



Direct Dial: 020-7901 7412

16 May 2002

The National Grid Company, BSC Signatories and
Other Interested Parties

Your Ref:
Our Ref : MP No: P1

Dear Colleague,

**Modification to the Balancing and Settlement Code - Decision and Notice in relation to
Modification Proposal P1: "Extension of the definition of ECVAA System Failure"**

The Gas and Electricity Markets Authority (the "Authority") has carefully considered the issues raised in the Modification Report dated 31 August 2001 for Modification Proposal P1 "Extension of the definition of ECVAA System Failure".

The Balancing and Settlement Code Panel (the "Panel") recommended to the Authority that the Modification, as submitted, is rejected and the Alternative Modification Proposal, is approved and implemented immediately upon such approval.

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

The New Electricity Trading Arrangements ("NETA") are designed to ensure that there is sufficient incentive on participants to balance their positions and minimise the costs to the National Grid Company plc ("NGC") as System Operator ("SO") and therefore customers of balancing the Transmission System ("System"). Market participants have commercial freedom to contract ahead in the forwards, futures and short-term markets to balance their contract position ahead of Gate Closure (3½ hours before real time¹). Gate Closure is the last point at which Parties can notify their contract position to NETA Central Systems. For each Settlement Period the metered volumes for each Trading Party are used to determine if the actual volumes taken

¹ On the 2 May 2002 the Authority accepted Modification Proposal P12 "Reduction of Gate Closure From 3.5 Hours To 1 Hour". Modification Proposal P12 is due to be implemented on the 2 July 2002.

from, or put onto the System match their notified contractual volumes. Parties with a position of energy imbalance will be exposed to the relevant Energy Imbalance Prices for the relevant Settlement Period. Contract notifications² are only registered if they are notified from the participant's³ system via communications links to the Energy Contract Volume Aggregation Agent (ECVAA) System⁴ and acknowledged before Gate Closure.

Participants have a choice of two network communications options, the High and Low Grade Service, to support data communication in both directions between participant systems and NETA Central Systems. The High Grade Service provides communications links with NETA Central Systems through private network communication based on dedicated telecommunications facilities (frame relay technology with ISDN backup). The Low Grade Service provides communications links with the NETA Central Systems through the public Internet. Some participants use the Low Grade Service as an alternative service in the event of a failure in the private network.

The High Grade Service transmits communications from the router⁵ at the participant's site via dedicated telecommunications facilities to the router at the NETA Central Systems Site. Upon application by a participant for the provision of the High Grade Service to ELEXON the Service Provider provides the participant with a router at its site which connects to the participant's network infrastructure and communications lines. The participant is responsible for connection to the router. The Low Grade Service transmits communications from the router on the participant's site via the public Internet to the Internet Portal⁶ for the NETA Central Systems Internet Service Provider. Communications received by the Internet Service Provider are then transmitted to the router on the NETA Central Systems site. Participants are responsible for providing their own links into the Internet.

The NETA Central Service Agent⁷ currently provides the Communications Services under the terms of its agreement with ELEXON⁸. The NETA Central Service Agent subcontracts the provision of the Communications Services to one sole Service Provider, which is Energis Communications Limited ("Energis"). Energis is responsible for the procurement, installation, maintenance and operation of all telecommunications circuits and equipment utilised for the provision of the Communications Services.

² Contract notifications refers to either an Energy Contract Volume Notification and/or a Metered Volume Reallocation Notification.

³ The term participant refers to BSC Parties, Party Agents (Energy Contract Volume Notification Agents and or a Metered Volume Reallocation Notification Agents) and others that communicate or intend to communicate with BSC Agents (ECVAA is a BSC Agent).

⁴ The ECVAA System forms part of NETA Central Systems.

⁵ A router is an item of Equipment and which directs traffic from the Service Termination Point at a Location through the Communications Network.

⁶ The Internet Portal (in this context) is the collection of hardware, software and communications infrastructure that provides connectivity to the Internet.

