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The National Grid Company, BSC Signatories and
Other Interested Parties

26 May 2005

Our Ref: MP No P184

Dear Colleague,

Modification to the Balancing and Settlement Code (“BSC”) – “Decision and notice in relation to Modification Proposal P184”.

The Gas and Electricity Markets Authority (the “Authority”)¹ has considered the issues raised in the Modification Report² in respect of Modification Proposal P184, “Clarification of BSC Section W in relation to the application of the Query Deadline to Trading Queries/Disputes”.

The BSC Panel (the “Panel”) recommended to the Authority that Proposed Modification P184 should be approved.

Having considered the Modification Report and the Panel’s recommendation and having regard to the Applicable BSC Objectives³ and the Authority’s wider statutory duties,⁴ the Authority has decided to direct a Modification to the BSC in line with Modification Proposal P184.

This letter explains the background and sets out the Authority’s reasons for its decision.

This letter constitutes 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 P184MR, Version No. Final/1.0, dated 12 May 2005

³ 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

⁴ 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.

Background

At its December 2004 meeting, the Trading Disputes Committee (“TDC”) identified areas of ambiguity in Section W of the BSC, relating to the application of the Query Deadlines in relation to Trading Disputes.

In order to rectify this situation, the Panel, on the recommendation of the TDC, submitted Modification Proposal P184, “Clarification of BSC Section W in relation to the application of the Query Deadline to Trading Queries/Disputes”, on 14 January 2005.

The Modification Proposal

Modification Proposal P184 seeks to modify the BSC to clarify perceived ambiguities in Section W of the Code concerning the application of Query Deadlines in relation to Trading Disputes, with specific regard to:

- the perceived duration of a settlement error; and
- the Query Deadline in relation to a Settlement Period and the processes followed when only part of a Trading Query is deemed to have been raised within the Query Deadline.

The justification for the Modification Proposal was that it would better facilitate achievement of the Applicable BSC Objective C3 (3) (d).

The TDC believes that the Proposed Modification would improve the clarity of the BSC drafting, thereby eliminating any scope for ambiguity in the interpretation of the affected clauses.

The Panel considered the Initial Written Assessment at its meeting of 10 February 2004 and agreed to submit Modification Proposal P184 to the Assessment Procedure. It was agreed that Modification Proposal P184 would be progressed in parallel with Modification Proposal P185, “Redrafting of BSC Sections U and W in relation to clauses pertaining to the processing and rectification of Trading Queries/Disputes”. The Modification Group (the “Group”) considered the Modification Proposal at its meeting on 21 February 2005 and discussed the issues raised by the proposal. An industry consultation was issued on 8 March 2005 and the responses were discussed by the Group at its meeting on 23 March 2005. The Group considered a number of issues raised by the Modification Proposal and unanimously concluded that:

- The Code is unclear as to the correct duration of a settlement period;
- The Code should state the Trading Query deadlines in relation to Settlement Periods;
- The Code requires clarification on the processes to be followed when only part of a Trading Query is deemed to have been raised within the Query Deadline;
- The Code does not clearly set out the consequences of the BSCCo being satisfied or not with regard to the Trading Query validation tests;
- The BSCCo should not validate Trading Queries that it has raised;

- Irrevocable acceptance of the BSCCO's findings that the criteria are not met is assumed from all affected Parties unless highlighted otherwise; and
- The validation of Trading Queries by the TDC should be in relation to timeliness and whether a settlement error has occurred.

The Assessment Report for P184 was considered by the Panel at its meeting on 14 April 2005. At that meeting, the Panel supported the recommendations of the Group and submitted P184 to the Report Phase.

Responses to ELEXON Consultation

ELEXON published a draft Modification Report on 19 April 2005, which invited respondents' views by 27 April 2005. Six responses were received. Six responses (representing 37 Parties) expressed support for the Proposed Modification. No responses opposed the Proposed Modification.

One respondent raised a number of queries with regard to the rationale behind certain parts of the legal text. The legal advice given on each was discussed with the respondent, who agreed that no changes to the legal text were required.

The respondents' views are summarised in the Modification Report for Modification Proposal P184, which also includes the complete text of all respondents' replies.

Panel's recommendation

The Panel met on 12 May 2005 and considered the Modification Proposal, the draft Modification Report, the views of the Modification Group 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 on 2 November 2005 if an Authority decision is made on or before 2 August 2005; or 22 February 2006 if an Authority decision is received after that date but on or before 25 October 2005.

