

National Grid Electricity Transmission plc,
BSC Signatories and Other Interested Parties

Direct Dial: 020 7901 7326
8 September 2005
Our Ref: MP No P186

Dear Colleague,

Modification to the Balancing and Settlement Code ("BSC") - Decision and notice in relation to Modification Proposal P186 "Rationalising the criteria for the submission and redeclaration of Demand and Generation Capacities"

The Gas and Electricity Markets Authority (the "Authority")¹ has carefully considered the issues raised in the Modification Report² in respect of Modification Proposal P186, "Rationalising the criteria for the submission and redeclaration of Demand and Generation Capacities".

The BSC Panel (the "Panel") recommended to the Authority that the Proposed Modification P186 should not be made, and that the Alternative Modification P186 should be made with an implementation date of 10 working days following an Authority decision.

Having carefully considered the Modification Report and the Panel's recommendation and having regard to the Applicable BSC Objectives³ and the Authority's wider statutory duties,⁴ the Authority has decided to direct a Modification to the BSC in line with Alternative Modification Proposal P186.

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

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

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

² ELEXON document reference P186RR, Version No. Final/1.0, dated 12 May 2005.

³ The Applicable BSC Objectives, as contained in Standard Condition C3 (3) of 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.

⁴ Ofgem's statutory duties are wider than the matters that the Panel must take into consideration.

Background

Lead Parties are required to submit estimates of the most positive and negative Balancing Mechanism (BM) Unit Metered Volume (QM_{ij}) value for each individual BM Unit for each BSC Season. These are divided by the Settlement Period Duration (SPD) in order to calculate the Generation Capacity (GC) and Demand Capacity (DC) of the BM Unit for that BSC Season. These GC and DC values are used to determine whether the BM Unit is classed as “Production” or “Consumption”, (its P/C Status) and also in the calculation of a party’s Credit Assessment Energy Indebtedness (CEI) and Credit Cover Percentage (CCP). The relevant capacity of a BM Unit is GC, if GC plus DC is positive. If GC plus DC is zero, or negative, the relevant capacity of the BM Unit is DC.

Currently, a Lead Party is required to redeclare its GC (Positive Value) or DC (negative value) estimate within a BSC Season for any Settlement Period if it becomes aware or believes in good faith that either one, or both, of two defined thresholds has been, or will be, exceeded. One of these thresholds is absolute (0.5MW), the other is relative (1% of capacity). Under the current criteria, only those BM Units with a capacity of over 50MW may be required to redeclare GC/DC following a breach by less than 1%.

The Modification Proposal

Modification Proposal P186 proposes to remove the 0.5MW absolute volume breach limit from the BSC in order that Parties would only be required to redeclare their GC/DC following a breach by a magnitude of more than 1%. The Proposer considered that a uniform 1% limit would treat all BM Units proportionally, and also remove any existing discrimination against Parties with GC/DCs over 50MW. This may also avoid the need for parties to overestimate their BM Unit Metered Volumes.

The Proposer also contended that the current BSC criteria may lead to Parties intentionally overstating their Metered Volume estimates to avoid frequent redeclarations, and this in turn may lead to the overprovision of Credit Cover. Further that the absolute volume redeclaration threshold places an unnecessary administrative burden on BSCCo in enforcing redeclarations for minor percentage breaches.

The Panel considered the Initial Written Assessment at its meeting of 10 February 2005 and agreed to submit Modification Proposal P186 to a two-month Assessment Procedure. The Modification Group (“the Group”) held meetings on 22 February and 23 March 2005 during the Assessment Procedure, and developed an Alternative Modification which is detailed below. The Group considered and agreed that what constituted a material breach of GC/DC, and whether the current redeclaration thresholds should be relaxed, would depend on the point at which the maximum allowed breach could lead to a significant underestimation of a Party’s Energy Indebtedness. The view of the majority of the Group was that relaxation of the current thresholds would be unlikely to have a material impact on the provision of Credit Cover. The group also issued an Assessment Procedure consultation on 7 March 2005, and commissioned impact assessments from ELEXON and the Transmission Company.

The majority of the Group believed that Proposed Modification P186 would better facilitate the achievement of the Applicable BSC objectives than the current BSC baseline. During its discussions the Group also developed an Alternative Modification.

