



Direct Dial: 020 7901 7355

28 August 2002

The National Grid Company, BSC Signatories and
Other Interested Parties

Our Ref: MP No P61

Dear Colleague,

Modification to the Balancing and Settlement Code ("BSC") - Decision and Direction in relation to Modification Proposal P61: "Ad Hoc Adjustments to Settlement involving material errors without resorting to Ad Hoc Settlement Runs"

The Gas and Electricity Markets Authority (the "Authority")¹ has carefully considered the issues raised in the Modification Report² in respect of Modification Proposal P61, "Ad Hoc Adjustments to Settlement involving material errors without resorting to Ad Hoc Settlement Runs".

The Balancing and Settlement Code Panel (the "Panel") recommended to the Authority that Modification Proposal P61 should be made and implemented on a Calendar Day basis. It recommended that the implementation date should be 12 August 2002, subject to an Authority determination by 20 May 2002, or 10 December 2002 if an Authority determination were made between 21 May 2002 and 10 September 2002.

The Authority has decided to direct a Modification to the BSC.

This letter explains the background and sets out the Authority's reasons for its decision. In addition, the letter contains a direction to The National Grid Company plc ("NGC") to modify the Balancing and Settlement Code ("BSC") in line with Modification Proposal P61, as set out in Supplement 1 of the Modification Report.

This letter constitutes the notice by the Authority under section 49A Electricity Act 1989 in relation to the direction.

Background

Scottish Power Energy Trading Limited submitted Modification Proposal P61, "Ad Hoc Adjustments to Settlement involving material errors without resorting to Ad Hoc Settlement

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

² ELEXON document reference MR44/004, Version No. 1, dated 17 May 2002

Runs", on 31 December 2001. The justification for the Modification Proposal was that it better facilitated achievement of the Applicable BSC Objective³ C3 (3) (d).

Following the presentation of an Initial Written Assessment to the Panel at its January 2002 meeting, an Assessment Report was presented to the April Panel meeting. The final Modification Report was sent to the Authority on 17 May 2002, after the Panel had made its recommendation at the May 2002 Panel meeting.

While the Modification Report was submitted to the Authority for determination, ELEXON informed the Authority that the legal wording did not capture the intent of the Modification Report as clearly as desirable. ELEXON believed that there was potential for confusion if the wording was implemented some time in the future. Accordingly, on 25 July 2002, all BSC Parties were made aware of the concerns and of proposed changes to the legal text to provide clarification. Parties were told that in the absence of any adverse comments, revised legal text would be provided to the Authority and posted on the BSC Website. BSC Parties were also given the opportunity to comment on the process followed by ELEXON in respect of these Modification Proposals. Five responses were received, all of which either agreed with the proposed changes or had no adverse comments in respect of these changes. ELEXON wrote to the Authority on 1 August 2002. The letter explained the process followed and provided the revised legal text as a Supplement to the Modification Report.

The Modification Proposal

ELEXON's systems are currently unable to perform multiple Disputes Pre- and Post-Final Settlement Runs (also known as Ad-Hoc Settlement Runs). This represents a non-compliance with the BSC. Change Proposal 517 (CP517) has been developed as a means to remedy this non-compliance, but analysis indicates that there would be a severe impact on BSC Party systems and processes if CP517 was implemented.

Modification Proposal P61 seeks to modify the BSC so as to dispense with Ad-Hoc Settlement Runs as a means of correcting material errors under the Code and proposes the following procedure:

- Applying the correction at the next convenient Timetabled Reconciliation Settlement Run; or
- Using a single Dispute Final Run post the Timetabled Final Reconciliation Run; or
- Using an interim adjustment between Settlement Runs

The single Dispute Final Run would not be a timetabled Reconciliation Run but would be run at the discretion of the Panel/Trading Disputes Committee (TDC). An interim adjustment would only be used where there was a need on the grounds of urgency (e.g., cash flow). In such an instance, an approximate manual calculation of the error effects would be carried out. The Funds Administration Agent (FAA) would then recover monies from the advantaged Parties (as determined by ELEXON) which would be payable to the disadvantaged Party. Just prior to the next timetabled Reconciliation Run, the FAA would then reverse these monies flows (with the

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

addition of an interest payment) so that the Reconciliation Run can proceed without the complication of having to take the urgent payments into account.

