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The National Grid Company, BSC Signatories and
Other Interested Parties

30 July 2004

Our Ref: MP No P166

Dear Colleague,

Modification to the Balancing and Settlement Code (“BSC”) - Decision and notice in relation to Modification Proposal P166 “Removal of unintentional effects of P123 to allow Supplier BM unit DC values to be revised downwards during a BSC Season”

The Gas and Electricity Markets Authority (the “Authority”)¹ has carefully considered the issues raised in the Modification Report² in respect of Modification Proposal P166, “Removal of unintentional effects of P123 to allow Supplier BM unit DC values to be revised downwards during a BSC Season”.

The BSC Panel (the “Panel”) recommended to the Authority that:

- Proposed Modification P166 should be made;
- An Implementation Date for Proposed Modification P166 of 10 Working Days after the Authority’s decision; and

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 P166MR, Version No. Final/1.0, dated 18 May 2004

³ 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
- 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 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.

Authority has decided to direct a Modification to the BSC in line with the Modification Proposal P166.

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.

Background

Section K⁵ of the BSC requires the Lead Party of a Balancing Mechanism (BM) Unit to notify to the Central Registration Agent (CRA) the expected maximum magnitude of the negative BM Unit Metered Volume (QMij) for each BM Unit for the following BSC Season. By dividing this by the Settlement Period Duration (SPD), this QMij value is converted into one for the Demand Capacity (DC) for the BM Unit for that BSC Season. Therefore, the DC is an hourly MW value for the anticipated peak energy Metered Volume for the BM Unit in that BSC Season. Modification Proposal P123 (as approved by the Authority on 8 September 2003 and implemented on 27 February 2004) introduced the ability for Lead Parties to notify to the CRA a reduced QMij value for the remainder of the BSC Season up to twice during a BSC Season⁶ hence, the DC value for the remainder of the BSC Season would be reduced as a result.

Section K also obliges Parties to declare to the CRA, as soon as reasonably practicable, when they became aware that tolerances detailed in Section K3.4.3 have been exceeded. These tolerances are that the QMij, divided by the SPD to equate the units, will be less than the DC value by 0.5MW or 1% of the magnitude of DC for any Settlement Period in the relevant BSC Season. These tolerances are therefore applied retrospectively, as well as prospectively, across the relevant BSC Season. If a Party has decreased its DC during the BSC Season, and has already achieved a QMij greater than the revised value, the Party is immediately obligated to increase the peak QMij value for the BSC Season.

Modification Proposal P166 notes that the fact that the tolerances in Section K3.4.5 apply across the whole BSC Season, rather than across the remainder of the BSC Season after a revised DC value has been accepted means that the intention of Approved Modification Proposal P123 may not be realised in many cases. Many DC decreases, allowed by Modification Proposal P123, would need to be immediately revised upwards by virtue of Section K3.4.5.

In order to rectify this position, Bizzenergy submitted Modification Proposal P166, "Removal of unintentional effects of P123 to allow Supplier BM unit DC values to be revised downwards during a BSC Season" on 26 March 2004.

The Modification Proposal

Modification Proposal P166 seeks to modify the BSC by amending the legal text, so that the tolerances are applied for the Settlement Periods in the remainder of the BSC Season, if DC has been reduced mid-BSC Season. It is submitted that this will put the intention of Modification Proposal P123 into full effect.

⁵ Section K3.4.1b

⁶ Introduced by inclusion of Section 3.4.2A

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

The Panel considered the Initial Written Assessment at its meeting of 8 April 2004 and agreed to submit Modification Proposal P166 directly to the Report Phase. ELEXON published a draft Modification Report on 19 April 2004, which invited respondents' views by 28 April 2004.

Responses to ELEXON Consultation

Six responses were received to the ELEXON consultation. Four responses (representing 22 Parties) expressed support for the Proposed Modification, one response (representing 3 Parties) opposed the Proposed Modification and the remaining response (representing 1 Party) provided a "no comment" response.