Under the Alternative Modification, the existing 0.5MW absolute volume redeclaration threshold would still be removed from the BSC and a percentage threshold would be applied, but only for BM Units whose declared GC/DC values were above a set minimum (“de minimis”) capacity and below a set maximum capacity. The lower and upper MW limits would be derived by applying a percentage limit to the set minimum and maximum capacities.

Under the Alternative Modification, a Lead Party would be required to redeclare its GC or DC estimate within a BSC season if, for any Settlement Period:

1. the actual positive value of QM_{ij}/SPD exceeded GC or
2. the actual negative value of QM_{ij}/SPD was less (more negative) than DC;

by an amount the magnitude of which was more than 2MW and more than either or both of the following:

1. 2% of that capacity, and/or
2. 10MW.

In respect of the BM Units qualifying under the minimum or above the maximum capacity, an absolute MW limit, and not a percentage limit, would be applied. The percentage threshold chosen by the Group was 2%, which would be applied to BM Units between a minimum 100MW and maximum 500MW capacity.

The application of a MW limit to small BM Units is designed to eliminate the administrative effort involved in monitoring and redeclaring GC/DC values, following minor absolute breaches of a low capacity. The application of a percentage limit to breaches above the lower MW limit, is designed to provide larger BM Units with a margin for error in proportion to their size similarly eliminating the need for monitoring and redeclaring GC/DC, and addressing the issue identified by the Modification Proposal.

Capping the percentage threshold at an upper MW limit is designed to remove the risk that such an application to high-capacity BM Units could result in large absolute breaches. This is therefore intended to remove the possibility of any consequential impact on the provision of Credit Cover. The Alternative Modification would therefore impact all BM Units, in contrast to the Proposed Modification which would only impact those BM Units with a capacity greater than 50MW.

The unanimous view of the Group was that the Alternative Modification would benefit all BM Units by only requiring them to redeclare GC or DC following material absolute breaches, in contrast to the Proposed Modification, which would only benefit BM Units over 50MW. In addition, the Group agreed that by capping the maximum breach at a chosen upper MW limit, the Alternative Modification would remove any concerns over the potential impact of a relaxation of the percentage threshold. The Group also agreed that the Alternative Modification would better facilitate the achievement of Applicable BSC objectives (c) and (d) when compared to both the Proposed Modification and the current BSC baseline.

The Assessment Report was presented to the Panel on 14 April 2005, and the Panel unanimously agreed with the recommendation of the Group that Modification Proposal P186

should proceed to the Report Phase with a provisional recommendation that the Alternative Modification should be made, and the Proposed Modification should not be made.

The draft Modification Report was issued for industry consultation on 19 April 2005, allowing 5 working days to respond, and the Panel considered the report and the consultation responses at its meeting on 12 May 2005.

Responses to ELEXON Consultation

ELEXON published a draft Modification Report on 19 April 2005, which invited respondents' views by 27 April 2005. Nine responses were received. Eight responses (representing 36 Parties) expressed support for the Alternative Modification, and one response (representing 5 Parties) opposed the Alternative Modification.⁵ In respect of the Proposed Modification, eight responses (representing 36 Parties) agreed that it should not be made, and one response expressed support for the Proposed Modification.

The majority of the respondents agreed that the Alternative Modification should be made as it would offer greater administrative savings to parties and ELEXON than the Proposed Modification as it would benefit all Parties regardless of their size. The respondents also considered that the 2MW limit would eliminate the significant administrative effort required at present in monitoring and redeclaring GC/DC values where the amounts involved are not material.

One respondent, representing 5 Parties, considered that the 1% threshold under the Proposed Modification to be more appropriate than the Alternative Modification as it would treat all BM Units proportionally. This respondent also clarified that although they believed the Alternative Modification to be superior to the current BSC baseline, they considered that the Proposed Modification would better facilitate the achievement of the Applicable BSC Objectives when compared to the Alternative Modification.

The respondents' views are summarised in the final Modification Report for Modification Proposal P186, which also includes the complete text of all responses.

Panel's recommendation

The Panel met on 12 May 2005 and considered Modification Proposal P186, the draft Modification Report, the views of the Modification Group and the consultation responses received.