The Proposer considered that the use of timetabled Settlement Runs (or manual interim adjustments where required) would bring about a more cost effective and practical means for adjusting material errors in the Settlement process. Given the low expected frequency of interim adjustments (only one has been necessary since Go-Live), the Modification Group have preferred that the interim adjustment process should remain a manual one in the interests of minimising cost.

ELEXON published a Draft Modification Report on 3 May 2002, which invited respondents' views by 13 May 2002.

Respondents' views

ELEXON received ten responses to the consultation on Modification Proposal P61. Seven responses (representing 22 Parties) expressed support for the proposed Modification and one response (representing 1 Party) supported the proposal subject to clarification of points raised. One response (representing 4 Parties) was not in favour of the proposal and the remaining respondent (representing 1 Party) did not express an opinion.

Those in favour of the proposed Modification thought that it was a pragmatic and cost-effective solution to the current non-compliance with the BSC. The Party against the Modification Proposal objected on the basis that the BSC was written with the expectation of being able to use software to perform 'settlement between or after normal runs' in special circumstances (to avoid the numerous problems associated with manual processes). The Party felt that there was no good reason to remove this objective, though it had no objection to a manual process also being available in a more formalised form than at present.

The respondents' views are summarised in the Modification Report for Modification Proposal P61, which also includes the complete text of all respondents' replies.

Panel's recommendation

The Panel met on 16 May 2002 and considered the Modification Proposal P61, 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 made and implemented on a Calendar Day basis. It recommended that the implementation date should be 12 August 2002, subject to an Authority determination by 20 May 2002, or 10 December 2002 subject to an Authority determination between 21 May 2002 and 10 September 2002.

Ofgem's view

Ofgem considers, having had regard to its statutory duties, that Modification Proposal P61 will better facilitate achievement of the Applicable BSC Objective C3 (3) (d).

The inability of ELEXON's systems to perform multiple disputes Ad-Hoc Settlement Runs constitutes a clear non-compliance with the BSC Code. The Proposed Modification represents a pragmatic and cost-efficient procedure for correcting this non-compliance. Ofgem notes the

objection of the respondent who was against the introduction of a manual procedure in such a complex area. However, Ofgem observes that the implementation cost of an automated procedure is estimated at £60,000, plus annual maintenance cost. Ofgem considers that the manual calculation will only be used infrequently and is sufficiently robust to serve the purpose for which it is intended.

Modification Proposal P61 proposes a change to the process for correcting Settlement errors under the BSC. Ofgem does not consider that a Calendar Day implementation will introduce a real element of retrospection and any retrospective effect on settlement periods prior to the calendar day on which the proposal is implemented is purely process related. In past decision letters, Ofgem have outlined why they consider retrospective rules changes ought to be avoided and Ofgem is satisfied that none of these circumstances prevail in this instance in that this rule change could not affect the behaviour of industry participants in a way that would distort the market in their favour, nor would it affect the expected material outcome of the rectification process.

Ofgem agrees with the Panel's recommendation that Modification Proposal P61 should be made and implemented.

The Authority's decision

The Authority has therefore decided to direct that the Proposed Modification P61, as set out in Supplement 1 of the Modification Report for Modification Proposal P61, should be made and implemented.

Direction under Condition C3 (5) (a) of NGC's Transmission Licence

Having regard to the above, the Authority, in accordance with Condition C3 (5) (a) of the licence to transmit electricity granted to NGC under Section 6 of the Electricity Act 1989 as amended (the "Transmission Licence"), hereby directs NGC to modify the BSC as set out in Supplement 1 of the Modification Report.

The Implementation Date of Modification Proposal P61 is 10 December 2002.

In accordance with Condition C3 (5) (b) of NGC's Transmission Licence, NGC shall modify the BSC in accordance with this direction of the Authority.

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, Industry Codes Development

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