



Direct Dial: 020-7901-7412

23 April 2003

The National Grid Company, BSC Signatories and
Other Interested Parties

Our Ref: MP No P110

Dear Colleague,

Modification to the Balancing and Settlement Code (“BSC”) - Decision and Direction in relation to Modification Proposal P110: “Nullification of Volume Notifications where no Notification Authorisations are in place”

The Gas and Electricity Markets Authority (the “Authority”)¹ has carefully considered the issues raised in the Modification Report² in respect of Modification Proposal P110, “Nullification of Volume Notifications where no Notification Authorisations are in place”.

The BSC Panel (the “Panel”) recommended to the Authority that Proposed Modification P110 should be made.

Having considered the Modification Report and the Panel’s recommendation and having regard to the Applicable BSC Objectives and the Authority’s wider statutory duties, the Authority has decided to direct a Modification to the BSC in line with Modification Proposal P110.

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 BSC in line with Modification Proposal P110, as set out in the Modification Report.

This letter constitutes the 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 P110RR, Version No. 1.0, dated 18 March 2003.

Background

The majority of trading in the wholesale electricity market in England and Wales uses bilateral trading between generators, suppliers, traders and customers. The Grid Trade Master Agreements (“GTMA”) are standard contracts developed by the industry that describe the framework on which counter-Parties bilaterally trade, confirm, notify and settle energy accounts.

In the event that these bilateral contracts are terminated it is likely that the Notification Agent Authorisations³ between the counter-Parties will be cancelled under the BSC. The counter-Parties may also want to disregard outstanding notified contract volumes that cover Settlement Periods for which Gate Closure has not yet occurred. However, if agreement cannot be reached by the counter-Parties to establish new Notification Agent Authorisations to enable the amendment of outstanding notified contract volumes with the Energy Contract Volume Aggregation Agent (“ECVAA”), there is the potential for a Party to be left in a position of energy imbalance without any way of altering their position.

On 4 November 2002, AES Drax Power Limited (the “Proposer”) submitted Modification Proposal P110, “Nullification of Volume Notifications where no Notification Authorisations are in place”.

The Proposer considered that the Modification Proposal would mitigate the risk of Parties being exposed to energy imbalance with no ability to adjust their notified contract position in the event of circumstances occurring as described above. Therefore, the Proposer considered that the Modification Proposal would better facilitate the achievement of Applicable BSC Objective (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.

The Modification Proposal

Modification Proposal P110 seeks to modify the BSC to provide a mechanism for a Party to nullify its notified contracts with a counter-Party, for those Settlement Periods that have not yet passed Gate Closure, if the following conditions are met:

- all the Notification Agent Authorisations between the two Energy Accounts have been terminated; and
- the two Parties cannot agree to establish new Notification Agent Authorisations.

The Party initiating a Nullification Request would be required to complete a form specifying the following information:

- Party ID, name and Energy Account;
- Counter-Party ID, name and Energy Account;

³ A Notification Agent Authorisation authorises the appointed Notification Agent to submit, while it is effective, contract notifications on behalf of the Relevant Contract Parties to be taken into account in Settlement. Reference to ‘Notification Agent(s)’ includes both Energy Contract Volume Notification Agents (ECVNAs) and Metered Volume Reallocation Notification Agents (MVRNAs).

- Settlement Date and Settlement Period from which the Party wishes the Nullification Request to be effective; and
- Name of authorised signatory, password and signature.

The interface for both requesting a nullification and sending the completed form from a Party to the ECVAA would be manual (i.e. via either fax or email) and not via an electronic data file.

Upon receipt of a Nullification Request the ECVAA would verify that all Notification Agent Authorisations between the two Energy Accounts have been terminated and validate the information provided. In addition, the ECVAA would calculate the first possible Settlement Period from which nullification can take place.

