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National Grid Company, BSC
Signatories and Other Interested
Parties

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19 April 2005

Dear Colleague,

Modification to the Balancing and Settlement Code ("BSC") - Decision and notice in relation to Modification Proposal P174 "Provision for Users of an Interconnector with a Single Boundary Point connection to form a Trading Unit amongst themselves and with other BM Units at the same site"

The Gas and Electricity Markets Authority (the "Authority")¹ has carefully considered the issues raised in the Modification Report² in respect of Modification Proposal P174, "Provision for Users of an Interconnector with a Single Boundary Point connection to form a Trading Unit amongst themselves and with other BM Units at the same site".

The BSC Panel (the "Panel") recommended to the Authority that Proposed Modification P174 should be made and that the Implementation Date should be 29 June 2005 if an Authority decision is received on or before 2 March 2005, or 2 November 2005 if the Authority decision is received after 2 March 2005 but on or before 6 July 2005.

Having carefully 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

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

² ELEXON document reference P174MR, Version No. 1.0, dated 10/12/04

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 of the GB 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) 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 See footnote 8 for further information.

Authority has decided to direct a Modification to the BSC in line with Modification Proposal P174.

This letter explains the background to the Modification and sets out the Authority's reasons for its decision. This letter constitutes the notice by the Authority under Section 49A of the Electricity Act 1989 in relation to the direction.

Background

A Trading Unit is a group of Balancing Mechanism Units (BM Units)⁵ that are electrically close to each other with respect to the transmission system. Because of this proximity they are afforded "net" treatment, meaning that the overall commercial effect is the same as if the demand occurring within the group were satisfied directly by generation within the group (or vice-versa), with only the net of the two being traded over the system. Five classes of Trading Unit are listed in Annex K-2 of the Code defining the nature of the configurations and plant types that can be grouped into a Trading Unit. There is no requirement for the BM Units in a Trading Unit to all belong to the same Trading Party, but all of the Lead Parties of the BM Units must be party to the application to group them into a Trading Unit. The benefits of Trading Unit treatment accrue to one or more Lead Parties and may then be shared by the Parties concerned according to any contractual arrangements, outside the scope of the BSC, which the Parties may choose to put in place.

Section K 5.7.1 of the Balancing and Settlement Code (the Code) explicitly excludes Interconnector BM Units from forming Trading Units:

*"An Interconnector BM Unit may not belong to a Trading Unit other than a Sole Trading Unit."*⁶

The Modification Proposal

As set out previously, under section K of the BSC, Interconnector BM Units are prohibited from forming Trading Units, other than a Sole Trading Unit. As such, a number of charges are levied on Interconnector BM Units on a gross basis. These charges include transmission loss charges, BSCCo charges, Residual Cashflow Reallocation Cashflows (RCRC), Balancing Services Use of System (BSUoS) charges and Transmission Network Use of System (TNUoS) charges.

Modification Proposal P174 seeks to remove the restriction on participation in multi-party Trading Units which currently applies to Interconnector BM Units, but only for those BM Units associated with an Interconnector with a single boundary point connection. This would allow

⁵ The term 'BM Unit' is used to describe collections of generation plant and 'demand plant' that import and/or export electricity, so that physical imports and exports can be treated appropriately under the BSC. Because of the number of different types of generation and demand that it must cover, the exact definition of a BM Unit is somewhat involved (Section K3.1.2 of the BSC). However, for generating plant, a BM Unit is typically a single generating unit. For demand the definition of a BM Unit is largely dictated by the metering information available to Imbalance Settlement. For large demands, separate metering information is available on a half-hourly basis. In this case, the associated BM Unit is essentially defined as the aggregate of a party's demand behind a single point of connection to the transmission or distribution system.

⁶ Lead Parties of BM Units may elect to form Trading Units comprising two or more BM Units, but all BM Units belong, by default and unless they elect otherwise, to a "Sole Trading Unit", which comprises of only that BM Unit. References to "Trading Unit(s)" are often to those that have been formed with two or more BM Units.

Interconnector BM Units to form Trading Units with other Interconnector BM Units on the same single boundary point Interconnector, and with non-Interconnector BM Units that are linked by contiguous or dedicated assets, allowing the Trading Units to benefit from net treatment in relation to the charges described in the previous paragraph.