⁷ The NETA Central Service Agent is Logica UK Limited.

⁸ ELEXON is the Balancing and Settlement Code Company (BSCCo).

It is technically possible for there to be multiple providers of the High Grade Service so potentially it would be possible to have competition in the provision of the High Grade Service. However, there may be costs involved in both adding equipment at the NETA Central Service Agent which could support other networks, and in terminating existing contracts with participants wanting to buy the service from elsewhere. The Low Grade Service only requires one Internet Portal and therefore it is economic and efficient for there to be one sole Internet Service Provider for the Low Grade Service.

The contract between the NETA Central Service Agent and ELEXON is due to expire 5 years from the Initial Date (1 April 2001). The Minimum Service Period to ELEXON for a High Grade Service provided by Energis is 5 years commencing on and including the Service Commencement Date⁹. Participants are charged in respect of the provision of the High Grade Service for a minimum period of 12 months¹⁰. ELEXON may terminate on a participant's behalf the provision of the Communications Service before the end of the Minimum Service Period by giving 90 days' written notice to the Service Provider. Should ELEXON terminate the provision of a High Grade Service before the Minimum Service Period expires, ELEXON will be bound to pay the applicable Communications Charges of the terminated High Grade Service for the period from the date of termination until the end of the Minimum Service Period. In the event participants who take up the High Grade Service post Go-Live terminate their service with ELEXON before the Minimum Service Period, ELEXON is bound to pay the costs of that service for the remainder of the Minimum Service Period. ELEXON's costs are recovered from all BSC Parties via BSCCo charges. Therefore the period for which ELEXON will be bound to pay the cost of a terminated High Grade Service can extend beyond 5 years post Go-Live.

Under the current arrangements, if the ECVAA experiences a System Failure, a recovery procedure exists that allows participants to submit/re-submit contract notifications to the ECVAA post Gate Closure for the affected Settlement Periods. The current ECVAA System Boundary for the High Grade and Low Grade Services extends only as far as the router on the NETA Central Systems site. In the event of a communications failure beyond the current ECVAA System Boundary that prevents contract notifications being made, participants do not have recovery provisions.

The OM London Exchange submitted a Modification Proposal on 27 March 2001 to extend the definition of ECVAA System Failure to include participants' High Grade communication links to the ECVAA System. The Proposer argued that the treatment of ECVAA Systems Failures and communications failures is inconsistent on the basis that both have the same impact on contract notifications but participants are only protected in the event of an ECVAA Systems Failure. The Proposer argued that exposure to imbalance charges arising from communications failure cannot

⁹ The Service Commencement Date is in respect of any Location, the date on which the Communications Service is accepted at the Location.

¹⁰ Outlined in Section D Annex D3 3.3 (a) (ii) of the BSC.

be insured against nor can it be mitigated under the current arrangements by the use of a telecommunications provider other than Energis.

The Modification Proposal

Modification Proposal P1 seeks to further the applicable BSC Objectives¹¹ by modifying the BSC to enable the re-submission of contract notifications affected by failures of the High Grade Service by extending the contingencies for ECVAA System Failures to cover failures of the centrally provided elements of the High Grade Service. The Modification Proposal includes a retrospective implementation date of 27 March 2001.

During the Assessment Phase the Modification Group (“the Group”) developed an Alternative Modification Proposal which they considered better facilitated the applicable BSC Objectives than the original Modification Proposal. The Alternative Modification extends the contingencies covering ECVAA System Failures to include the centrally provided elements of the Low Grade Service and proposes a prospective implementation date.

The Alternative Modification Proposal changes the definition of ECVAA System Failure to Notification System Failure. The definition of the Notification System is the ECVAA System and for every Trading Party (and Party Agents) the Communications Medium¹² by which they send and receive communications to and from the ECVAA, and any part of the relevant system¹³, to but not beyond, the Party System Boundary. The Party System Boundary would be redefined for the High Grade Service to include the router at the participant site but not any source of power for the router. The Party System Boundary for the Low Grade Service would be redefined to include the Internet interface of the Internet Portal by which the ECVAA System is connected to the Internet.

