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12 August 2002

The National Grid Company, BSC Signatories and
Other Interested Parties

Our Ref: MP No P62

Dear Colleague,

Modification to the Balancing and Settlement Code ("BSC") - Decision and Direction in relation to Modification Proposal P62: "Changes to Facilitate Competitive Supply On the Network of New Licensed Distributors"

The Gas and Electricity Markets Authority (the "Authority")¹ has carefully considered the issues raised in the Modification Report² in respect of Modification Proposal P62, "Changes to Facilitate Competitive Supply On the Network of New Licensed Distributors".

The Balancing and Settlement Code Panel (the "Panel") recommended to the Authority that Modification Proposal P62 should be made with an Implementation Date of 1 August 2003, if an Authority decision is received by 1 September 2002, and an Implementation Date of 30 June 2004 if an Authority decision is received after 1 September 2002 and before 30 June 2003.

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 P62, 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.

Background

Modification Proposal P62, "Changes to Facilitate Competitive Supply On the Network of New Licensed Distributors", was submitted on 3 January 2002 by TXU UK Ltd. The justification for

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

² ELEXON document reference P062RR, Version No. 1, dated 22 July 2002

the Modification Proposal was the better facilitation of the Applicable BSC Objective³ C3 (3) (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”.

An Initial Written Assessment of Modification Proposal P62 was presented to the Panel at its meeting of 17 January 2002. The Modification Proposal was progressed by the Volume Allocation Modification Group (VAMG). The VAMG drew heavily on work already done by the Distribution Business Focus Group (DBFG), an industry group established under the Master Registration Agreement (MRA) Executive Committee (MEC). An initial consultation document⁴ was issued, followed by a Definition Report⁵ which was presented to the Panel at its meeting of 14 March 2002.

The VAMG met three times during the Assessment Procedure, during which they sent out a Requirements Specification⁶ for both consultation and impact assessment. An Assessment Report⁷ was presented to the Panel meeting on 13 June 2002, where it was agreed to send the Modification Proposal to the Report Procedure.

The Modification Proposal

The Utilities Act 2000 amended the Electricity Act 1989 so that “*The same person may not be a holder of both a distribution licence and a supply licence*”⁸. This amendment made electricity distribution a separate licensable activity. Consequently, entities other than the current Public Distribution System Operators (PDSOs) may be required, or choose, to obtain Distribution Licences. Being a licensed distributor carries the obligation to join the BSC, the MRA and comply with the Settlement Agreement for Scotland (SAS) (as appropriate).

In order to evaluate the implications of these changes to the industry, the MEC convened the DBFG, which has had widespread industry participation. After consultation with industry, the DBFG reached a consensus on key principles and issues in relation to how new licensed distributors could enter the marketplace, with minimal disruption to current systems and procedures. It was felt that the optimal solution for industry was to determine a cost effective solution within the BSC, as otherwise parallel trading arrangements would be required.

Modification Proposal P62 seeks to modify the BSC so as to allow new licensed distributors to participate in the electricity industry and meet their obligations under the Utilities Act 2000. It proposes to do this by:

- Establishing the principle that every licensed distributor should be connected to only one Supplier Meter Registration Service (SMRS), irrespective of the number of different

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;
- a) the efficient, economic and co-ordinated operation by the licensee of the licensee’s transmission system;
- a) 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;
- a) promoting efficiency in the implementation and administration of the balancing and settlement arrangements.

⁴ ELEXON document reference 001MBB, Version 1.0, dated 21 February 2002

⁵ ELEXON document reference 018MMU, Version 1.0, dated 8 March 2002

⁶ ELEXON document reference 002MBR, Version 1.0, dated 25 April 2002

⁷ ELEXON document reference P062AR, Version 1.0, dated 7 June 2002

⁸ Utilities Act 2000, Part IV, Paragraph 30

distribution networks that it operates or Grid Supply Point (GSP) Groups to which those networks are connected

- Preventing the necessity for the establishment of new GSP Groups by allowing for the reallocation of any new licensed distributor who connects directly to the grid into an already existing GSP Group

The VAMG summarised these points with the phrase “one distribution business equals one SMRS, without the introduction of new GSP Groups”.