The majority of respondents agreed that implementation of Modification Proposal P166 would better facilitate the achievement of Applicable BSC Objective (d) by improving efficiency in the administration of the balancing and settlement arrangements. One respondent noted that the implementation of Modification Proposal P166 would also better facilitate achievement of Applicable BSC Objective (c) by allowing Parties to decrease their DC values in accordance with the original intent of the mechanism approved in Modification Proposal P123.

One respondent did not agree that Modification Proposal P166 should be made. It was this respondent's view that the original Modification Proposal P123 did not better facilitate achievement of Applicable BSC Objective (c). Therefore they felt that they could not support Modification Proposal P166. Whilst the respondent believed in principle it is reasonable that parties should be able to change their credit levels to reflect changing circumstances, there was concern that the legal drafting for Modification Proposal P123 appeared to require no evidence from a party concerning its projected reduction in DC, nor independent scrutiny of evidence on behalf of other parties. The respondent also added that the special provisions are, in their view, inequitably applied only to suppliers rather than all parties. The respondent was concerned that the implementation of Modification Proposal P166 could allow a party to reduce its DC to avoid credit default and trade for 7 days or more before credit default is revealed. The respondent believed that this would result in unacceptable risk to other Parties.

The respondents' views are summarised in the Modification Report for Modification Proposal P166, which also includes the complete text of all respondents' replies.

Panel's recommendation

The Panel met on 13 May 2004 and considered Modification Proposal, 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 10 Working Days after the Authority's decision.

The Panel's rationale for recommending the approval of Modification Proposal P166 was that its implementation will give full effect to the Approved Modification Proposal P123. The Panel noted that Modification Proposal P123 (and thus the principle associated with Modification Proposal P166) had previously been considered and agreed by a Modification Group, the Panel and the Authority. The Panel believes that Modification Proposal P166 better facilitates the

achievement of Applicable BSC Objective (d) in that if Modification Proposal P166 was approved the administration of the balancing and settlement arrangements would be more efficient. In the Panel's view Modification Proposal P166 removes the obligation on BSCCo to inform Parties that they are required to increase their DC values if they have utilised the Modification Proposal P123 mechanism but have breached the tolerances retrospectively.

Responses to Ofgem GB Consultation

On 5 December 2003 Ofgem undertook to invite responses on additional implications that a Proposed Modification may have, were it to be applied on a GB wide basis, as opposed to being limited to England and Wales. In order to discharge this undertaking Ofgem published a GB Consultation Paper on 25 May 2004 which invited respondents' views by 21 June 2004. Ofgem received no responses to the GB Consultation.

The GB Consultation Paper and other related documents can be found on the *BETTA GB Consultation* section of the Ofgem website.⁷

Ofgem's view

Having carefully 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 P166 will better facilitate achievement of Applicable BSC Objective (d). Ofgem concurs with the Panel view that approval of Modification Proposal P166 will make the administration of the balancing and settlement arrangements more efficient by removing the obligation on BSCCo to inform Parties that they are required to increase their DC values if they have utilised the Modification Proposal P123 mechanism but have breached the tolerances retrospectively.

Ofgem notes that Section K3.4.5 obliges Parties to inform the CRA, as soon as reasonably practicable, when they became aware that tolerances detailed in Section K3.4.3 have been exceeded. As stated above these tolerances are therefore applied retrospectively, as well as prospectively, across the relevant BSC Season.

Ofgem also notes that if a Party has decreased its DC during the BSC Season and has already achieved a QMij greater than the revised value, the Party is immediately obligated to increase the peak QMij value for the BSC Season.

It is Ofgem's view that the tolerances in Section K3.4.5 apply across the whole BSC Season, rather than across the remainder of the BSC Season after a revised DC value has been accepted. It is therefore Ofgem's view that the current wording of the approval of Modification Proposal P166 will remove the defect by amending the legal text, so that the tolerances are applied for the Settlement Periods in the remainder of the BSC Season, if DC has been reduced mid-BSC Season. This will allow DC values to be revised downward more effectively during a BSC Season.

⁷ <http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/bettagbcons>

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