



Direct Dial: 020 7901 7355

13 May 2002

The National Grid Company, BSC Signatories and
Other Interested Parties

Our Ref : MP No: P35

Dear Colleague,

Modification to the Balancing and Settlement Code (“BSC”) - Decision and Notice in relation to Modification Proposal P35: “Qualified ECVNAs”

1. The Gas and Electricity Markets Authority (the “Authority”)¹ has carefully considered the issues raised in the Modification Report in respect of Modification Proposal P35, “Qualified ECVNAs”.
2. The Balancing and Settlement Code Panel (the “Panel”) recommended to the Authority that the Alternative Modification Proposal be approved with an Implementation Date of twenty business days from any Authority determination.
3. The Authority has decided not to direct a Modification to the BSC.
4. This letter explains the background and sets out the Authority’s reasons for its decision.

Background

5. On 5 September 2001 Automated Power Exchange (APX) submitted Modification Proposal P35: “Qualified ECVNAs”. The purpose of this Modification was to introduce a category of privileged (“qualified”) Energy Contract Volume Notification Agents (ECVNAs) who, in the event of a failure of their systems or processes, would, on a limited basis, be able to notify contracts they had previously received to the central Energy Contract Volume Aggregation Agent (ECVAA) after Gate Closure for the settlement period to which the contracts related.
6. In making the Modification Proposal, APX argued that it would improve liquidity in the short-term markets, by lowering the risk of failed or erroneous notification close to Gate

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

Closure. At present Gate Closure is set at three and a half-hours², although in reality BSC Parties do not normally trade less than four hours before delivery due to the risk of notification failure. APX emphasised that it was typical of other power exchanges and third party ECVNAs in that it closes service thirty minutes before Gate Closure to provide sufficient contingency to successfully notify positions to the ECVA. It argued that a Power Exchange, which acts as an ECVNA, would be able to allow trading and third party notifications to continue until closer to Gate Closure if the current risks associated with contract notification were reduced. It also argued that if the Modification was implemented, qualified ECVNA's would be in a position to offer higher value services to participants according to their needs, such as enhanced reporting services and dual notification. These factors in turn would improve trading conditions and help promote effective competition in the generation and supply of electricity.

7. The Modification Proposal was first discussed at the Panel meeting on 20 September 2001 where it was determined that further definition of the Modification Proposal was required. The Contract Notification Modification Group met to review and discuss the Consultation responses and to finalise the Definition Report for Modification Proposal P35. During this stage it was decided that the terminology of the Modification Proposal should be changed from "Qualified ECVNAs" to "Privileged ECVNAs", as this was a more appropriate description.
8. The Panel considered the Assessment Report at its meeting on 17 January 2002, and agreed that Modification Proposal P35 be submitted to the Report Phase, with the Modification Report containing a provisional recommendation to the Authority to approve the Proposed Modification.
9. A Draft Modification Report was prepared on this basis and submitted for industry consultation on 29 January 2002.

The Modification Proposal

10. Modification Proposal P35 seeks to change the BSC so as to recognise the status of "Privileged ECVNAs". An ECVNA wishing to be granted Privileged Status would request such status from the Performance Assurance Board and would provide an undertaking that its notification systems accorded with the Performance Assurance requirements of the BSC.
11. Once granted Privileged Status, the ECVNA would be allowed to submit claims for ex post correction of notifications received by the ECVNA on an ex ante basis provided that such notifications were received by the ECVNA in sufficient time to have provided the notification to the ECVA by Gate Closure for the relevant Settlement Period.
12. Individual claims would be limited to four hour periods and would need to be submitted within two Business Days of the Settlement Day to which the claim refers. A non-

² The Authority has now approved Modification Proposal P12: "Reduction Of Gate Closure From 3.5 Hours To 1 Hour" with an Implementation Date of 2 July 2002

refundable administration fee of £5,000 would be payable in respect of each claim and the number of claims by a Privileged ECVNA would be limited to 12 claims in a rolling period of a year.

13. When a Privileged ECVNA first makes a claim, or in respect of the first claim (or at the discretion of the Performance Assurance Board) raised after a previous claim as been rejected, a site visit may be initiated. The purpose of such a visit would be to verify the Privileged ECVNA's system(s) with regard to the Performance Assurance and to verify and audit the claim raised. Where a site visit is undertaken and the Performance Assurance Board does not consider that the system meets the specified requirements or where the Privileged ECVNA has exceeded its claim allowance, the claim would be rejected.
14. ELEXON published a Draft Modification Report on 14 February 2002, which invited respondents' views.

Respondents' views

15. In total, ELEXON received 6 responses (representing the views of 32 Parties) to the consultation on the draft Modification Report. The respondents' views are summarised in the Modification Report³ for Modification Proposal P35, which also includes the complete text of all respondents' replies.
16. Of the respondents, all but one supported the recommendations made in the Draft Modification Report although a number suggested improvements to the proposal.