In order to ensure that Modification Proposal P62 was sufficiently focused, the following areas were intentionally deemed to be outside of its scope:

- There is no requirement for the metering point between two distribution networks to be registered in the Central Meter Registration Service (CMRS), although several respondents stated that this would be desirable. This has since been raised as Modification Proposal P70⁹
- No consideration has been given as to how Line Loss Factors (LLFs) and Distribution Use of System (DuoS) charges will be calculated and proportioned to each distribution network. It was noted that these were not matters for the BSC and will be dealt with by the DBFG
- No consideration has been given as to the issue of the transfer of metering points from one distribution business to another. It was felt that since this problem is not limited to new licensed distributors, it should be addressed outside of Modification Proposal P62. Likewise, issues regarding a Distributor of Last Resort have been excluded

The VAMG felt that the resulting Modification Proposal represented a pragmatic solution to the problems posed through the implementation of the Utilities Act 2000, whilst taking account of the limitations of the current operational procedures and systems. The specific detail of the consequential effects on the BSC, BSCCo Documentation and BSC Systems is given in Sections 7 and 8 of the Assessment Report.

ELEXON published a draft Modification Report on 25 June 2002, which invited respondents' views by 4 July 2002.

Respondents' views

ELEXON received eight responses to the consultation on the draft Modification Report for Modification Proposal P62. Six responses (representing 32 Parties) expressed support for the proposed Modification, one respondent (representing 1 Party) believed the proposed Modification should be rejected and the remaining respondent (representing 4 Parties) raised a number of issues, but did not express a clear opinion for or against the proposed Modification.

The respondent against the proposed Modification claimed that it would be costly, would require a considerable amount of work and it would be difficult to recover costs. It should be noted that the majority of respondents expressed support for Modification Proposal P70 to be

⁹ Modification Proposal P70, “CMRS Metering for inter-DNO Boundaries within a GSP Group”, submitted by SEEBOARD Power Networks plc on 1 March 2002

approved in conjunction with Modification Proposal P62. This response was consistent with the majority of responses from the Assessment Procedure.

The respondents' views are summarised in the Modification Report for Modification Proposal P62, which also includes the complete text of all respondents' replies.

Panel's recommendation

The Panel met on 18 July 2002 and considered the Modification Proposal P62, 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 implemented on 1 August 2003, if an Authority decision is received by 1 September 2002, and implemented on 30 June 2004 if an Authority decision is received after 1 September 2002 and before 30 June 2003. Moreover, the Panel noted that in its view, a combination of both Modification Proposal P62 and Modification Proposal P70 would provide a better technical solution and would better facilitate achievement of the Applicable BSC Objectives.

Ofgem's view

Ofgem considers, having had regard to its statutory duties, that Modification Proposal P62 will better facilitate achievement of the Applicable BSC Objectives, since it appears to Ofgem that Modification Proposal P62 represents the most appropriate means of providing competition in the supply of electricity on new and embedded licensed distribution networks.

The BSC makes provision for market roles within the trading arrangements that relate to licensed distribution company activities. Such roles include the PDSO and the Supplier Meter Registration Agent (SMRA), the provider of SMRS. The BSC also provides the definition of a GSP Group. GSP Groups have a historic correlation to distribution service areas but have no relevance to distribution activities from a BSC perspective. Modification Proposal P62 does not propose any substantive change to the definitions of these entities nor to the processes in which they are involved.

From an industry point of view this has two main benefits:

Prominence of Distributor Identifier

The main benefit of maintaining existing industry design is that the first two digits of the core Metering Point Administration Number (MPAN) will continue to represent the distribution network operator responsible for the distribution network to which the relevant metering point is connected. This will maintain the existing level of customer and supplier visibility to data, which is essential to the swift resolution of safety and quality of supply incidents. It may also have potential benefits to suppliers in facilitating derivation of the appropriate DUoS charges to be incorporated into the terms of customer contracts.