The Modification Group (the "Group") considered that the first effective Settlement Period should be as soon as possible following the receipt of the Nullification Request. Therefore, if Gate Closure for the Settlement Period requested in the Nullification Request had passed then the next Settlement Period for which Gate Closure had not passed would be used for nullification of the relevant contract notifications. If, however, Gate Closure for the requested Settlement Period had not passed, the requested Settlement Period would be used.

Once the ECVAA has processed a Party's request, a feedback report would be issued to the originator of the request either rejecting the request or confirming that the nullification process is to take place. If the nullification process is to take place, the ECVAA would also issue the feedback report to the counter-Party. The ECVAA would be required to process and validate a Nullification Request and send a feedback report within one hour of receipt of the request, within a normal Business Day. In the event that the ECVAA fails to process the Nullification Request and issue a feedback report within the required timescale the Party submitting the request would be able to raise a Trading Dispute or Trading Query.

It should be noted that the majority of the Group considered that the Nullification Request process should only be available during a normal Business Day. This was because having the process available at all times would involve significant cost and also require trained operators and signatories to be available at all times. In addition, the majority of the Group considered that the process was only likely to be triggered during a normal Business Day.

The Group considered what mechanism should be used by the ECVAA to nullify the relevant contract notifications. The Group agreed that due to the high risk involved in the ECVAA manually changing Parties contract positions, an automated process should be implemented. The automated process would be triggered once the Nullification Request has been validated and a feedback report issued to both Parties involved. The ECVAA would then automatically identify the contract notifications to be nullified and would set the volumes to zero in the NETA Central Systems. Once the ECVAA had completed the process of setting any outstanding contract volumes to zero, a report would be issued either by fax or email to both counter-Parties

informing them that the process had been completed. Parties would then be able to request a Forward Contract Report⁴ if they require confirmation of their position.

The Group noted the BSC Central Service Agent development and implementation costs associated with Proposed Modification P110 of £88,000 (excluding ELEXON effort of 66 man-days).

The Group agreed that the BSC does not currently provide a robust or reliable method for notifying the ECVAAs that agreed outstanding contract volumes have been disregarded. The majority of the Group considered that this presents an unnecessary risk to Parties. The majority of the Group considered that the Modification Proposal would provide Parties with a means to limit their exposure to energy imbalance in situations where bilateral energy contracts and the relevant Notification Agent Authorisations have been terminated. Therefore the majority of the Group considered that the Modification Proposal better facilitates the achievement of Applicable BSC Objective (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.

The Group considered that the Modification Proposal is complementary to the commercial bilateral contracts such as the GTMA, and that the firmness of contracts would not be undermined by the implementation of the Modification Proposal.

ELEXON published a draft Modification Report on 21 February 2003, which invited respondents' views by 28 February 2003.

Respondents' views

ELEXON received eleven responses to the consultation on the draft Modification Report. Eight responses expressed support for the Proposed Modification, one did not support the Proposed Modification and the remaining two were neither in favour nor opposed to the Proposed Modification.

Of the respondents that supported the Proposed Modification the majority considered that during the process of bilateral contract termination a Party can be left with no ability to amend notified contract volumes for Settlement Periods that have not yet passed Gate Closure. The majority of respondents considered this to be an unnecessary risk that could result in unjustified settlement liabilities. These respondents considered that the Proposed Modification enables Parties to mitigate this risk and therefore would promote effective competition. One of these respondents considered that the Proposed Modification is a pragmatic solution to a problem that is not solved via the GTMA and that it would bring more certainty to default situations, thereby increasing party confidence. Another respondent acknowledged the risk presented by a counter-Party failing to honour its obligations under a bilateral contract, and also the need for a method to nullify notifications going forward where there is no reasonable expectation of satisfactory resolution by other means.

⁴ ECVAAs-I022 sub-flow 1.

The respondent that did not support the Proposed Modification considered that the perceived defect could be dealt with through other processes, such as the GTMA. Furthermore, they considered that the cost of implementation of the Proposed Modification outweighs any perceived benefits.