The proposer suggested that by providing new and existing Interconnector Users with similar opportunities to form a Trading Unit to those afforded to other Trading Units, the Modification Proposal would facilitate more efficient and competitive trading activity among neighbouring systems and remove the potential for duplicate charging of BSUoS. The proposer was of the view that the proposal would remove an “unnecessary and unfair potential financial burden” and “undue discrimination”. The proposer considered that the proposal would better facilitate Applicable BSC Objective C3 (c).

The Initial Written Assessment (IWA) was presented to the Panel at its meeting on 9 September 2004. The Panel agreed with the recommendation in the IWA that P174 be submitted to a two month Assessment Procedure to be carried out by the Settlement Standing Modification Group (the Group). The Group met twice during the Assessment Procedure and the Assessment Report for P174 was considered by the Panel at its meeting of 11 November 2004. At that meeting, the Panel supported the recommendations of the Group and submitted P174 to the Report Phase with a recommendation that Proposed Modification P174 should be made. The draft Modification Report was issued for consultation on 16 November 2004, and on consideration of the draft report and consultation responses, the Panel at its meeting on 9 December 2004 confirmed its provisional recommendation that Proposed Modification P174 should be made.

BSC Modification Proposal P139

BSC Modification Proposal P174 was raised following the group assessment and Authority decision in relation to P139 “Removal of Trading Unit restriction on Interconnector Users”, which the Authority rejected on 20 July 2004⁷. Modification Proposal P139 was similar to P174 in that it sought to modify the BSC so as to remove the restriction preventing Interconnector BM Units from belonging to a Trading Unit other than a Sole Trading Unit, thereby allowing Interconnector BM Units to form Trading Units with other Interconnector BM Units on the same Interconnector (i.e. with no restriction on whether the Interconnector BM Units were on the same single boundary point). This would have made it possible for electrically remote BM Units to be party to the same Trading Unit.

In its decision letter on Modification Proposals P139, Ofgem expressed concern that allowing Interconnector BM Units to form Trading Units in the manner in which they would be defined under P139 would undermine the purpose of Trading Unit status, which is to net off on-site generation and demand. Ofgem was of the view that retaining the high level principle of proximity is important as it seeks to ensure that, wherever practicable, energy is available to the traded markets, thereby helping to ensure their efficient and competitive functioning. In its decision letter, Ofgem expressed the view that netting exposure to the various trading charges may be worthy of consideration, but that the provisions of P139 went far beyond this high level principle.

⁷ The Authority's decision document can be found on ELEXON's website at the following location: http://www.elexon.co.uk/documents/modifications/139/P139_Ofgem_Decision.pdf

In addition, Ofgem considered that, were it to direct that BSC Modification Proposal P139 be made, it would be necessary to revise the Interconnector arrangements on a GB basis at BETTA go-live. Ofgem expressed that it would be inefficient to direct a Modification to the BSC in line with P139 as the Scottish Interconnector would be subsumed into the BETTA arrangements at BETTA go-live. As a consequence, the costs of developing and implementing P139 would have been irrecoverable.

Settlement Standing Modification Group considerations

Trading Unit criteria

The existing Trading Unit criteria apply to the ownership and electrical proximity of specified assets and equipment. Interconnector BM Units are not related to a set of assets owned by any individual Interconnector User. Interconnector BM Units are created to allow the separate trades conducted by the different users of a single piece of electrical equipment (i.e. the Interconnector) to be identified. Therefore, the Group concluded that it would be inappropriate to assess Interconnector BM Units against the existing Trading Classes defined within the Code. However, it was the view of the Group that Interconnector BM Units on the same Interconnector should be considered electrically proximate (since they relate to the same piece of electrical equipment) and, as such, should be considered consistent with the principles of Trading Units. Therefore, the Group concluded that it would be inappropriate to apply the existing Trading Unit classes to Interconnector BM Units and that a new class of Trading Unit would be required.

Having agreed that a new class of Trading Unit would be required under P174, the Group considered the criteria for forming such a new class of Trading Unit. P174 proposes that the formation of Trading Units involving Interconnector BM Units should be restricted to Interconnectors with a single Boundary Point and non-Interconnector BM Units linked to the Interconnector by contiguous or dedicated assets. P174 also includes scope for non-Interconnector BM Units joining a Trading Unit with Interconnector BM Units.

