



Direct Dial: 020-7901 7256

24 July 2002

The National Grid Company, BSC Signatories and  
Other Interested Parties

Our Ref: MP No P68

Dear Colleague,

**Modification to the Balancing and Settlement Code (“BSC”) - Decision and Direction in relation to Modification Proposal P68: “Modification to the BSC relating to the setting of Supplier Caps for use in the Supplier Charges (Liquidated Damages) calculation”**

The Gas and Electricity Markets Authority (the “Authority”)<sup>1</sup> has carefully considered the issues raised in the Modification Report<sup>2</sup> in respect of Modification Proposal P68, “Modification to the BSC relating to the setting of Supplier Caps for use in the Supplier Charges (Liquidated Damages) calculation”.

The Balancing and Settlement Code Panel (the “Panel”) recommended to the Authority that the Modification Proposal P68 be approved with an Implementation Date of the first day of the fourth calendar month after the calendar month in which the Authority approves the Modification Proposal.

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

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 the Balancing and Settlement Code (“BSC”) in line with Modification Proposal P68, 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.

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

<sup>2</sup> ELEXON document reference MR 068, Version No. 2, dated 19 June 2002.

## Background

Modification Proposal P68, "Modification to the BSC relating to the setting of Supplier Caps for use in the Supplier Charges (Liquidated Damages) calculation" was raised by the BSC Panel, on the recommendation of ELEXON, on 14 February 2002. The justification for the Modification Proposal was the better facilitation of the Applicable BSC Objectives<sup>3</sup> C3 (3) (c) and (d).

ELEXON issued an Initial Written Assessment for consideration by the Panel on 5 March 2002. The Panel considered the Initial Written Assessment for Modification Proposal P68 at its meeting of 14 March 2002 and agreed to submit the Modification Proposal to a three month Assessment Procedure to be undertaken by the Volume Allocation Modification Group (the Modification Group).

The Modification Group considered Modification Proposal P68 during three meetings on 26 March 2002, 16 April 2002 and 2 May 2002. The Assessment Report for Modification Proposal P68 was submitted for consideration at the Panel meeting of 16 May 2002. The Panel agreed with the recommendation of the Modification Group and decided to submit Modification Proposal P68 to the Report Phase. The recommendation was that the Modification Proposal P68 be approved with an implementation date of the first day of the fourth calendar month after the calendar month in which the Authority approves the Modification Proposal.

## The Modification Proposal

Supplier Charges (Liquidated Damages) are charges that apply to each Supplier should they not meet specified Performance Levels<sup>4</sup>. Where a Supplier fails to meet the agreed Performance Levels the charges they incur are set to reflect the loss likely to be suffered by other Parties as a result of the failure.

The Supplier Charges calculations are conducted on a monthly basis and are performed by Grid Supply Point (GSP) Group using the Performance Assurance Reporting & Monitoring System (PARMS), according to calculations made on a given formula. The calculations include the computation of a financial cap for each Supplier's liabilities within a GSP Group (the Supplier's Monthly Cap). The Supplier Monthly Cap is calculated on the basis of a 'Supplier Deemed Take' (as defined in Section X<sup>5</sup> of the BSC) in the relevant GSP Group for the relevant month. The Supplier Charges calculation has not been executed for settlement days since the New Electricity Trading Arrangements (NETA) Go-Live date<sup>6</sup> because of testing and amendment to the PARMS system<sup>7</sup>. Testing was completed in December 2001. Detailed analysis of the results identified an anomaly in the use of 'Supplier Deemed Take' as defined in the BSC. It was discovered that the use of the term could give rise to a negative Supplier Monthly Cap in the Liquidated Damages calculation. Consequently, Supplier Charges arising from any non-

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<sup>3</sup> 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.

<sup>4</sup> Performance Levels are defined for the proportion of consumption through Non Half Hourly Metering Systems for which a Supplier is responsible that should be settled at each of the Supplier Volume Allocation runs on the basis of Annualised Advance data rather than Estimated Annual Consumption.

<sup>5</sup> BSC Section X, Table X-6. The deemed take at GSP Group level for a Supplier Volume Allocation supplier during a Settlement Period is determined by way of a given formula in paragraph 9.4 of Annex S-2 of the BSC.

<sup>6</sup> NETA Go Live date was 27 March 2001.

