



Direct Dial: 020 7901 7355

1 September 2003

The National Grid Company, BSC Signatories and
Other Interested Parties

Our Ref: MP No P128

Dear Colleague,

Modification to the Balancing and Settlement Code (“BSC”) - Decision and Notice in relation to Modification Proposal P128: “Correction of Erroneous Energy Contract Volume Notifications in Specifically Defined Limited Circumstances”

The Gas and Electricity Markets Authority (the “Authority”)¹ has carefully considered the issues raised in the Modification Report² in respect of Modification Proposal P128, “Correction of Erroneous Energy Contract Volume Notifications in Specifically Defined Limited Circumstances”.

The BSC Panel (the “Panel”) recommended to the Authority that the Proposed Modification P128 should not be made, but in the event that the Authority determines that the Proposed Modification should be made, the Implementation Date should be 5 Business Days after the Authority's decision.

Having 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

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

² ELEXON document reference P128UR10, Version No. 1.0, dated 13 June 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.

An Energy Contract Volume Notification (ECVN) is a notification by a BSC Party to the central settlement system of a transfer of an energy quantity from one account to another. Similarly a Metered Volume Reallocation Notification (MVRN) is a notification of a transfer of metered energy.

Modification Proposal P37 entitled 'To provide for the remedy of past errors in Energy Contract Notifications and in Metered Volume Reallocation Notifications' was raised on 11 September 2001. Prior to the implementation of Modification Proposal P37 there was no facility available to Parties to correct erroneous Volume Notifications. The Authority directed the licensee to make Modification Proposal P37 on 10 May 2002 and introduced paragraph 6 into Section P of the BSC. Paragraph 6 applies to retrospective claims to correct Past Notification Errors and is intended to apply in very limited instances.

Gaz de France Energy Marketing Limited submitted Modification Proposal P128, "Correction of Erroneous Energy Contract Volume Notifications in Specifically Defined Limited Circumstances" on 6 May 2003. Modification Proposal P128 was submitted with the request that it be treated as an Urgent Modification Proposal.

The Modification Proposal

Modification Proposal P128 seeks to modify the BSC so as to allow certain Parties the possibility of correcting erroneous ECVNs under specifically defined limited circumstances. The Proposer indicated that Modification Proposal P128 had been raised to provide 'new entrants' with the same provisions that were allowed for existing entrants following the introduction of paragraph 6 into the Section P of the BSC. A new entrant in this context, means a single Party who carries out trades between its Production and Consumption Energy Accounts for the first time.

Under the modification proposal new internal transactors would be able to claim in respect of a Past Notification Error to the Panel. Only ECVNs would be capable of inclusion within the claim. Modification Proposal P128 excludes the possibility of claiming for MVRNs. Claims will only apply to Notifications made in respect of Settlement Periods within the first 28 Settlement Days for which Notifications between Production and Consumption Energy Accounts have been made. The Proposal anticipates that the resulting change to the BSC will have an effective Implementation Date of 5 Business Days after an Authority decision. The claimant will then have a further 5 Business Days to submit claims for relevant Settlement Periods that occurred prior to the Implementation Date. For all subsequent Settlement Periods, claimants must submit claims by the closure of a period 5 Business Days after the first 28 Settlement Days during which the relevant ECVN applied.

The justification for the Modification Proposal was that it would better facilitate achievement of the Applicable BSC Objective⁴ C3 (3) (c).

⁴ 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;

Upon receipt of the Proposal, ELEXON recommended to the BSC Panel Chairman that it be treated as an Urgent Modification Proposal because there was a concern that impacted parties may be facing disproportionate costs. The Panel Chairman sought the views of the Panel as to whether Modification Proposal P128 should be treated as an Urgent Modification Proposal. The Panel agreed that it should be so treated and the Panel Chairman passed this recommendation on to the Authority. The Authority agreed that P128 should be progressed as an Urgent Modification Proposal on 7 May 2003.

The Modification Group (the "Group") considered the Modification Proposal over the course of three meetings (9 & 16 May 2003 and 2 June 2003). During its meetings, the majority of the Group considered that the P128 did not facilitate achievement of Applicable BSC Objective C 3 (3) (c), as the Modification Proposal would increase uncertainty in the market and thus decrease confidence. It was their opinion that this would potentially deter new entrants. A minority of Group members felt that P128 did better facilitate the achievement of Applicable BSC Objective (c) because the ability for a new entrant to make Past Notification Error claims would, in their view, decrease the risk of entry into the market.

The majority of the Group considered that the Modification Proposal did not better facilitate the achievement of Applicable BSC Objective C 3 (3) (d). They felt that incorporating an enduring Past Notification Error claims process would decrease efficiency in the implementation and administration of the balancing and settlement arrangements. A minority felt that P128 would better facilitate the achievement of Applicable BSC Objective (d) by reducing the risk of participating in the market and thereby reduce the risk related costs of balancing and settlement activities.

ELEXON published a draft consultation document and consultation questions regarding Modification Proposal P128 on 19 May 2003. Respondents were invited reply with their views by 30 May 2003. ELEXON published the draft Urgent Modification Report on 6 May 2003.