Impact on Party systems

By sticking to existing BSC definitions and principles, Modification Proposal P62 minimises impact on the systems operated by BSC parties in the context of being a potentially long-term solution that will support the development of competition in the supply of electricity on new and embedded licensed distribution networks.

Ofgem understands that one of the consequences of the implementation of Modification Proposal P62 is that the supply number will no longer identify the GSP Group in which the customer's metering point resides. However, the customer's address data should give a strong indication. Ofgem also considers that improving access to Metering Point Administration Service (MPAS) standing data will alleviate problems in this area and developments are already taking place via the establishment of MPAS information internet services. Some existing distribution companies are in the process of setting up such a service, which they are committed to having in place by early October 2002. Ofgem is supportive of this development.

Ofgem is aware that many industry participant systems, including core BSC systems, are currently configured on a dependency between PDSO / SMRS and GSP Group. Modification Proposal P62 will maintain the relationship between PDSO and SMRS but break the dependency between PDSO and GSP Group. We understand that this will necessitate changes to these systems. However, Modification Proposal P62 delivers a potentially long-term solution in a marketplace where existing PDSOs have GB wide distribution licences, so changes of this nature would appear to be inevitable if the BSC is to continue to meet its objectives. Ofgem agrees with the VAMG assessment of Modification Proposal P62 as representing the optimal level of change.

Ofgem notes the view of one respondent who expresses concern at the costs that will be incurred and the system amendments necessary to implement the P62 solution. The issue of cost was considered by the VAMG who noted that the "do nothing" option left service area distributors in a position where they would be required to offer "fostering arrangements" to new licensed Distribution Network Operators (DNOs) in accordance with their licence obligations. This option will itself result in extra costs to the service area distributor and is not the most desirable from a customer safety and service perspective. It would also not appear to offer a stable framework within which new licensed distributors could operate networks on a GB wide basis. Ofgem therefore considers that "fostering arrangements" are not feasible on anything other than an interim basis until Modification Proposal P62 can be implemented.

One respondent posed questions in relation to visibility of DUoS charging, DUoS billing and LLF production. Ofgem agrees with the position established in the definition report that the issues of DUoS billing and LLF production are out of scope for consideration within Modification Proposal P62 and should be resolved with distribution companies. As explained above, the visibility of the distributor id and therefore the relevant DUoS agreement should allow suppliers the opportunity to refer to actual distribution costs.

The same respondent raised the question of arrangements to handle a Distributor of Last Resort. Again, this issue would appear to be outside the scope of Modification Proposal P62 but it does form part of the wider debate surrounding industry processes to handle the transfer of ownership of distribution assets. This issue will be considered by the next meeting of the MRA Issue Resolution Expert Group (IREG). Suppliers and Distributors should contact their MRA contract managers if they wish to contribute to these discussions.

Ofgem therefore agrees with the Panel's recommendation that Modification Proposal P62 should be made and implemented.

Ofgem notes the support for a combined Modification Proposal P62 and Modification Proposal P70 solution from three respondents and from the Panel. It would be inappropriate for the Authority to create a dependency between two separate Modifications. Each proposed

Modification to the BSC will be considered on its merits. In addition, we refer back to the VAMG discussions on this issue. It clarified that the aim of Modification Proposal P62 is to support supply competition on the networks of new licensed distributors and it was not entirely clear how the registration of inter-DNO boundary meters (that are not used for settlement purposes) in CMRS would better facilitate that aim. Ofgem will consider Modification Proposal P70 independently and on its own merits, though taking into account this approval of Modification Proposal P62.

The Authority's decision

The Authority has therefore decided to direct that the Proposed Modification P62, as set out in the Modification Report for Modification Proposal P62, 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 of Modification Proposal P62 is 1 August 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 questions, please contact me on the above number.

Yours sincerely,



Iain Osborne

Director of Supply

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