



Direct Dial: 020-7901-7412
4 December 2002

The National Grid Company, BSC Signatories and
Other Interested Parties

Your Ref:
Our Ref: MP No: P77

Dear Colleague

Modification to the Balancing and Settlement Code (“BSC”) - Decision and Notice in relation to Modification Proposal P77: “Interconnector Multiple BM Units”

The Gas and Electricity Markets Authority (the “Authority”¹) has carefully considered the issues raised in the Modification Report² in respect of Modification Proposal P77 “Interconnector Multiple BM Units”.

The BSC Panel (the “Panel”) recommended to the Authority that Modification Proposal P77 should be made and implemented on 10 December 2002 if a determination was made by the Authority prior to 11 September 2002 or 25 February 2003 if a determination was made on or after 11 September 2002.

The Authority has decided not 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.

Background to the proposal

Currently, an Interconnector User (“IU”) may apply for only two Interconnector Balancing Mechanism Units (“BMUs”) (one Production BMU and one Consumption BMU) for the purpose of trading in the England and Wales wholesale electricity market via an interconnector. When submitting Bid/Offer pairs into the Balancing Mechanism IUs can only submit one set of dynamic data for each Settlement Period whereas participants in England and Wales have separate BMUs and associated dynamic parameters for each of their generating sets.

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

² ELEXON document reference P77MR, Version No.1.0, dated 19 August 2002.

On 5 April 2002 Scottish and Southern Energy raised Modification Proposal P77 “Interconnector Multiple BM Units”. The Proposer believes that the Modification Proposal will better facilitate the achievement of Applicable BSC Objective³ (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.

The Proposer argued that the current arrangements do not allow for the dynamics of the different types of plant outside England and Wales to be fully represented in the Balancing mechanism and that this is limiting their ability to submit Bid/Offer pairs that will be accepted by the System Operator (“SO”).

The Modification Proposal

Modification Proposal P77 seeks to modify the BSC to allow IUs to register up to three pairs of Interconnector BMUs. This would be an increase of two pairs compared to the current baseline.

In the Assessment process the Modification Group (the “Group”) discussed the potential for market abuse within the BSC as a result of the Modification Proposal. The Group concluded that provided the IU delivers any accepted Bids and Offers, no issues of market abuse within England and Wales exist. The Group noted that IUs are not treated any differently to any other Balancing Mechanism participant and that the relevant clauses in the Grid Code, BC2.5.1⁴ and BC2.5.3.2⁵ would still apply. The Group considered that the SO would not expect to see last minute changes to plant dynamics on Interconnector BMUs any more than for BMUs in England and Wales. If IUs did not adhere to these rules they would be subject to current SO investigation procedures and could potentially be prevented from using the Interconnector. The Group also noted that, although IUs are not necessarily subject to the same governance arrangements as operators in England and Wales, they could have their Interconnector capacity removed in the event that any market abuse occurs.

Following assessment of the Modification Proposal, the Group considered that IUs should be allowed more easily to be able to represent the dynamics of the plant they have available in the

³ The applicable BSC Objectives are contained in Condition C3.3 of NGC’s Transmission Licence and 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) without prejudice to the foregoing objectives and subject to paragraph 3A, 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.

⁴ Under this clause each BM Participant must, applying Good Industry Practice, ensure that each of its BM Units follows the Physical Notification in respect of that BM Unit prevailing at Gate Closure.

⁵ Under this clause revisions to Export and Import Limits or Other Relevant Data supplied (or revised) must be notified to NGC without delay as soon as any change becomes apparent to the BM Participant.

Balancing Mechanism and doing so would increase the range of choices available to the SO in the Balancing Mechanism. The Group recommended that the Modification Proposal should be made and implemented

A Draft Modification Report was issued on 26 July 2002 inviting respondents' views by 1 August 2002.

Respondents' views

In total, 11 responses were received on the consultation on Modification Proposal P77. Of the responses, eight expressed support for the Proposed Modification, two were opposed to the Proposed Modification and one was neither in favour nor opposed to the Proposed Modification.

In general respondents in favour of the Modification Proposal considered that it would better achieve facilitation of competition in the generation and supply of electricity, as it could give greater choice to the SO in the Balancing Mechanism. Several respondents stated their preference for more than the proposed two additional Interconnector BMU pairs but accepted that the Transmission Company's systems have operational limitations.

Both respondents opposed to the Modification Proposal cited discrimination against England and Wales BMUs as a main factor in their opposition to the proposal.

One of the two respondents that opposed the Modification Proposal felt that generators in Scotland trading in England and Wales via the Scottish Interconnector were currently better placed than their England and Wales counterparts. The respondent suggested that IUs can already substitute between generating plants in the event of plant problems after Gate Closure so as to avoid incurring imbalance charges (an option not open to England and Wales BMUs). Hence, allowing two additional Interconnector BMU pairs would increase IUs ability to substitute generation. The respondent also considered that the Group consisted of only one member who did not have a direct interest in this Modification Proposal being approved and suggested that issues appear to have been either overlooked or not fully explored by the Group.

The other respondent opposed to the Modification Proposal questioned the sufficiency of the present sanctions available to the SO to tackle market abuse arising from the use of an Interconnector as IUs reside outside England and Wales and are subject to different governance arrangements. The respondent suggested that the Modification Proposal increases the opportunities for market abuse.