Respondents' views

ELEXON received ten responses to the consultation on Modification Proposal P128. One response (representing 1 Party) expressed support for the Proposed Modification, eight responses (representing 43 Parties) opposed the Proposed Modification and the remaining one (representing 1 Party) provided a "no comment" response.

The respondent in favour of the Proposal (the Proposer) argued that Modification Proposal P128 was consistent with the principle of Modification Proposal P37 and with the intent of BSC Section P paragraph 6, in extending similar rights and opportunities to new Parties to retrospectively amend erroneous notifications. Other responses argued that Modification

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- 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.

Proposal P128 did not promote increased competition, but rather that it would lead to disincentives on BSC Parties to make correct Volume Notifications. A common argument against the Proposal was that it would reduce the incentives for Parties to have robust notification systems in place from the point of commencement of trading, thereby undermining market confidence in the Settlement system. One Party pointed out that in contrast to the post Go-Live⁵ situation, which resulted in the origination of Modification Proposal P37, ELEXON provide a test site for participants and new entrants have the benefit of being able to purchase fully tested and proven trading systems from a variety of providers.

A further respondent noted the potential for similar issues to arise with regards BETTA. Ofgem considers that such issues will be highlighted during the BETTA consultation process and they are not relevant for the Modification Proposal under consideration.

The respondents' views are summarised in the Modification Report for Modification Proposal P128, which also includes the complete text of all respondents' replies.

Panel's recommendation

The Panel met on 12 June 2003 and considered Urgent Modification Proposal P128, 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 with an Implementation Date of 5 Business Days after the Authority's 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 Modification P128 would not better facilitate achievement of the Applicable BSC Objectives.

It is the Proposer's assertion that Standard Condition C 3 (1) of the NGC Transmission Licence requires NGC to have in force a BSC which sets out the terms of the balancing arrangements described in C3 (2) (b) (ii) of the same Transmission Licence. The Proposer goes on to state that the Modification Proposal is designed to ensure that the BSC does in fact fulfil the requirements of Condition C3 (2) (b) (ii) and consequently better facilitate the achievement of the Applicable BSC Objectives.

Having considered the Proposer's concern with regard to the Transmission Licence, Ofgem is satisfied that the current arrangements under Condition C3 (2) (b) (ii) will allow parties to meet their obligations.

Modification Proposal P128 seeks to allow certain Parties the possibility of correcting erroneous ECVNs under specific defined limited circumstances. However it is Ofgem's view that the

⁵ Go-Live refers to the Go-Live date of the New Electricity Trading Arrangements (NETA) 27 March 2001

uncertainty introduced by Modification Proposal P128 would not engender confidence in the electricity retail market.

The incentives of Parties to balance their positions is a key feature of the New Electricity Trading Arrangements (NETA). It is Ofgem's view that a central element involved in this is for Parties to take active responsibility for the accurate notification of their energy transfer quantities. In the foreknowledge of the risks associated with incorrect notifications, many Parties will take extra care in their notifying arrangements and systems to avoid such errors and the consequences of such errors.

As stated in the decision document for Modification Proposal P19, Ofgem considers that there are widely accepted and well understood reasons as to why retrospective modifications are normally to be avoided. Modifications generally ought not to change the character of past transactions completed on the basis of the then existing rules. Retrospective changes to the BSC will tend to damage market confidence in, and the efficient operation of, NETA. Ofgem understands that BSC Parties generally prefer the assurance of rules that are unlikely to be changed retrospectively.

Introducing changes which allow for the retrospective correction of notification errors on a routine basis would, in Ofgem's opinion, be likely to increase uncertainty in the market, which would not promote competition.

In its decision on Modification Proposal P35, "Qualified ECVNAs", Ofgem expressed its reservations as to the idea of having an allowable level of error in the notification of Volume Notifications. Further, the decision letter for Approved Modification P37 noted: *"... participants have been continually gaining experience and understanding of the processes of NETA and any trading risks that the Parties may face in consequence of their decisions. Ofgem would therefore expect that the test for a reasonable and prudent Party would effectively become progressively more stringent in relation to notification errors occurring later in time. As such, it is Ofgem's view that it would only be in relation to errors which occurred during the early days of NETA that it could sensibly be argued that a reasonable and prudent operator could not have either foreseen or been expected to bear the risk of alleged errors and their consequences."*

Bearing in mind Ofgem's previous statements as to the level of care Parties should take with regards their notification systems, and the accessibility of both trading system test facilities and trading expertise to new and existing Parties alike, Ofgem considers that Modification Proposal P128 would not better facilitate either of applicable BSC Objectives (c) or (d).

In considering the limited circumstances under which the Modification Proposal would operate, Ofgem notes that only 'new internal transactors' (i.e., Parties who are trading internally between their Production and Consumption Energy Accounts where there are no previous Notifications between these accounts) can make a claim under Modification Proposal P128. Ofgem considers that whilst it could be argued that experience and facilities for testing were limited at the start of NETA, this is not the case after two years of operation. Ofgem therefore does not consider that this proposal would better facilitate achievement of the Applicable BSC Objectives.

The Authority's decision

The Authority has therefore decided not to direct that the Proposed Modification P128, 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 'N. Simpson', written over a horizontal line.

Nick Simpson

Director of Industry Code Development

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