One respondent suggested that the counter-Party that did not make the Nullification Request should be given more notice prior to validated nullifications occurring to enable them to seek other counter-Parties to trade out the impending effect of the nullification. One respondent also suggested that the process should be available to Parties at any time rather than the recommended approach that allows only for nullification requests during a normal Business Day.

Panel's recommendation

The Panel met on 13 March 2003 and considered the Modification Proposal P110, the draft Modification Report, the views of the Group and the consultation responses received.

The Panel recommended that the Authority should approve the Proposed Modification. The Panel recommended that the Implementation Date should be 5 November 2003 if a decision is received from the Authority prior to 24 April 2003 or 25 February 2004 if a decision is received on or after 24 April 2003 and prior to 14 August 2003.

The Panel considered that currently there is an unnecessary risk in the process of contract termination and it was agreed that implementing the Modification Proposal would provide Parties with a means to limit their exposure to imbalance in situations where termination of Notification Agent Authorisations has taken place. The panel also considered that the Modification Proposal provides a method of dealing with counter-Party notifications during an event of default under a commercial bilateral contract, such as the GTMA.

The majority of the Panel agreed with the recommendation of the Group that the Modification Proposal better facilitates achievement of the Applicable BSC Objective (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.

Ofgem's view

Ofgem considers, having had regard to the Applicable BSC Objectives and its statutory duties, that Modification Proposal P110 will better facilitate achievement of Applicable BSC Objective (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.

Ofgem considers that where counter-Parties have terminated their bilateral energy contracts and the Notification Agent Authorisations between the two Energy Accounts, they should seek to establish new Notification Agent Authorisations so that outstanding notified contract volumes can be amended with the ECVAA if necessary. However, Ofgem notes that there can be situations where Parties cannot reach agreement in this respect and as a result have no means of altering their notified contract position to reflect their physical position, ahead of Gate Closure.

Ofgem considers that the Modification Proposal provides a robust process under the BSC for mitigating this risk.

Ofgem considers that the Modification Proposal would increase market participant's confidence in the robustness of the contract notification process. In addition, a more robust contract notification process could potentially encourage new entrants which would further promote competition. Therefore Ofgem agrees with the majority of the Group, the majority of respondents and the Panel that the Modification Proposal better facilitates the achievement of Applicable BSC Objective (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.

Ofgem notes the BSC Central Service Agent development and implementation costs associated with Proposed Modification P110 of £88,000 (excluding ELEXON effort of 66 man-days). Ofgem considers that these costs are outweighed by the benefits of the Modification Proposal in terms of the better facilitation of the achievement of Applicable BSC Objective (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.

Ofgem notes one respondent's suggestion that more notice should be given to the counter-Party that did not make the Nullification Request prior to validated nullification's occurring, to enable them to seek other counter-Parties to trade out of the impending effect of the nullification. Ofgem considers that in the event a bilateral contract and the Notification Agent Authorisations between the two Energy Accounts have been terminated and the counter-Parties cannot reach agreement to establish new Notification Agent Authorisations, both counter-Parties will have a reasonable expectation that a Nullification Request may be initiated.

Ofgem also notes one respondent's suggestion that the process should be available to Parties at all times rather than the recommended approach that only allows for Nullification Requests during a normal Business Day. Ofgem considers that, as Parties should seek to reach agreement where possible to avoid having to make Nullification Requests this mechanism should be used as a last resort. Ofgem considers that because of the significant costs involved it would not be efficient to make the process available at all times.

The Authority's decision

The Authority has therefore decided to direct that the Proposed Modification P110, as set out in the Modification Report, 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 the Modification Report.

The Implementation Date for Modification Proposal P110 is 5 November 2003.

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 queries in relation to the issues raised in this letter contact me on the above number or alternatively contact Adam Higginson on 020 7901 7410.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Sonia Brown". The signature is written in a cursive style with a large initial 'S'.

Sonia Brown

Director, Electricity Trading Arrangements

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