modification Report² in respect of Modification Proposal P127, “Optional De-registration by Insolvent Party”.

The BSC Panel (the “Panel”) recommended to the Authority that the Alternative Modification P127 should be made and that the Proposed Modification P127 should not be made. It was also recommended that the Implementation Date for the Alternative Modification should be 13 weeks after the Authority’s decision and in the event that the Authority determines that the Proposed Modification should be made, the Implementation Date for the Proposed Modification should be 13 weeks after the Authority’s decision.

Having carefully considered the Modification Report and the Panel’s recommendation and having regard to the Applicable BSC Objectives and the Authority’s wider statutory duties,³ the Authority has decided to direct a Modification to the BSC in line with the Alternative Modification Proposal P127.

This letter explains the background 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

¹ Ofgem is the office of the Authority. The terms “Ofgem” and “the Authority” are used interchangeably in this letter.

² ELEXON document reference P127RR, Version No. 1.0, dated 15 October 2003

³ Ofgem’s statutory duties are wider than the matters that the Panel must take into consideration and include amongst other things a duty to have regard to social and environmental guidance provided to Ofgem by the government.

the BSC in line with the Alternative Modification Proposal P127, as set out in the Modification Report.

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

Background

Under the current BSC arrangements a Party that enters a process of formal insolvency is in Default of the BSC.⁴ Whilst in Default the Party is unable to withdraw from the BSC,⁵ meaning that such parties must continue to pay the Base Monthly Charge.⁶ Those responsible for managing the insolvency process for Parties in Default (administrators/receivers/liquidators) are unable to limit further loss of value to creditors in pursuance of their duty of care due to the increasing debt to BSCCo resulting from the BSC Monthly Charge.

The only way for a Defaulting Party to cease to be liable under the Base Monthly Charge is for the Panel to expel them from the BSC.⁷ In order to rectify this situation, Enron Capital & Trade Resources Limited submitted Modification Proposal P127, "Optional De-registration by Insolvent Party" on 28 April 2003. The Proposer believes that withdrawal should be voluntary, as there may be grounds for an insolvent Party to retain the status of signatory to the BSC. The Proposer's objective in raising P127 is to bring an end to escalating liabilities in respect of the Base Monthly Charge.

The Modification Proposal

Modification Proposal P127 seeks to modify the BSC so as allow insolvent BSC Parties to "de-register" voluntarily. The Proposed Modification would allow an insolvent Party to withdraw from the BSC "at any time". Subsequent to submission of the Proposal, the Proposer clarified this point to mean to mean a "withdrawal from the Code".⁸ The justification for the Modification Proposal was that it would better facilitate achievement of the Applicable BSC Objectives⁹ C3 (3) (c) and (d).

The Panel considered the Initial Written Assessment at its meeting of 12 June 2003 and agreed to submit Modification Proposal P127 to the Assessment Procedure for a period of 3 months. The

⁴ Section H3.1.1(g)(ii).

⁵ Section A5.1.3(e).

⁶ Levied under Annex D-3 paragraph 3.1(a). The Base Monthly Charge is invoiced to Parties by BSCCo every 2 months at £500

⁷ Section H3.2.1(e).

⁸ Pursuant to Section A5

⁹ The Applicable BSC Objectives, as contained in Standard Condition C3 (3) of NGC'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
- e) the undertaking of work by BSCCo (as defined in the BSC) which is:
 - (i) necessary for the timely and effective implementation of the proposed British Electricity Trading and Transmission Arrangements (BETTA); and
 - (ii) relevant to the proposed GB wide balancing and settlement code; and does not prevent BSCCo performing its other functions under the BSC in accordance with its objectives.

Governance Standing Modification Group (the “Group”) considered the Modification Proposal. During the Assessment Procedure the Group’s opinion was that Proposed Modification P127 would not better facilitate the achievement of the Applicable BSC Objectives. They considered that if implemented Parties would be able to withdraw from the BSC with outstanding liabilities, as may be implied by the term “at any time” as stated in the Modification Proposal.

The Group were of the opinion that enabling an insolvent Party to withdraw “at any time” would not better facilitate Applicable BSC Objective (d), as it would compromise BSCCo’s ability to recoup, on behalf of Parties, insolvent Parties’ outstanding liabilities in respect of Trading Charges and BSCCo Charges. The Group also considered Applicable BSC Objective (c) and decided that the Modification Proposal did not better facilitate achievement of this objective as Parties would be required to jointly defray any unpaid Trading Charges and BSCCo Charges incurred by insolvent Parties which did not settle their debts.

The Group also believed that the cost saving resulting from the reduced administrative burden on BSCCo would be outweighed by the cost of BSCCo pursuing outstanding debts of Parties released from the Code before they have paid them by legal means.

The Group then considered whether an Alternative Modification Proposal existed that, when compared with the Proposed Modification, better facilitated the achievement of the Applicable BSC Objectives. The Group developed two options. However after undertaking consultation with the industry a third option was developed and chosen as the Alternative Modification Proposal.

The Alternative Modification proposes a solution whereby an insolvent Party¹⁰ is provided with a mechanism through which it is able to withdraw from the BSC in certain circumstances. Once the insolvent Party has submitted a Withdrawal Notice¹¹ the Panel may decide that the balance of the Base Monthly Charge, which accrues from that point onward, need not be settled before it can withdraw from the BSC. However if the Party was to follow this mechanism, the current drafting of the BSC means that it would still be in Default of the BSC by virtue of being insolvent under Section H. Therefore the Alternative Modification Proposal also discounts the Party’s Default due to Section H from the conditions the Party is required to meet before it can withdraw from the BSC.