Ofgem's view

Having considered the Modification Report and the Panel's recommendation, Ofgem considers, having regard to the Applicable BSC Objectives and its statutory duties, that Proposed Modification P184 will better facilitate achievement of Applicable BSC Objectives (c) and (d).

Ofgem notes that P184 was prompted in part by consideration of Modification Proposal P179, "Housekeeping Modification". The BSC makes provision for the BSCCo to recommend that the Panel raises a Modification Proposal to rectify manifest errors, correct minor inconsistencies and/or make other minor consequential changes to that code, pursuant to F2.1.1(d)(iv). Such amendments are informally referred to as "housekeeping" changes, and the Modification Proposal submitted for P179 contained 28 suggested housekeeping changes. Subsequent to its

submission, two of these changes, relating to clauses W3.4.6 and W4.1.1, were identified as being sufficiently significant that they might not fall within the scope of F2.1.1(d)(iv) and were removed from P179 at the Panel's direction for this reason. Both clauses related to activities conducted in relation to Trading Queries and Trading Disputes under the auspices of the TDC.

The TDC has the right to recommend that the Panel raise a Modification Proposal in circumstances set down in F2.1.1(d)(v); W2.2.1; W5.3.1; and W5.3.2. These powers were used to raise P184 and P185, each of which sought to address one of the problem clauses taken out of P179: W3.4.6 in the case of P184; and W4.1.1 in the case of P185. Both Modification Proposals additionally sought wider remit to remedy perceived deficiencies and improve the conciseness of provisions relating to Trading Queries and Trading Disputes.

Ofgem considers that the scope of P184 is relatively restricted and that it concentrates on improving the robustness of, and removing ambiguities in, current provisions in the BSC, and does not result in any more significant shift in the principles underlying the Trading Disputes process.

Ofgem considers that it is in the interests of all BSC Parties for the provisions of the BSC to be as clear as possible. It is noted that there was unanimous agreement from all market respondents during both the Assessment Procedure and Report Phase consultations that P184 would result in greater clarity and the removal of ambiguity from provisions relating to the progression of Trading Queries and Trading Disputes. Whilst noting that only a subset of industry responded to either consultation, the unanimity of both subsets suggests that P184 would provide better clarity, thereby giving Parties, the BSCCo, and the TDC, a greater degree of confidence that the provisions of the BSC are both efficient and are being correctly applied.

The arguments for P184 have principally been framed against Applicable BSC Objective (d). There is a requirement under that objective to promote efficiency in the implementation and administration of the balancing and settlement arrangements. If administration is to be carried out in an efficient and economic manner, it is desirable that any perceived ambiguities are removed from the existing requirements. Ofgem considers that a persuasive case has been made that P184 would achieve this, and that it therefore better facilitates achievement of objective (d).

It is noted that one respondent to the consultation on the draft Modification Report additionally considered that achievement of Applicable BSC Objective (c) would be better facilitated due to a reduction in participant uncertainty as to how rules will be applied. Ofgem considers this a valid argument. Market confidence in the ability of the Trading Query and Disputes process to appropriately resolve exceptional circumstances resulting from disputes relating to data and/or processes used for the purposes of Settlement; the application of the rules for Settlement; or the existence, nature or effects of errors in the data or processes used in applying the rules when a Trading Party is in Credit Default, will be increased through the clarification of obligations and processes. Ofgem considers that P184 will enable Parties to trade with greater confidence in the integrity of Settlement, thereby facilitating competition.

Ofgem notes that no arguments have been put forward either for or against the facilitation of Applicable BSC Objectives (a) and (b) and is in agreement that this perception of their application is reasonable in this case. In addition, Ofgem does not consider that any of its wider statutory duties would be either better met, or impeded, by the approval of the Proposed Modification.

It is noted that both P184 and P185 affect section W of the Code and BSCP11, and that their proposed Implementation Dates, and associated decision cut-off dates, are aligned. Ofgem considers that the parallel implementation of P184 and P185 would be desirable, in order both to best realise any efficiency gains that may result from combined implementation; and to remove the potential for ambiguity as to what provisions are being applied that might result from staggered implementations.

If you have any questions, please contact me on the above number.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'N. Simpson', written over a horizontal line.

Nick Simpson

Director, Modifications

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