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RB/MVB

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Dear Brian

FURTHER CONSULTATION ON P37

I refer to the consultation report published by Elexon yesterday, seeking views on 'P37 Clarified' and also on the Alternative Proposal that was formulated by the Modification Group at its meeting held last Friday.

It is not clear to us why Elexon considers it is appropriate to consult the whole industry again at this stage, but, since it has now done so, our principal concern is to ensure that the industry is provided with an accurate and helpful account of the issues. We are therefore taking this opportunity to rectify what we consider to be a misleading account, in the report, of the legal issues which arise in respect of the presently proposed modifications to the BSC.

Accordingly, I shall be grateful if you would arrange, immediately on receiving this letter of clarification, for it to be treated in the same way that modification proposals are dealt with under paragraph F2.1.10 of the BSC.

Page 9 of the report purports to set out an account of the various legal issues which arise, and to comment on the rival arguments advanced by London and by Elexon. On page 9, it is recognised that the debate centres around:

- (a) the meaning of 'contracted' in Condition 7A(2), and
- (b) the relationship between Conditions 7A(2) and 7A(3).

However, the text on page 9 does not provide a clear or fair account of what the issues are. We would wish the industry to be aware of the following points in considering its responses to the report.

Settlement by Reference to Contracted Volumes

James Goudie QC has advised London that, on its true construction, Condition 7A(2) requires that any balancing and settlement arrangements should provide for settlement of imbalances to be effected by reference to trading parties' contracted volumes, and that that includes volumes notionally traded between the separate accounts of a single trading party.

Mr Goudie has also advised that Condition 7A(2) envisages that those contracted volumes are to be ascertained quite independently of any amounts which a party may have notified under the BSC, and that, to the extent that there is discrepancy between a party's actual contracted volumes and the amounts which it has notified under the BSC, then settlement should be effected by reference to the actual contracted amount, and not the erroneously notified amount.

The consultation report states that Elexon and the Panel 'have been advised' that there are 'good arguments' to the contrary.

London has published Mr Goudie's opinion. In it, Mr Goudie expressly considers the advice which Elexon received in connection with P19 (which was summarised or quoted in the Panel report on that modification proposal). He concludes that that advice was incorrect. We do not know whether Elexon has now sought further advice, nor (if it has) do we know whether and, if so, on what basis Elexon's advisers persist in their view. We consider that, if Elexon has received further advice, contrary to Mr Goudie's opinion, then the best way forward would be for them to publish that advice. Meanwhile, London continues to believe that Mr Goudie's advice is correct.

London, therefore, continues to advance its case on the basis that, in its present form, the BSC does not comply with the requirements of Condition 7A(2) and that P37 is to be favoured, on the basis that it would bring the BSC into line with the requirements of that condition.

The Relationship Between Conditions 7A(2) and 7A(3)

On page 9 of the report, it is also suggested that, even if London's arguments as to the meaning of contracted volumes were correct, nonetheless that would not be determinative of the matter: it would be for the Panel and ultimately Ofgem to weigh up that factor against other factors embraced within the applicable BSC objectives, as set out in Condition 7A(3). This point was not raised until the Modification Group meeting last Friday, and Mr Goudie was not invited to address it in his opinion, which was issued in September.

London contends that the position advanced in Elexon's report is incorrect. Our reasons are as follows:

- (a) Condition 7A(2) takes priority over Condition 7A(3). Condition 7A(2) specifies the requirements which the BSC is to fulfil. To the extent that there would be more than one possible means of fulfilling those requirements, Condition 7A(3) requires that Ofgem should favour a version which best facilitates the attainment of the objectives laid down in Condition 7A(3).

- (b) In other words, Condition 7A(2) effectively determines *what* the BSC must achieve, whereas Condition 7A(3) determines *how* it should be achieved, if there is more than one way of achieving it. That this is the correct view is confirmed by Condition 7A(1), which distinguishes between *what* the BSC must comprise (see paragraph (a)) and *how* it should be designed to do so (see paragraph (b)). It should be noted that references elsewhere in Condition 7A to balancing and settlement arrangements are to arrangements fulfilling the requirements of Condition 7A(2).
- (c) It follows that, in arguing that Ofgem should direct the adoption of P37 in order to bring the BSC into line with the requirements of Condition 7A(2), London does not need to rely on objective (a) of Condition 7A(3) at all. It is London's argument, endorsed now by Mr Goudie's opinion, that there is an overriding obligation on Ofgem, in deciding whether to direct that a particular proposed modification to the BSC should be adopted, to perform its functions so as to ensure, first of all, that the BSC does fulfil the requirements of Condition 7A(2).
- (d) On this basis, the Panel and ultimately Ofgem need to resort to a weighing of competing considerations under Condition 7A(3) only if they are presented with two or more modification options which would each fulfil the requirements of Condition 7A(2), and therefore need to decide which of these is to be preferred. It may be that, in deciding between P37 Clarified and the newly proposed alternative, Condition 7A(3) could come into play: but such considerations do not arise at all in any comparison of P37 Clarified with the existing BSC.

However, London further contends that, even if it were necessary for the Panel and/or Ofgem to weigh up considerations of compliance with Condition 7A(2) alongside other factors arising by reference to the BSC objectives in deciding whether to direct the adoption of P37 Clarified, there would, in the present case, be no good reason for Ofgem to conclude that P37 should be rejected.

The role of respondents and the Panel

The report invites respondents to indicate, in their comments, what assumptions they have made as to the correct answer to the legal issues raised above and, hence, by reference to what factors respondents have made their comments. It is suggested that the Panel may also adopt that approach in framing its report, thereby leaving it to Ofgem to decide what is the correct legal approach, and to take account of the Panel's report only to the extent that it proceeds on the correct legal basis.

Given that the report advocates that approach, the purpose of this letter is to assist respondents (and members of the Panel) in identifying the implications of the different legal arguments raised in this case, so that they can identify clearly what assumptions they are making in formulating their comments.

London must, however, reserve its rights to argue at a later stage (should it be necessary to do so) that the publication of the report in its present form, and the consideration of responses from the industry to that form of the report, has tainted the entire process for the examination of P37.

Yours sincerely

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Electricity Group