



Direct Dial: 020 7901 7435

28 January 2002

The National Grid Company, BSC Signatories and
Other Interested Parties

Your Ref:
Our Ref: MP No: P7

Dear Colleague,

Modification to the Balancing and Settlement Code (“BSC”) - Decision and Notice in relation to Modification Proposal P7: “Allocation of Supplier demand to the same BM Unit in a GSP group for all suppliers in the same company”.

The Gas and Electricity Markets Authority (the “Authority”)¹ has carefully considered the issues raised in Modification Proposal P7 “Allocation of Supplier demand to the same BM Unit in a GSP group for all suppliers in the same company”.

The Balancing and Settlement Code Panel (the “Panel”) recommended to the Authority that

- (i) The original Modification Proposal be rejected,
- (ii) The Alternative modification be approved and implemented on the Settlement Day one calendar month after such approval.

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

This letter explains the background to the modification proposal 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”) as set out in Alternative Modification Proposal P7.

Background to the proposal

The BSC makes provision for Licence Exempt Generators (LEGs), who are deemed not to be making use of the transmission system, to avoid associated transmission and other charges (known as obtaining “embedded benefits”) by “netting off” their generated energy against local demand in a Grid Supply Point Group (GSPG). At present these benefits can only be attained by companies grouping LEGs and demand within a Balancing Mechanism Unit

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

(BMU) or within a Trading Unit (TU). A stand alone embedded generator, in order to obtain the embedded benefits, has to find a single supplier of sufficient size who will allow registration of their export within the same GSPG Trading Unit against which they can net-off their energy. In some GSPGs there are few suppliers and it has been asserted that this has left limited opportunity for the embedded generator to obtain a competitive commercial agreement to net-off.

Modification Proposal P7 was submitted by PowerGen on 18 April 2001 and presented to the Panel at its meeting of 3 May 2001. At this meeting, the Panel agreed that the proposal should be submitted to the Definition procedure and that a Modification Group should be established to discuss the necessary issues relating to this proposal. The Definition Report was presented to the Panel on 31 May and an Assessment procedure was then undertaken.

The Assessment Report was presented to the Panel on 26 July and the Modification returned to the Modification Group for further analysis. The Panel considered the revised Assessment Report at its meeting on 23 August 2001 and determined that the original P7 proposal be submitted to the Report stage with a recommendation that the Proposed modification be rejected by the Authority and the Alternative Proposal P7 be approved and implemented with effect from the Settlement Day falling one month after approval from the Authority.

The Modification Proposal

Modification Proposal P7 seeks to modify the BSC so that the Supplier demand, for all supply companies in the same company group, can be allocated to the same BM Unit within a GSPG.

It was suggested that the particular benefit of this proposed change would be to allow embedded, licence exempt generation to be more effectively netted against demand where generation exceeded the demand on any one supply BM Unit for that group of companies within the GSPG.

It was noted in the Initial Written Assessment that facilities already available under the BSC could enable Licence Exempt Generators (LEGs) to realise embedded benefits with a number of Suppliers. This was discussed by the Modification Group and it was concluded that the Metered Volume Reallocation Notification (MVRN) facility did not allow the LEG to gain embedded benefits from more than one Supplier, since all the benefits described are associated with Trading Units, rather than purely with credited energy.

During the Assessment Phase, the Modification Group considered an Alternative Modification Proposal whereby the demand BM Units associated with the Suppliers in the Company Group could together form a Trading Unit. Given that embedded benefits can be obtained through Trading Units, it was suggested that this approach provided a mechanism for improving the likelihood that a LEG could realise embedded benefits for its entire output. The Alternative Modification also had the advantage that it would be less expensive to implement within the BSC than the Original Proposal.

At a later stage of the Assessment phase, the Modification Group considered allowing any grouping of Suppliers in a GSPG to join the Trading Unit. The Assessment Report was amended to include this in the Alternative Proposal so it would permit any grouping of Supplier BM Units in the same GSPG to be within the same Trading Unit together with any number of CVA registered Licence Exemptable Generator (LEG) BM units in the GSPG.

ELEXON published a Draft Modification Report on 10 September, which invited respondents' views.

Respondents' views

In total, ELEXON received 10 responses to the consultation on Modification Proposal P7. Of these responses, eight supported the recommendations, one rejected the recommendations and one neither supported nor rejected the recommendations.