<sup>7</sup> So as to accommodate a change in the calculation of Supplier Charges which affected the post Go-Live operation of PARMS.

performance will also be negative i.e. there will be a payment to the Supplier, rather than a payment by the Supplier for their non-performance. The under-performing Parties would therefore be rewarded for its under-performance whilst evading all liability for Supplier Charges. The overall sum of funds available for re-distribution to other Suppliers within a GSP Group would also be reduced.

Although the Supplier Monthly Cap is calculated on the basis of a Supplier Deemed Take in the relevant GSP Group for the relevant month, a Supplier Deemed Take can legitimately be a negative value. This can occur, for example, when a Supplier's Active Export is greater than the sum of its Active Import and Unmetered Supplies.

Modification Proposal P68 proposes that in the setting of monthly Supplier GSP Group Caps for Supplier Charges, the term 'Supplier Deemed Take' in Annex S-1 is replaced by a newly defined term 'Supplier Cap Take'. This has been defined as a measure of the volume of a Suppliers' Active Import and Unmetered Supplies given over a calendar month within a given GSP Group, capped at zero. This solution ensures that only a Supplier's Import values are used to calculate that Supplier's share of the GSP Group Take for any particular month. The Modification Report notes that in the unlikely event that a Supplier Cap Take is negative the quantity would be set to zero to avoid a negative Supplier Monthly Cap occurring.

ELEXON published a Draft Modification Report on 23 May 2002 which invited respondents' views by 31 May 2002.

### **Respondents' views**

ELEXON received eight responses to the consultation on Modification Proposal P68. Six responses (representing 38 Parties) expressed support for the proposed Modification and the remaining one Party supported the principle of the Modification but felt there may not be a net benefit for Parties. One response was 'no comment'.

The respondents' views are summarised in the Modification Report for Modification Proposal P68, which also includes the complete text of all respondents' replies.

### **Panel's recommendation**

The Panel met on 13 June 2002 and considered the Modification Proposal P68, the Draft Modification Report, the views of the Modification Group and the consultation responses received. ELEXON did raise an issue relating to the legal text contained within the Draft Modification Report. The Panel agreed that the legal text should be modified, in accordance with Section F 2.7.5 (b) to improve clarity

The Panel recommended that the Authority should approve the Proposed Modification on the basis of the support received and noted that, if approved, the Proposed Modification should be implemented on the first day of the fourth calendar month after the calendar month in which the Authority approves the Modification Proposal.

## **Ofgem's view**

Ofgem considers, having had regard to its statutory duties, that Modification Proposal P68 will better facilitate achievement of the Applicable BSC Objectives, since Implementation of Modification Proposal P68 in the manner proposed will ensure that it would not be possible to calculate a negative Supplier Monthly Cap.

It is Ofgem's view that implementation of the Modification Proposal would better facilitate achievement of Applicable BSC Objective (c) as Supplier Charges are set at a level that reflects the costs imposed on other Suppliers through under performance by the errant Supplier. Modification Proposal P68 seeks to recompense acceptably performing Suppliers for additional costs arising from the actions of poorly-performing suppliers. It is Ofgem's view that the current situation, where poor performance may be rewarded rather than penalised, represents an impediment to effective competition in the supply and sale of electricity.

It is also Ofgem's view that the implementation Modification Proposal P68 will better facilitate achievement of Applicable BSC Objective C3 (3)(d), as implementing the change will correct the BSC and the supporting systems to what they should have been at the time of NETA Go-Live. This will help to promote efficiency in the implementation and administration of the balancing and settlement arrangements.

In addressing the concerns of the respondent who felt that there might not be a net benefit for Parties from the Modification Proposal, Ofgem acknowledges that the analysis carried out as part of the Assessment Report showed that the materiality was small. Despite this, Ofgem agrees with the Modification Group and the majority of respondents that the anomaly Modification Proposal P68 seeks to address must be corrected to ensure the application of Supplier charges is performed in the manner originally intended. Although the materiality appears to be small, the anomaly occurs almost monthly and leads to the allocation of funds in a manner that does not reflect the true intention of Supplier Charges. The present situation rewards under-performance rather than penalising it, as it should. It is Ofgem's view that this is not appropriate.

Ofgem therefore agrees with the Panel's recommendation that the Proposed Modification should be made.

## **The Authority's decision**

The Authority has therefore decided to direct that the Proposed Modification P68, as set out in the Modification Report for Modification Proposal P68, 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 Modification Report.

The Modification is to take effect on 1 November 2002.

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 'Iain Osborne', with a long horizontal flourish extending to the right.

**Iain Osborne**

**Director of Supply**

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