



Direct Dial: 020-7901 7435

5 July 2002

The National Grid Company, BSC Signatories and
Other Interested Parties

Our Ref: MP No P72

Dear Colleague,

Modification to the Balancing and Settlement Code (“BSC”) - Decision and Direction in relation to Modification Proposal P72: “Correction of a Minor Inconsistency in the BSC Arbitrage and Trade Tagging Methodology”

The Gas and Electricity Markets Authority (the “Authority”)¹ has carefully considered the issues raised in the Modification Report² in respect of Modification Proposal P72, “Correction of a Minor Inconsistency in the BSC Arbitrage and Trade Tagging Methodology”.

The Balancing and Settlement Code Panel (the “Panel”) recommended to the Authority that the Proposed Modification be made with an implementation date that is five Business Days after the Authority’s decision.

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 P72, 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.

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

² ELEXON document reference 020MMU, Version No. 1, dated 10 May 2002

Background

Modification Proposal P72, "Correction of a Minor Inconsistency in the BSC Arbitrage and Trade Tagging Methodology", was submitted on 14 March 2002 by the BSC Panel. The justification for the Modification Proposal was the better facilitation of the Applicable BSC Objective³ C3 (3) (d), "promoting efficiency in the implementation and administration of the balancing and settlement arrangements".

The Initial Written Assessment of Modification Proposal P72 was presented to the Panel at their meeting on 18 April 2002. The Panel decided that the Modification Proposal should go directly to Report Phase, in accordance with Section F2.2.4 of the BSC.

The Modification Proposal

The prices of Balancing Mechanism Offers (to generate extra energy) and Bids (to consume extra energy) are two of the components used in the derivation of Balancing Mechanism cash-out prices. Not all Offers and Bids are included in the cash-out price calculation. 'Arbitrage Accepted' Offers and Bids and 'Trade Tagged' Offers and Bids are two of the types excluded.

Arbitrage occurs when NGC accept Offers at a Price which is lower than the Price of a corresponding accepted Bid. This has no effect on the energy balance of the system. Profits from Arbitrage are used to offset the total costs of balancing the system.

Trade Tagging can occur as a result of technicalities relating to the transmission system, such as the resolution of transmission constraints.

In relation to both the Arbitrage and Trade Tagging processes, it is possible that equally priced Offers or Bids may be equally suited to being acted upon. The current BSC rules declare that in such circumstances, the equally priced Offers or Bids are randomly selected for processing.

Modification Proposal P72 seeks to modify the BSC so as to eliminate the random selection element in the Arbitrage and Trade Tagging processes. It proposes that where equally priced Offers or Bids qualify for Arbitrage or Trade Tagging, then each such Offer or Bid will be subjected to Arbitrage or Trade Tagging by the same proportional amount of its volume. It should be noted that this is how the Settlement Administration Agent system currently operates; this Modification Proposal seeks to align the BSC Code with operational practice.

It has been identified that without this refinement to the Arbitrage and Trade Tagging methodologies, there is a potential for Energy Imbalance Prices to change randomly and spuriously between settlement runs.

ELEXON published a Draft Modification Report on 25 April 2002, which invited respondents' views by 9 May 2002.

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.

Respondents' views

ELEXON received eight responses to the consultation on Modification Proposal P72. Seven responses (representing 23 Parties) expressed support for the proposed Modification and the remaining response (representing 1 Party) was 'no comment'.

The respondents' views are summarised in the Modification Report for Modification Proposal P72, which also includes the complete text of all respondents' replies.

Panel's recommendation

The Panel met on 16 May 2002 and considered the Modification Proposal P72, the draft Modification Report and the consultation responses received.

The Panel recommended that the Authority should approve the Proposed Modification and that if approved, the Proposed Modification should be implemented five Business Days after the Authority's decision. The Panel commented that if approved, the Modification Proposal would only apply prospectively and that a minor inconsistency between BSC Central Systems and the BSC itself would remain for the period between Go-Live and the Implementation date for the Modification.

Ofgem's view

Ofgem considers, having had regard to its statutory duties, that Modification Proposal P72 will better facilitate achievement of the Applicable BSC Objective C3 (3) (d).

This Modification Proposal allows for the equitable allocation of Arbitrage and Trade Tagging between the Offers and Bids of affected Parties. It eliminates the random element in the allocation of such processes and allows for consistent calculation of Energy Imbalance Prices between different settlement runs. It also allows for the provisions of the BSC Code and operational practice to be aligned in this respect.

Ofgem agrees with the Panel's recommendation that Modification Proposal P72 should be made and implemented.

The Authority's decision

The Authority has therefore decided to direct that the Proposed Modification P72, as set out in the Modification Report for Modification Proposal P72, 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 from five Business 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 'D. Edward', written in a cursive style.

David Edward

Head of Electricity Code Development

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