With these changes included in the solution, the insolvent Party would then be able to withdraw from the BSC after the Final Reconciliation Settlement Run¹² had taken place for the Party’s last day of trading, provided it had paid all outstanding Trading Charges and BSCCo Charges (except for the Base Monthly Charge accrued between the submission date of its Withdrawal Notice and the date of withdrawal).

¹⁰ Being in Default by virtue of being insolvent pursuant to Section H3.3.1(g).

¹¹ Section A5.1.1.

¹² A Settlement Run is a determination of amounts in respect of Trading Charges in relation to a Settlement Day (i.e. the period from 00.00 hours to 24.00 hours on each day) to be paid by Trading Parties and NGC or amounts to be paid to them. The BSC requires that the Settlement Administration Agent (SAA) be responsible for determining Trading Charges and intermediate calculations. The SAA is required to carry out an Interim Information Settlement Run, an Initial Settlement Run, four timetabled Reconciliation Settlement Runs for each Settlement Day as well as any Ad Hoc Settlement Runs required by the BSC Panel.

The Alternative Modification Proposal also provides a mechanism through which an insolvent Party seeking to withdraw from the BSC, can reclaim unused Credit Cover once it has complied with the circumstances for withdrawal. As a Defaulting Party cannot currently withdraw from the BSC, there are no provisions for that Party to recover its Credit Cover. Presently as soon as the Party becomes a Defaulting Party their Credit Cover is frozen pursuant to Section M of the BSC.

The majority of the Group felt that the Alternative Modification would better facilitate the achievement of Applicable BSC Objective (d) as they considered that BSCCo's internal working processes would be improved as BSCCo would be able, when so instructed by the Panel, to cease invoicing insolvent Parties.

The Group was unable to quantify the cost saving to the industry with the implementation of the Alternative Modification Proposal. However, the Group did believe that the implementation of the Alternative Modification Proposal would reduce the administrative burden on BSCCo to invoice a Party in the often certain knowledge that the amount would not be forthcoming. The Group also noted that BSCCo would be saved the unquantifiable cost of pursuing liabilities for outstanding Trading Charges and BSCCo Charges through the legal process.

ELEXON published a draft Modification Report on 18 September 2003, which invited respondents' views by 25 September 2003.

Respondents' views

ELEXON received eight responses to the consultation on Modification Proposal P127. 5 responses (representing 25 Parties) expressed support for the Alternative Modification Proposal P127, 1 response (representing 0 parties and 1 non-Party) opposed the Alternative Modification Proposal P127 whilst the remaining 2 responses (representing 1 Party and 2 non Parties) did not express an opinion.

The respondents' views are summarised in the Modification Report for Modification Proposal P127, which also includes the complete text of all respondents' replies.

Panel's recommendation

The Panel met on 9 October 2003 and considered the Modification Proposal P127, the draft Modification Report, the views of the Modification Group and the consultation responses received.

The Panel recommended that the Alternative Modification P127 should be made and that the Proposed Modification P127 should not be made. It also recommended that the Implementation Date for the Alternative Modification should be 13 weeks after the Authority's decision and in the event that the Authority determined that the Proposed Modification should be made, the Implementation Date for the Proposed Modification should be 13 weeks after the Authority's decision.

Ofgem's view

Having carefully considered the Modification Report and the Panel's recommendation, Ofgem considers, having regard to the Applicable BSC Objectives and its statutory duties, that Alternative Modification P127 will better facilitate achievement of the Applicable BSC Objectives.

It is Ofgem's view that the Alternative Modification Proposal P127 offers a practical mechanism which allows an insolvent Party in default to withdraw from the BSC under certain circumstances, without adversely impacting on BSCCo's ability to recover the liabilities accrued by the defaulting party from Trading Charges and BSCCo charges. Ofgem considers that Alternative Modification Proposal P127 will better facilitate the achievement of Applicable BSC Objective (d) as it will increase the efficiency of the implementation and administration of the balancing and settlement arrangements. BSCCo's internal working processes will also be improved as BSCCo will be able to cease invoicing insolvent Parties when so instructed by the Panel and will thus be spared the cost of pursuing the liabilities of defaulting parties through the legal process. It is Ofgem's view that this will improve the efficiency of the implementation and administration of the balancing and settlement arrangements.

It is Ofgem's view that the Proposed Modification would not better facilitate the achievement of the Applicable BSC Objectives. The implementation of the Proposed Modification would incur particular problems in the recovery of funds from liable parties. Ofgem agrees that to enable an insolvent Party to withdraw "at any time" would not better facilitate Applicable BSC Objective (d), as this would hinder BSCCo's ability to recoup outstanding liabilities in respect of Trading Charges and BSCCo Charges.

Further, it is Ofgem's view that the Proposed Modification does not meet Applicable BSC Objective (c). Ofgem considers it undesirable that unpaid Trading Charges and BSCCo Charges, incurred by insolvent Parties seeking to withdraw from the BSC, should be defrayed amongst the remaining Parties. Such an arrangement would fail to promote competition in the generation and supply of electricity.

The Authority's decision

The Authority has therefore decided to direct that the Alternative Modification P127, as set out in the Modification Report, 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 the Modification Report.

The Implementation Date for Modification Proposal P127 is 15 March 2004.

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 'A. Simpson', written over a horizontal line.

Nick Simpson
Director Industry Codes Development

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