In the event of a Notification System Incident¹⁴ it is proposed that the ECVAA would notify all participants of a failure so that they are able to submit/re-submit any affected contract notifications. Any participant would be able to notify ELEXON of a Notification System Incident

¹¹ 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.

¹² The Communications Medium is defined as a particular method of transmitting Communications, including telefax, e-mail, telephone or other electronic communications system.

¹³ The definition of ‘system’ includes telecommunications facilities, other equipment, hardware and software, and includes systems for redundancy, contingency and disaster recovery purposes.

¹⁴ A “Notification Service Incident” is a failure, breakdown or unavailability of the Notification System.

if it considers such an incident has occurred. Upon receiving notice of a Notification System Incident, ELEXON would notify the ECVAAs and investigate the matter to determine if a Notification System Incident had occurred and the effects of that incident. If ELEXON determined that a Notification System Incident had occurred, the participant would be able to submit/re-submit the affected contract notifications by a deadline determined by ELEXON.

The Group considered two options for the implementation of the Alternative Modification Proposal, an automated solution that would be able to deal with high volumes of failures and the existing manual solution currently in place for the re-submission of contract notifications affected by ECVAAs System Failures. The existing manual solution requires participants to submit/re-submit the affected contract notifications to ELEXON to verify and, if valid, manually submit to the ECVAAs. The ECVAAs edit the relevant data in the ECVAAs database to reflect the submitted/resubmitted notifications and ELEXON informs the relevant participant of the changes that have been made. In the Assessment Report, the Group recommended using the manual solution currently in place for ECVAAs System Failures, to deal with communications failures.

The Panel considered the Group's Assessment Report at its meeting of the 26 July 2001. The Panel determined to go to Report Phase with a recommendation that the original Modification Proposal is rejected and the Alternative Modification Proposal is approved and implemented immediately. ELEXON published a Draft Modification Report on 30 July 2001, which invited respondents' views by 13 August 2001.

Respondents' views

In total, ELEXON received nine responses to the consultation on the Draft Modification Report. All nine of the respondents expressed support for the Alternative Modification Proposal.

Respondents commented that communication failures are beyond the control of market participants and therefore market participants should be able to submit/re-submit contract notifications in the event of a communications failure.

One respondent commented that it was not clear how the provisions for the Low Grade Service will work in regard to Internet connections. Their concerns centred on the possible use of the proposed system to allow questionable ex-post contract notifications.

Some respondents expressed agreement that the Alternative Modification Proposal should not be retrospective because retrospective application would undermine confidence in the BSC and associated markets.

Panel's Recommendation

The Panel met on 23 August 2001 and considered the Modification Report, the views of the Modification Group and the consultation responses received.

The Panel recommended that the original Modification Proposal is rejected and the Alternative Modification Proposal is approved and implemented immediately upon such approval.

Ofgem's view

Ofgem¹⁵ considers, having had regard to its statutory duties, that Modification Proposal P1 will not better facilitate the achievement of the applicable BSC Objectives. In particular, BSC Objectives (c) promoting effective competition in the electricity markets, and (d) promoting efficiency in the implementation and arrangements of balancing and settlement arrangements for the following reasons.

During the development of NETA, Ofgem and the DTI concluded that no failure or breakdown of any Party System or any communications link not forming part of the ECVAAs System should be considered as an ECVAAs System Failure¹⁶. Ofgem and the DTI believed that it is appropriate that the risks associated with notification agent failure should be borne by the Contract Notification Agents themselves rather than being catered for within the BSC. This would ensure that notification agents have an incentive to develop and maintain robust systems for market operation.

