



Direct Dial: 020-7901 7355

6 June 2002

The National Grid Company, BSC Signatories and
Other Interested Parties

Our Ref: MP No P53

Dear Colleague,

Modification to the Balancing and Settlement Code ("BSC") - Decision and Direction in relation to Modification Proposal P53: "Changes to DC, GC and CALF and the Effect on Indebtedness"

The Gas and Electricity Markets Authority (the "Authority")¹ has carefully considered the issues raised in the Modification Report² for Modification Proposal P53, "Changes to DC, GC and CALF and the Effect on Indebtedness"

The Balancing and Settlement Code Panel (the "Panel") recommended to the Authority that the Proposed Modification should be made, with an implementation date of thirty business days from any Authority decision to direct that Modification Proposal P53 should be made.

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 P53, 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 P53, "Changes to DC, GC and CALF and the Effect on Indebtedness", was submitted on 16 November 2001 by the Panel on the recommendation of BSCCo ("ELEXON"). The justification for the Modification Proposal was the better facilitation of the Applicable BSC

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

² ELEXON Document Reference MR053, Version No 1, dated 18 March 2002

Objective³ C3 (3) (d), "promoting efficiency in the implementation and administration of the balancing and settlement arrangements".

The Panel considered the Initial Written Assessment for Modification Proposal P53 at the meeting of 13 December 2001. It agreed that the Credit Modification Group (CMG) should carry out a two month Assessment procedure on the Modification. The CMG met on 7 January 2002 to assess Modification Proposal P53 and issued a consultation to industry on 25 January 2002. Responses from the consultation were received on 4 February 2002. These were circulated to the CMG who felt that no additional Modification Group meeting was required, so the Assessment Report and the associated recommendations of the CMG were agreed by e-mail.

The Assessment Report for Modification Proposal P53 was submitted to the Panel meeting of 14 February 2002. The Panel agreed with the recommendations of the CMG and agreed to submit Modification Proposal P53 to the Report Phase.

The Modification Proposal

Under the BSC, payments to and from Trading Parties for the settlement of imbalance positions relating to any given Settlement Period take place on average 29 calendar days later. As a result, Trading Parties may have debts (or be due payments) under the BSC in respect of Settlement Periods over the previous 29 days. A Trading Party must deposit collateral appropriate to their level of indebtedness with the Funds Administration Agent (the "FAA"). This collateral is used to cover their debt in the event of default.

A Trading Party's indebtedness is based on their notified contract position, their actual metered volumes and any previously due payments. Energy Contract Volumes are submitted ex-ante and so are known with precision, but actual metered data is not available for several days after a given Settlement Period. Currently, an estimate of the physical contribution of demand or generation over the previous 29 days is used, which is either:

(i) in the case of a Production Balancing Mechanism ("BM") Unit, the "BM Unit Credit Assessment Export Capability" (or "BMCAEC"), which is the product of the Generation Capacity ("GC") and Credit Assessment Load Factor ("CALF") for that BM Unit,

$$\text{BMCAEC} = \text{GC} * \text{CALF}$$

or

(ii) in the case of a Consumption BM Unit, BM Unit Credit Assessment Import Capability (or "BMCAIC") which is the product of the Demand Capacity ("DC") and CALF for that BM Unit,

$$\text{BMCAIC} = \text{DC} * \text{CALF}$$

The Generation Capacity is the Party's estimate of the largest metered export of the BM Unit in the BSC Season and the Demand Capacity is the Party's estimate of the largest metered import

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;
- (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.

for the BM Unit in the BSC Season. ELEXON determines the value of CALF for each BM Unit according to principles and guidelines established by the BSC Panel⁴.

BSC Parties may submit revised figures for GC and DC to reflect seasonal variations in supply and demand; BSC Section K 3.4 deals with this regular procedure. If a Party either submits revised values in mid-Season or has their CALF value revised in mid-Season, there is a consequential effect on their BMCAEC / BMCAIC. This typically happens when a Party is appealing an erroneous CALF value so they can improve their credit position. In such instances, BSC Section M 1.2.4 states their Energy Indebtedness should be recalculated "*...as though such change were effective with effect from the first of the 29 days referred to in paragraph 1.2.1.*" A successful appeal would then give the Party an immediate improvement in their indebtedness position.

In reality, the Energy Contract Volume Aggregation Agent systems do not apply these changes retrospectively, and so are in breach of the Code. Impact assessment of the system changes needed to implement this feature provided an indicative cost of £176,045⁵

Modification Proposal P53 seeks to modify the BSC to:

- remove the obligation placed on the Energy Contract Volume Aggregation Agent (ECVAA) to treat mid-Season changes of BMCAEC and BMCAIC retrospectively; and
- bring the Code in line with the Central Services practice of applying mid-Season changes of BMCAEC / BMCAIC on the day the change becomes effective.