Panel's Recommendation

17. The Panel met on 17 January 2002 and considered Modification Proposal P35, the draft Modification Report, the views of the Modification Group and the consultation responses received.
18. The Panel supported the views of the Modification Group and concluded that Modification Proposal P35 would better facilitate achievement of the Applicable Code Objectives (c)⁴ and (d)⁵ as set out in Condition C3 (3) of NGC's transmission licence.
19. The rationale for the Panel's recommendation was that implementing the Modification could increase trading, especially within day, which may have the effect of increasing liquidity and transparency in the trading market. The Panel considered that this would increase confidence in the market and hence encourage participation, thus promoting competition. The Panel also believed that the Modification Proposal would enable Privileged ECVNAs to offer services whereby the number of interfaces into the central

³ ELEXON document reference MR035, Version 2.0, dated 18 February 2002

⁴ 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

⁵ Promoting efficiency in the implementation and administration of the balancing and settlement arrangements.

BSC systems would be reduced and this would promote efficiency in the administration and operation of the balancing and settlement arrangements.

20. The Panel, therefore, recommended that the Authority should approve the Proposed Modification with an Implementation Date of twenty Business Days from any Authority determination to approve Modification Proposal P35.

Ofgem's view

21. When Ofgem initially considered this Modification Proposal we were concerned that it would be inappropriate for us to take any decision pending the outcome of the litigation between ScottishPower and Elexon. However, having now intervened in those proceedings and having had the opportunity to consider the relevant matters further and in more detail, Ofgem has decided that, notwithstanding the litigation, it is appropriate for us to issue a decision in relation to Modification Proposal P35.
22. Having assessed the relevant issues and reviewed the consultation responses, Ofgem has considered the Modification Report pursuant to its duty under Condition C3 5(a) of NGC's transmission licence and in the light of its statutory duties. Ofgem does not agree that Modification Proposal P35 would better facilitate achievement of the Applicable BSC Objectives for the reasons set out below.
23. This Modification Proposal is very closely related to matters that were considered before Go Live and, in particular, were discussed in the consultation and conclusions documents on Special Provisions for Computing System Failures.⁶ These considered whether failures in ECVNA systems should be subject to special provisions i.e. error correction provisions. Following consideration of responses to the consultation, Ofgem and the DTI concluded that special provisions to cater for the eventuality of notification agent failure should not be introduced for a number of reasons including:
- The BSC consultation process (in June and July 2000) had already concluded that it was not appropriate to include provisions for ECVNA accreditation in the BSC;
 - It would dilute incentives on ECVNAs to develop robust systems; and
 - Any exposure to costs of such failures is likely to be very small if notification agents regularly update their submissions to the ECVAA, and develop systems with the appropriate degree of redundancy and diversification.
24. Ofgem continues to believe that the arguments outlined above are valid and hence that it is not appropriate to introduce accreditation for ECVNAs, which would be the effect of implementing this Modification Proposal. To the extent that participants require third party ECVNAs to provide enhanced levels of service, this should be a commercial decision between the ECVNA and its customers. In addition, ECVNAs could insure

⁶ "The New Electricity Trading Arrangements: Special Provisions for Computing System Failures", NETA Programme/Elexon Consultation (on behalf of Ofgem), November 2000 and "Manifest Errors in Balancing Mechanism Transactions, October 2000 ;and Special Provisions for Computing System Failures, November 2000; and The Treatment of Black Start Events Under the BSC, December 2000", Conclusions Paper by NETA Programme/Elexon (on behalf of Ofgem/DTI), February 2001.

themselves against the risks of notification errors and it is our understanding that some third party ECVNAs already do this.

25. Ofgem also notes that a number of concerns were raised by respondents to the consultation on the draft Modification Report. It was pointed out that the ability for parties to set up a number of Privileged ECVNAs could undermine the restriction on the number of claims that can be made in each rolling 12 month period. In addition, concerns were raised regarding the adequacy of the monitoring process. Ofgem shares both these concerns. Moreover, Ofgem does not consider that up to twelve notification errors per ECVNA per year is an acceptable level of operation.
26. Ofgem has recently approved Modification Proposal P12: "Reduction Of Gate Closure From 3.5 Hours To 1 Hour". As a result of the P12 modification, trading and notification, after the Implementation Date of P12, will be able to take place closer to Gate Closure than was envisaged when this modification proposal was put forward.
27. Ofgem has therefore concluded that it would not be appropriate to accept the proposed Modification. In particular, Ofgem believes that to do so would significantly reduce the incentive to make accurate notifications at all times and this would not outweigh the benefit of the potential for increasing liquidity and transparency in the trading market. As a result, Ofgem does not consider that the Modification Proposal would better facilitate the achievement of the relevant objectives because:
 - it would be likely to increase uncertainty in the market, which would not promote competition; and
 - it would increase the need to re-run settlement calculations and therefore increase the burden on the central systems and processes which would not promote efficiency in the implementation and administration of the balancing and settlement arrangements.
28. Ofgem therefore disagrees with the Panel's recommendation that the Modification Proposal P35 should be approved.

The Authority's decision

29. The Authority has therefore decided that it does not intend to direct that the Proposed Modification P35, as set out in the Modification Report for Modification Proposal P35, should be made and implemented.
30. 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.

Contact point

31. If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the above number.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'A. 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