



Direct Dial: 020-7901 7355

05 December 2003

The National Grid Company, BSC Signatories and
Other Interested Parties

Our Ref: MP No P145

Dear Colleague,

Modification to the Balancing and Settlement Code (“BSC”) - Decision and Notice in relation to Modification Proposal P145: “Cost reflective mechanism to allocate any deficit arising from the application of the PNE claims fee”

The Gas and Electricity Markets Authority (the “Authority”)¹ has carefully considered the issues raised in the Modification Report² in respect of Modification Proposal P145, “Cost reflective mechanism to allocate any deficit arising from the application of the PNE claims fee”.

The BSC Panel (the “Panel”) recommended to the Authority that the Proposed Modification P145 should not be made. In the event the Authority determined that Proposed Modification P145 should be made, the Panel agreed that the P145 Implementation Date shall be 5 Working Days from an Authority decision.

Having carefully considered the Modification Report and the Panel’s recommendation and having regard to the Applicable BSC Objectives and the Authority’s wider statutory duties³, the Authority has decided not to direct a Modification to the BSC.

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

Background

Provisions for a Past Notification Error (PNE) claims process were incorporated into the BSC following the approval of Proposed Modification P37 Alternative on 10 May 2002. It was

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

² ELEXON document reference P145UMR, Version No. 1.0, dated 13 November 2003.

³ 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.

subsequently implemented on 20 May 2002. Parties were able to submit PNE claims from the implementation date through to 24 May 2002.

On 22 May 2002, following on from the Authority approval of Proposed Modification P37 Alternative, Modification Proposals P83 and P84 were submitted for evaluation under the BSC procedures. The purport of Modification Proposal P83 was to extend the PNE claims window so as to allow Modification Proposal P84 to be considered. The Authority approved Modification Proposal P83 on 23 May 2002 the result of which was PNE claims could have been submitted through to 31 May 2002.

Modification Proposal P84 was approved by the Authority on 28 May 2003. The effect of implementation of this modification was that parties who submitted two or more claims could request that these be treated as one claim for the purposes of calculating the claim fee on the grounds that the claims arose from the same cause. The PNE Committee could then decide whether the relevant mistake described in these claims resulted from the same cause.

All claims that are upheld will be subject to an Error Correction Payment (ECP) and Error Correction Payment Reallocation (ECPR) will be calculated by ELEXON. The ECP is set at 20% of the value of each claim and is paid by the benefiting Party (claimant or counterparty) The ECP is then redistributed to all non benefiting Parties as the ECPR. These Ad Hoc Trading Charges will be invoiced by the Funds Administration Agent (FAA) in batches on a monthly basis with each batch relating to PNE claims processed in the PFSRs for the previous month. ELEXON's Finance Department will then invoice PNE claimants for the relevant claim fees. This will be offset against BSCCo costs.

The BSC currently states that where a Party makes a PNE claim, such Party shall pay a fee to ELEXON⁴. The fee shall be £5,000 or such other amount as the Panel may from time to time determine after consultation with Parties and subject to the approval of the Authority.

The BSC goes on to state that where a Party has submitted a number of PNE claims and the PNE Committee is satisfied that the relevant mistake for two or more such claims resulted from the same cause then the relevant claims shall be treated as a single claim⁵. The BSC also states that the fee shall be invoiced as and included in determining BSCCo Charges for the next month following notification of the PNE Committee's determination⁶.

Modification Proposal P145 seeks to modify the BSC so as to ensure that the total cost of the Past Notification Errors (PNE) process is recovered from only PNE claimants and that the costs are recovered from those claimants on a differential basis dependent on the size of the claim.

Modification Proposal P145 was submitted on 17 October 2003 with the request that it be treated as an Urgent Modification Proposal. ELEXON made a recommendation to the Panel Chairman that P145 be treated as urgent.

The Panel agreed with ELEXON's recommendation that P145 be treated as urgent, and requested that the Authority grant urgent status. The Authority granted Urgency on 21 October 2003 and agreed that P145 should be progressed with the requisite timetable as agreed by the Authority.

⁴ Section P Paragraph 6.2.2

⁵ Section P Paragraph 6.2.6

⁶ Section P Paragraph 6.4.4(g)

The Modification Proposal

The basis for submission of Modification Proposal P145 was that there was a possibility of there being a difference between the monies to be collected from the application of the PNE claim fee and the total cost of the PNE process. Modification Proposal P145 seeks to ensure that any deficit arising from the application of the PNE claim fee is allocated in such a way as to ensure the costs of the PNE process are both allocated amongst PNE claimants only and that Parties that have not made any PNE claims or have decided not to pursue their claims are not required to fund such costs. The Proposal created a formula which apportions the PNE process costs to claimants on a pro rata basis according to the size of their claim. The Proposer believes that placing an unreasonable cost burden on non-claimants and new entrants or a disproportionate cost burden on claimants with relatively small value claims will tend to undermine those Parties' ability to compete in the market. The Proposer states that targeting costs at those that to a greater or lesser extent have contributed to the costs will thus help promote competition in the generation and supply of electricity.