However, a number of concerns were raised within the representations. First, three respondents expressed a preference for limiting the ability to aggregate within a GSPG to Affiliate companies only. Another issue raised by a respondent concerned associated amendments to the Use of System (UoS) charging methodologies being undertaken by the Transmission Company. The respondent requested that the Panel and Ofgem recognise that the full realisation of embedded benefits requires co-ordination of the implementation of the amendments to the BSC required to give effect to Alternative Modification P7 and of the implementation of any amendment to the Transmission Company's UoS Charging Methodology

The above concerns were addressed by the Modification Group. The respondents who rejected the recommendations did so as they felt that it would incur costs for many, but with benefits for few. They also expressed concerns regarding the mechanism for determination of 'exempt' status, if the aggregation defined under the Modification / Alternative Modification was enabled. Again the above concerns were addressed by the Modification Group.

The respondents' views are comprehensively summarised in the Modification Report for Modification Proposal P7 dated 10 September 2001.

Panel's Recommendation

The Panel met on 20 September 2001 and considered the Modification Proposal P7, the Modification Report, the views of the Modification Group and the consultation responses received.

The Panel recommended that the Authority should approve the Alternative Proposed Modification and that the Proposed Modification should be implemented one calendar month from the Authority's approval.

Ofgem's view

Ofgem considers, having had regard to its statutory duties, that the Alternative Modification Proposal P7 will better facilitate the relevant objectives of the BSC because it will provide both Suppliers and embedded licence exempt generators greater choice in striking contracts that will allow them to access embedded benefits.

Under the Alternative Modification, embedded benefits would accrue to Suppliers who have contracts with Licence Exemptable Generators and who would be able to pass on a proportion of those benefits to those generators. Benefits would also accrue to the CVA Registered Licence Exemptable Generators choosing to form a Trading Unit with Supplier BM Units in their GSPG.

The rationale behind permitting access to embedded benefits is based on the fact that embedded generation is deemed to net off local demand and does not utilise the transmission system.

The embedded benefits that both the original modification and the Alternative are seeking to maximise are a reduction of charges applicable to traded energy. This would include a reduction in BSUoS charge (Balancing Services Use of System charges); TNUoS charges (Transmission Network Use of System Charges); Transmission losses; BSCCo charges (Balancing and Settlement Code participant charges)

It has been acknowledged that existing mechanisms such as Change of Supplier process or meter splitting arrangements within a GSPG are capable of delivering embedded benefits to participants. However, the Change of Supplier process is a comparatively inflexible and restrictive way to achieve this end. Similarly, while meter splitting can deliver some benefits, the Modification Group decided that this facility would restrict this opportunity to those LEGs registered in a supplier registration system. This approach also requires a specialised Supplier data collector agent to be accredited, is limited to two Suppliers for any one metering site and has restrictions in the ability to allocate energy. Hence the Alternative Modification would better facilitate the Applicable BSC Objective set out in Condition C3.3 (d) of the Transmission Licence in that it will promote efficiency in the implementation and administration of the balancing and settlement arrangements.

One respondent to the consultation argued that the approval of this proposal would enable Supplier BM units in each GSPG to use this facility to combine and form a very large single Trading Unit. However, unless Suppliers have contracts that provide them with a share of the resultant embedded benefits, there is no incentive for them to form very large multi-party trading units. Furthermore, competition legislation provides Ofgem with enforcement powers where a market participant abuses a dominant position. .

The Alternative Modification Proposal will create a climate enabling licence exempt generators and consolidators greater choice in finding Suppliers with whom to contract in order to access embedded benefits. Likewise, it would also provide Suppliers with a broader choice of LEGs with whom to establish contracts. As a result, the Alternative Modification would better facilitate the Applicable BSC Objective as set out in Condition C3.3 (c) of the Transmission Licence in that it will promote effective competition in the generation and supply of electricity.

Ofgem agrees with the Panel's recommendation that the Proposed Alternative Modification P7 be approved with an implementation date of one month after approval by the Authority.

The Authority's decision

The Authority has therefore decided to direct that Alternative Modification Proposal P7 should be made and implemented.

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 the Alternative Modification resulting from Modification Proposal P7.

The modification is to take effect from one calendar month of the Authority's approval.

In accordance with Condition C.3.5(b) of NGC's Transmission Licence, NGC shall modify the BSC in accordance with this direction of the Authority.

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 'DEU', written in a cursive style.

David Edward

Head of Electricity Code Development

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