Panel's Recommendation

The Panel met on 15 August 2002 and considered Modification Proposal P77, the draft Modification Report, the views of the Group and the consultation responses received. The Panel was of the view that Modification Proposal P77 would promote facilitation of Applicable BSC Objective (c) relating to promoting effective competition in the generation and supply of

electricity by allowing IUs to more easily represent the dynamics of their available plant and so allow greater choice to the SO in the Balancing Mechanism.

The Panel recommended that the Authority should approve the Modification Proposal and that, if approved, the Modification Proposal should be implemented on 10 December 2002 if a determination is made by the Authority prior to 11 September 2002 or 25 February 2003 if a determination is made on or after the 11 September 2002.

The Panel also agreed to a change to the drafted legal text. This change was not part of the draft legal text that was sent out for consultation, and interested Parties had therefore not commented on this change. However, the Panel agreed that the change was minor and fully in line with the intent of the Modification Proposal and therefore authorised the change at its 15 August 2002 meeting.

Ofgem's view

Ofgem considers, having had regard to its statutory duties, that Modification Proposal P77 does not better facilitate achievement of the Applicable BSC Objectives.

Prior to the introduction of NETA the arrangements for trading across interconnectors were given consideration and consulted upon with interested parties. The arrangements for trading across interconnectors were designed so that externally interconnected parties could effectively continue to operate as they did under the Pool and so that they would not introduce undue discrimination between parties in England & Wales and in external systems.

Under the Pool rules, externally interconnected parties bid into the Pool via multiple Grid Trading Blocks, which allowed for a number of different availability profiles and prices to be submitted for the day. This was necessary because the prices for each Grid Trading Block were fixed for the entire day. Under NETA Parties bid into the Balancing Mechanism separately for each half-hour, which gives them more flexibility in representing dynamics and Bid/Offer prices than under the Pool. Therefore because Trading Parties have more flexibility in representing dynamics and Bid/Offer prices, in the development of NETA it was determined that externally interconnected parties would not require multiple BMU pairs.

Ofgem agrees with the Panel that the Proposed Modification may increase the choice of Bids and Offers available to the SO in the Balancing Mechanism. However, Ofgem recognises the concerns of one respondent that allowing IUs to register two additional Interconnector BMU pairs would further increase their ability to substitute generation which Parties in England and Wales are unable to do due to provisions in the Grid Code.

Under the Grid Code⁶ all Parties are required to ensure that each of their BMUs follow the Physical Notification in respect of that BMU prevailing at Gate Closure. Therefore Parties are prohibited post Gate Closure from self balancing by substituting generation to compensate for the sudden loss of output from one BMU to avoid imbalance charges. BMUs in England and Wales are linked to specific generating units whereas IU BMUs are not linked to specific generating units. If an IU experiences a sudden loss of output from one generating unit post Gate Closure they can substitute this with another generating unit within their portfolio to follow the Physical Notification for the Interconnector BMU which potentially enables IUs to avoid imbalance charges. Ofgem considers that the Modification Proposal increases the opportunities for IUs to substitute generation and therefore disadvantages Parties in England and Wales for whom self balancing is prohibited.

On balance, Ofgem considers that the Modification Proposal would not better facilitate effective competition as although it increases the options available to the SO, it also unduly discriminates in favour of IUs in comparison to Parties in England and Wales. Therefore, Ofgem considers that the Modification Proposal would be to the detriment of Applicable BSC Objective (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.

One of the respondents voiced concern over the representation in the Group, noting that only one member of the Group did not have a direct interest in the Modification Proposal being approved. Ofgem does not accept that the membership of the Group influenced the outcome. All members of Groups are required to act as independent experts, without prejudice to the interests of certain groups of interested parties. Moreover, the invitation to sit as a member on a Group is open to all BSC Parties. Finally, all interested parties are consulted upon as part of the process before the Modification Proposal goes before the Panel and ultimately the Authority for decision. Ofgem considers the framework put in place in section F of the BSC for managing the change process of the BSC allows representations from all interested parties to be made before the Authority reaches its decision.

In addition, the respondent suggested that issues appear to have been either overlooked or not fully explored by the Group. Ofgem considers that the Group did address all of the issues outlined in the terms of reference⁷ as requested by the Panel.

The Authority's decision

The Authority has therefore decided not to direct that Modification Proposal P77 should be made and implemented.

⁶ Grid Code/Balancing Code (BC) clause 2.5.1.

⁷ The specific terms that the Group were tasked to address were;

- Whether the proposed limit of two additional BM Unit pairs is sufficient;
- The impact (in terms of timescales) on Interconnector Error Administrator Systems and Processes in relation to imbalance charges;
- The impact (in terms of timescales) on Interconnector Administrator Systems and Processes;
- Whether a distinction should be made between Interconnectors that exhibit different characteristics; and
- The Potential for Market Abuse.

Having regard to the above, the Authority, in accordance with Section F1.1.4 of the BSC, hereby notifies NGC that it does not intend to direct NGC to modify the BSC as set out in the Modification Report in respect of Modification Proposal P77.

Please contact me on the above number if you have any queries in relation to the issues raised in this letter. Alternatively, contact Richard Ford on 020 7901 7411.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Sonia Brown'.

Sonia Brown

Director of Electricity Trading Arrangements

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