Ofgem recognises that participants currently have no control over the centrally provided elements of the communications infrastructure for the Communications Services as part of the NETA Central Services Agent agreement with ELEXON. Ofgem considers that participant's should be allowed to determine their own approach to risk management and develop their systems accordingly. Experience since Go-Live has shown that the communications requirements from participants have become more varied and sophisticated as the new trading arrangements mature and technology is changing rapidly. Ofgem considers that, consistent with its principal objective,¹⁷ to protect the interests of consumers of electricity, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the generation, transmission, distribution or supply of electricity, the Communications Services should be made open to competition where it is economic and efficient to do so. This will enable participants to have control over the communications facilities they receive and allow participants to develop reliable management strategies to their individual requirements. Ofgem believes this would place a greater incentive for efficiency in the provision of the Communications Services and promote competition.

Ofgem recognises that under the terms of the current agreement between ELEXON and the NETA Central Service Agent it may be difficult to open the Communication Services up to competition. Ofgem considers that the most desirable solution would be to renegotiate the

¹⁵ Ofgem is the office of the Authority. The terms "Ofgem" and "the Authority" are used interchangeably in this letter.

¹⁶ Manifest Errors in Balancing Mechanism transactions, October 2000, Conclusions Paper by NETA Programme/ELEXON (on behalf of Ofgem/DTI), February 2001 & BSC and Grid Code Modifications – Ofgem/DTI Conclusions Document, March 2001.

¹⁷ The Electricity Act 1989 as amended by the Utilities Act 2000, Section 3A (1).

terms of the agreement between ELEXON and the NETA Central Services Agent applying to the provision of the Communications Services to enable participants to mitigate the risks associated with contract notification as they see appropriate. Ofgem considers that ELEXON could make provisions for competition to be introduced into the relevant parts of the Communications Services by 1 April 2006 at the latest, if ELEXON and market participants consider renegotiating the terms of the agreement with the NETA Central Service Agent in relation to the Communications Services would better facilitate the achievement of the applicable BSC Objectives.

As an interim measure, until competition can be introduced into the provision of the relevant parts of the Communications Services, Ofgem considers that the provisions for ECVAAs System Failures should be extended to the centrally provided elements of the Communications Services as proposed by the Modification Report. Ofgem believes that this would allocate the risks of communication failure more efficiently within the current arrangements.

However, Ofgem considers that a 'sunset' provision should apply to extending the provisions for ECVAAs System Failures to the centrally provided elements of the Communications Services. Ofgem suggests that the 'sunset' provision should apply when competition has been introduced into the Communications Services where appropriate. We would expect that this would be either the time when the contract between ELEXON and the NETA Central Services Agent expires or before that time if ELEXON and market participants renegotiate the terms of the agreement with the NETA Central Service Agent in relation to the Communications Services to better facilitate the achievement of the applicable BSC Objectives. At this point Ofgem believes that the definition of the Notification System Boundary should be revisited to remove from the provisions of ECVAAs System Failure elements of the Communications Services that have been made open to competition. This would ensure that BSC Parties have an incentive to manage the risk of a failure of the Communications Service efficiently once they are able to mitigate against this risk. Ofgem suggests that any 'sunset' provision should take effect no later than 1 April 2006 when the contract between ELEXON and the NETA Central Service Agent expires.

Neither the Alternative Modification Proposal nor the original Modification Proposal has a 'sunset' provision. Ofgem believes that neither the Alternative Modification Proposal nor the original Modification Proposal would ensure that Parties have an incentive to employ robust systems for communication once competition is brought into the provision of the relevant parts of the Communications Services. Therefore Ofgem considers that neither the Alternative Modification Proposal nor the original Modification Proposal would better facilitate the achievement of the applicable BSC Objectives.

The Authority's decision

The Authority has therefore decided not to direct that Alternative Modification Proposal P1 as set out in the Modification Report dated 31 August 2001 should be made and implemented.

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 original P1 Modification Proposal or the Alternative P1 Modification Proposal.

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the above number.

Please do not hesitate to contact me on the above number if you have any queries in relation to the issues raised in this letter or alternatively contact Anthony Doherty on 020 7901 7159.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Sonia Brown". The signature is written in a cursive style with a large initial 'S'.

Sonia Brown

Head of Electricity Trading Arrangements

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