The Group considered the implications of allowing non-Interconnector BM Units and Interconnector BM Units to combine and form 'mixed' Trading Units as proposed by P174. Under P139, the restriction on 'mixed' Trading Units was included due to concerns relating to Multi-Circuit Interconnectors. These related to the possibility of geographically remote non-Interconnector BM Units being able to form Trading Units via the Interconnector and thus violating the proximity criterion on which the concept of a Trading Unit is founded. However, since P174 only applies to single Boundary Point Interconnectors, these concerns do not apply. Therefore, providing the 'mixed' Trading Units are consistent with the existing Trading Unit principles (relating to electrical proximity), the Group was of the opinion that there were no reasons why 'mixed' Trading Units should not be allowed.

Assessment against the Applicable BSC Objectives

The majority of the Group concluded that P174 would better facilitate achievement of the Applicable BSC Objectives since it would enable Interconnector BM Units to participate in multi-BM Units Trading Units, which would remove the current discrimination against Interconnector Users by affording them the same trading opportunities as other Parties. In particular, they would be afforded the opportunity to realise the potentially material benefits in terms of transmission losses that participation in multi-BM Unit Trading Units can provide.

The minority of the Group considered that the consequential benefits of a Modification should not be greater in materiality than its permitted scope. Given that BSUoS benefits would be the greatest materiality derived from P174, it was noted that this issue may extend beyond the vires of the BSC. This minority also held the view that the remaining benefits received under the BSC alone were not sufficient to better facilitate the achievement of Applicable BSC Objective (c), and one member was of the view that the costs of implementing P174 outweighed the potential benefits it would introduce under the BSC.

Responses to ELEXON Consultation

Exxon published the draft Modification report for consultation on 16 November 2004, which invited respondents' views by 24 November 2004. Six responses were received. Three responses (representing 13 Parties) expressed support for the Proposed Modification, two responses (representing 16 Parties) opposed the Proposed Modification and the remaining response (representing one Party) provided a "no comment" response.

The key arguments expressed by those in support of P174 included:

- ◆ The current rules are discriminatory, and the Proposed Modification removes the restriction and allows Interconnector BM Units to be treated in the same way as other parties on the system;
- ◆ The removal of discriminatory charges on Interconnector BM Units would better facilitate Applicable BSC Objective (c) by encouraging trade across Interconnectors and promoting competition;
- ◆ The removal of discriminatory charges currently based on unrepresentative gross amounts, rather than the more representative net actual metered amounts, will promote effective competition in the generation and supply of electricity.

The key arguments expressed by those not in support of P174 included:

- ◆ The BSC is not the appropriate Code to deliver the BSUoS benefit sought by this Proposed Modification;
- ◆ Any perceived benefits available under the BSC (e.g. reduction in monthly BSCCo charges) are insufficient to suggest that competition will be better facilitated;
- ◆ The benefits do not outweigh the implementation costs;
- ◆ The benefits achievable under the BSC appear to be of secondary effect when compared to the BSUoS saving identified.

Panel's recommendation

The Panel met on 9 December 2004 and considered the draft Modification report and consultation responses. It was confirmed that the majority view of the Panel was that Proposed Modification P174 should be made. The proposed implementation date should be:

- ◆ 29 June 2005 if an Authority decision is received on or before 2 March 2005; or

- ◆ 2 November 2005 if the Authority decision is received after 2 March 2005 but on or before 6 July 2005.

Ofgem's view

Having carefully considered the Modification Report, the respondents' views and the Panel's recommendation, Ofgem, having regard to the Applicable BSC Objectives, is of the view that Modification Proposal P174 would better facilitate achievement of the Applicable BSC Objectives. In addition, Ofgem considers that this decision is consistent with its wider statutory duties⁸.

Applicable BSC Objective (c) – promoting effective competition in the generation and supply of electricity, and (so far as is consistent therewith) promoting such competition in the sale and purchase of electricity

Ofgem considers that the provisions of BSC Modification Proposal P174 would enable eligible BM Units to take advantage of the benefits derived from netting the various charges, for instance transmission loss charges and BSCCo charges, in the same way as other Trading Units are able, without creating concerns in respect to undue discrimination. Ofgem therefore considers that Modification Proposal P174 would better facilitate achievement of Applicable BSC Objective (c) for promoting effective competition in the generation and supply of electricity, and (so far as is consistent therewith) promoting such competition in the sale and purchase of electricity.