This means that where a Party is successful in their appeal, they would not receive an immediate improvement in their indebtedness position. The benefits would be received on a gradual basis over the following 29 days. This may pose a risk to small new entrants, if they are not given advance warning of this potential problem. The proposed Modification does not affect the obligations relating to amendments to the value of GC, DC and CALF on BSC Season changes⁶.

The Authority's approval of Modification Proposal P2, "Revision of the Methodology for Assessing Credit Indebtedness", has a bearing on the possible impact of Modification Proposal P53. The former, which is due to be implemented in September 2002, will allow for the use of data from the Settlement Administration Agent (SAA) Interim Information run in the calculation process for indebtedness of generators and suppliers. This will allow for the use of actual metered volumes and actual price data for 22 of the previous 29 days, thereby improving the accuracy of the indebtedness calculation. Therefore, implementation of Modification Proposal P2 alleviates the requirement for retrospective application of revised BMCAEC / BMCAIC in indebtedness calculation due to the reduced impact these estimated data have on the overall result.

ELEXON published a Draft Modification Report on 21 February 2002, which invited respondents' views on this subject.

Respondents' views

ELEXON received ten responses to the initial industry consultation on Modification Proposal P53. Nine of these (representing 48 Parties) supported the Modification Proposal, and the

⁴ A more complete description of the process may be found in "An Overview of Security and Credit Checking under NETA", Ofgem/DTI joint publication, December 2000

⁵ ELEXON Document Reference MAR053, Version 1.0, issued 14 February 2002 (p.5)

⁶ As specified under BSC Sections M 1.5 (CALF) and K 3.4 (DC / GC)

remaining response (representing 4 Parties) expressed support in principle, but had views on appeals of Season CALF which they felt should also be addressed.

ELEXON received nine responses to the consultation on the Draft Modification Report for P53. Eight responses (representing 27 Parties) expressed support for the Proposed Modification and the remaining one (representing 1 Party) replied with “no comment”.

The respondents’ views are summarised in the Assessment Report⁷ and Modification Report for Modification Proposal P53, which also include the complete text of all respondents’ replies.

Panel’s recommendation

The Panel met on 14 March 2002 and considered the Modification Proposal P53, the draft Modification Report, the views of the Modification Group and the consultation responses. The Panel noted that there were no new, substantive arguments contained within the consultation responses.

The Panel recommended that the Authority should approve the Proposed Modification with an implementation date of thirty business days from any Authority decision to direct that Modification Proposal P53 should be made.

Ofgem’s view

Ofgem considers, having had regard to its statutory duties, that Modification Proposal P53 will better facilitate achievement of the Applicable BSC Objectives, in particular the promotion of efficiency in the implementation and administration of the balancing and settlement arrangements.

Ofgem notes that the forthcoming implementation of Modification Proposal P2 will mitigate the risk of BSC Parties having grossly incorrect credit cover, since estimated data will only be used for 7 of the previous 29 days. In view of this change, it does not seem efficient to require the ECVA system to be amended, at a cost approaching £180,000, especially when the perceived gains in credit-checking are negligible. ELEXON have confirmed that the number of mid-Season changes to BMCAEC / BMCAIC are typically only 4 or 5 per year. This number is expected to reduce with the earlier publication of pre-season CALF values, which allows more time for pre-season appeals.

Implementation of Modification Proposal P53 would remove ELEXON’s discretion to withhold credit default authorisations that occur during appeals to CALF values⁸. It should therefore be made clear to new and small entrants, who are the most likely to find themselves with erroneous indebtedness positions, that in the event of a successful appeal they will get tapered rather than instant relief as a result of this Modification Proposal. This should incentivise BSC Parties to raise timely appeals of erroneous CALF values, which would in turn promote efficiency in the implementation and administration of the balancing and settlement arrangements.

The current operational procedures of the balancing mechanism should not be compromised by the decision, as it reflects current practice.

⁷ ELEXON document reference MAR053, Version No. 1, dated 14 February 2002

⁸ Section M3.4.3 (a) of the BSC refers

Ofgem agrees with the Panel's recommendation that this Modification Proposal be approved.

The Authority's decision

The Authority has therefore decided to direct that Modification Proposal P53, as set out in the Modification Report for Modification Proposal P53, 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 Modification is to take effect thirty business days from the date of this decision to approve the Modification Report.

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,

A handwritten signature in black ink, appearing to read 'A. N. Simpson', written over a horizontal line.

Nick Simpson

Director, Industry Codes Development

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