The justification for the Modification Proposal was that it would better facilitate achievement of the Applicable BSC Objective⁷ C3 (3) (c).

ELEXON published a draft Modification Report on 7 November 2003, which invited respondents' views by noon on 11 November 2003.

Respondents' views

ELEXON received 16 responses to the consultation on Modification Proposal P145. 8 responses (representing 27 Parties and 1 non-Party) expressed support for the Proposed Modification and 8 responses (representing 32 Parties) opposed the Proposed Modification.

The issue of retrospective changes to the code was specifically addressed in the consultation and the majority of respondents stated that they considered the proposal would have retrospective effect. They noted that the BSC could only be interpreted as potentially allowing a changing the uniform level rather than the methodology of calculating the fee.

Those respondents that considered that nevertheless it was an appropriate change to make retrospectively, argued that the costs of the PNE process were unknown at the time the claim fee was set and hence why the clause allowing the Panel to recommend a change was included. Therefore the eventuality had been flagged. Also that the costs are materially above those that might have been envisaged and therefore could not have been reasonably foreseen.

⁷ The Applicable BSC Objectives, as contained in Standard Condition C3 (3) of National Grid Company's ("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.

Others argued that if the flagging of a change existed, it could not be interpreted as applying to a non-uniform change in the fee.

A few Parties noted that the responses would be likely to be biased depending on whether the Parties were net receivers or payers of monies affected.

The respondents' views are summarised in the Modification Report for Modification Proposal P145, which also includes the complete text of all respondents' replies.

Panel's recommendation

The Panel met on 13 November 2003 and considered the Modification Proposal P145, the draft Urgent Modification Report, the views of the Modification Group and the consultation responses received.

The Panel recommended that the Authority should reject the Proposed Modification but that, if approved, the Proposed Modification should be implemented 5 Working Days from an Authority decision.

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 Urgent Modification P145 would not better facilitate achievement of the Applicable BSC Objectives.

Ofgem notes the comments of the Modification Group and the comments of the consultation respondents on the question of firstly whether this Proposed Modification is retrospective in nature and considers, like the majority of the consultation respondents, that by seeking to target costs on claimants on a pro rata basis, implementation of this Proposal would have a retrospective effect on all Parties who have made claims under the process. Further, the expectation of Parties, especially those with sizeable or numerous claims would not have been that they would have to pay proportionally more towards the as yet undetermined total costs of the PNE process.

Having established that the effects would be retrospective in nature, the question then arises as to whether the circumstances surrounding the Proposed Modification P145 are of the kind that, according to criteria outlined in the Authority Decision letter on Modification Proposal P19, might give rise to the need for a retrospective rule change. The criteria outlined under Authority Decision letter Modification Proposal P19 was that the "particular circumstances which could give rise to the need for a retrospective rule change could, for instance include:

- a situation where the fault or error occasioning the loss was directly attributable to central arrangements;
- Combinations of circumstances that could not have reasonably foreseen; or
- Where the possibility of a retrospective action had been clearly flagged to the participants in advance, allowing the detail and process of the change to be finalised with retrospective effect.

In any event , the losses incurred by the Parties involved would be have to be material;"

This proposal does not relate to central arrangements.

On the second bullet point, Ofgem does not consider that the shortfall between the aggregated claims fee and the final cost of the PNE process resulted from a combination of circumstances that could not have been reasonably foreseen.

Also, Ofgem considers that it was not flagged to parties with larger claims that they would have to pay proportionally more towards the costs of the PNE process.

Accordingly Ofgem considers that to retrospectively amend the cost recovery mechanisms by introducing a new fee mechanism to recoup the deficit on the basis that parties with larger claims pay proportionally more toward the PNE costs would not better facilitate achievement of the objective of promoting competition in generation and supply in line with BSC Objective c.

With regard to claimants under the PNE process, Ofgem observes that the BSC already contains provisions consistent with the principle that underpins much of this proposal; that those claiming under the BSC section P6 should not be seen to be completely exempt from the consequences of their notification errors and that likewise non-claimants should not suffer unduly as a result. The claim fee itself is an example of such a provision, as is the ECP. Non-claimants will, of course, benefit from the effect of notification errors for claims that are not upheld.

The Modification Group requested a legal opinion as to whether the Proposal would be retrospective in effect and if so whether it fulfilled the Ofgem criteria for the circumstances which might require a retrospective rule change. Ofgem notes the consultation response expressing concern about ELEXON's legal advice. Ofgem understands that in the context of tendering legal advice in a contentious climate, there will be differences of opinion. ELEXON's role is to furnish the Modification Group with sufficiently detailed and balanced information to enable them to reach a recommendation on the BSC objectives.

The Authority's decision

The Authority has therefore decided not to direct that the Proposed Urgent Modification P145, as set out in the Modification Report, 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 Modification Report.

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

Yours sincerely,

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

Nick Simpson
Director, Industry Codes Development

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