As noted previously, BSC Modification Proposal P174 was raised following the Authority's decision to reject P139. In its decision letter for P139, Ofgem noted that, on balance, it did not consider the Modification Proposal better facilitated achievement of the Applicable BSC Objectives. However, having considered the merits of Modification Proposal P174 against the Applicable BSC Objectives, Ofgem is of the view that this proposal delivers the same benefits of P139 but without the same disbenefits. BSC Modification Proposal P174 proposes to restrict the eligibility of BM Units to form Trading Units to those that are associated with an Interconnector at a single boundary point connection. In so doing, the proposal retains the principle of proximity which is fundamental when allowing certain classes of users to form Trading Units. By narrowing the scope of the modification in this way, P174 removes the concerns noted in respect of P139 that the requirement for proximity would be undermined, whereby Trading Unit status would have been extended to the Scottish multi-circuit Interconnector, which has connection points separated by many miles.

Further, in its decision letter on P139, Ofgem expressed concerns that the proposal did not allow for non Interconnector BM Units to join with Interconnector BM Units on the same Interconnector to form Trading Units, regardless of whether or not such a BM Unit was proximate to the Interconnector. BSC Modification Proposal P174 addresses this defect by enabling Trading Units to be formed between Interconnector BM Units and other BM Units on the basis that these are proximate to the Interconnector.

⁸ Set out in Sections 3A to 3C of the Electricity Act 1989, as amended by the Energy Act 2004. Ofgem's statutory duties are wider than the matters 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, a duty to contribute to the achievement of sustainable development and a duty to have regard to the principles of best regulatory practice.

Applicable BSC Objective (d) – promoting efficiency in the implementation and administration of the balancing and settlement arrangements

As indicated in its decision letter for P139, Ofgem was concerned that while there were benefits associated with the proposal, were it to direct that BSC Modification Proposal P139 be made, it would be necessary to revise the Interconnector arrangements on a GB basis at BETTA go-live. Ofgem expressed that it would be inefficient to direct a Modification to the BSC in line with P139 as the Scottish Interconnector would be subsumed into the BETTA arrangements at BETTA go-live. As a consequence, the costs of developing and implementing P139 would have been irrecoverable. This would be to the detriment of Applicable BSC Objective (d).

However, BSC Modification Proposal P174 can be seen as a more enduring solution as its implementation would be on a GB basis, and has been developed with this in mind. Ofgem considers that the development and implementation costs associated with BSC Modification Proposal P174 are not material, and are significantly outweighed by the potential benefits that can be derived, including the enhanced efficacy of the balancing and settlement arrangements.

Other Issues

As set out previously, Ofgem considers that the provisions of BSC Modification Proposal P174 would enable eligible BM Units to take advantage of the benefits derived from the net treatment of certain charges. However, Ofgem notes the view of the SSMG that TNUoS and BSUoS charges are outside the vires of the BSC. For the purpose of clarity, in taking its decision on this proposal Ofgem has not taken into account the effect of the net treatment of charges that are outside the vires of the BSC in relation to whether the Modification Proposal would better facilitate achievement of the Applicable BSC Objectives.

Ofgem does consider, however, that Modification Proposal P174 would enable eligible BM Units to take advantage of the benefits derived from netting charges outside the vires of the BSC, for instance BSUoS charges⁹, in the same way as other Trading Units are able, without creating concerns regarding undue discrimination. Ofgem considers that, in this respect, its decision in relation to Modification Proposal P174 is consistent with its wider statutory duties.

If you have any questions, please contact me on the above number or alternatively you can contact Liz Chester on 0207 901 7403.

Yours sincerely,



Sonia Brown
Director, Markets

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

⁹ Currently, in accordance with Section 9.3 of the Statement of the Use of System Charging Methodology, BM Units that are registered in Trading Units will be charged BSUoS charges on a net Trading Unit basis rather than the gross metered volume as is the case with non Trading Units.