The Panel unanimously agreed the final recommendation to the Authority that the Alternative Modification should be made, and that the Proposed Modification should therefore not be made, and that if approved, the Alternative Modification should be made with an Implementation Date of 10 working days following an Authority decision.

⁵ The respondent that opposed the Alternative Modification had initially stated that it supported the Panel's recommendation, but subsequently clarified its response.

Ofgem's view

Having carefully considered the Final Modification Report, the respondents' views and the Panel's recommendation, Ofgem, having had regard to the Applicable BSC Objectives, is of the view that Alternative Modification P186 would better facilitate achievement of the Applicable BSC Objectives. In addition, Ofgem considers that this decision is consistent with its wider statutory duties.

Applicable BSC Objective (c) – promoting effective competition in the generation and supply of electricity, and (so far as is consistent therewith) promoting such competition in the sale and purchase of electricity

Ofgem considers that Proposed Modification P186 would deliver greater cost and efficiency savings to BSC Parties than the current BSC baseline, by reducing the number of redeclarations of GC/DC following a material breach. This would reduce the administrative burden on BSC Parties and hence deliver cost and efficiency savings.

However, Ofgem agrees with the Group, the majority of respondents and the Panel that Alternative Modification Proposal P186 would deliver greater cost and efficiency savings than those likely to be delivered under Proposed Modification P186. Ofgem considers this to be the case as the savings would be spread across all BM Units, rather than only those above a certain capacity as in the Proposed Modification P186. Ofgem also considers that the upper MW breach limit set by the Alternative Modification P186 would offer greater reassurance than the Proposed Modification that the relaxation of the GC/DC redeclaration thresholds would not lead to under-provision of Credit Cover.

Ofgem notes that the Group and the majority of respondents therefore considered that the Alternative Modification better facilitated the achievement of Applicable Objective (c). However, while Ofgem considers that these effects would improve the current arrangements, Ofgem considers the effects of the Alternative Modification as described above would better facilitate the achievement of Applicable Objective (d).

Applicable BSC Objective (d) – promoting efficiency in the implementation and administration of the balancing and settlement arrangements

Ofgem is of the view that Proposed Modification P186 would also deliver greater cost and efficiency savings for ELEXON, through a greater reduction in the number of GC and DC breaches it would be required to pursue. However, Ofgem considers that by only requiring ELEXON to enforce redeclarations following a material absolute breach, Alternative Modification P186 could assist in reducing Parties perception that the tolerances for GC/DC accuracy are unnecessarily stringent. The relaxation of the thresholds also has the potential to lead to a reduction in the number of breaches, and therefore offers greater potential for efficiency savings when compared with the current BSC baseline and also Proposed Modification P186.

Overall, Ofgem considers that both Proposed Modification P186 and Alternative Modification Proposal P186 would better facilitate the achievement of the Applicable BSC Objectives, notably Applicable Objective (d). Ofgem considers this to be the case as amending the limits when BSC Parties are required to redeclare their GC/DC following a breach will reduce the

administrative burden on both BSC Parties and ELEXON and therefore result in cost and efficiency savings for both BSC Parties and ELEXON.

However, Ofgem considers that Alternative Modification Proposal P186 would better facilitate the achievement of the Applicable BSC Objectives relative to Modification Proposal P186 and the current BSC baseline. Ofgem recognises that the proposed amended limits are intended to reduce this administrative burden and Ofgem agrees with the Group and the majority of respondents that Alternative Modification Proposal P186 will result in the greater reduction across all BSC Parties (including those with a capacity of under 100MW), whilst ensuring no adverse impact on the provision of Credit Cover.

Ofgem notes that one respondent raised concerns about Parties deliberately or negligently mis-estimating data. Ofgem takes allegations in respect of inappropriate market behaviour seriously and would be happy to enter into further discussions on this issue if the respondent chose to take this further.

Therefore, Ofgem considers that Alternative Modification Proposal P186 would better facilitate the Applicable BSC Objectives. In addition, Ofgem considers that this decision is consistent with its wider statutory duties.

If you have any questions, please contact me on the above number, or alternatively you can contact Jo Witters on 020 7901 7159.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Sonia', followed by a period.

Sonia Brown
Director, Markets

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