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22 November 2002

The National Grid Company, BSC Signatories and  
Other Interested Parties

Our Ref: MP No: P34

Dear Colleague

**Modification to the Balancing and Settlement Code ("BSC") - Decision and Notice in relation to Modification Proposal P34: "Transfer of Imbalances caused by Balancing Services to the Transmission Company Energy Account"**

The Gas and Electricity Markets Authority (the "Authority"<sup>1</sup>) has carefully considered the issues raised in the Modification Report<sup>2</sup> for Modification Proposal P34 "Transfer of Imbalances caused by Balancing Services to the Transmission Company Energy Account".

The BSC Panel (the "Panel") recommended to the Authority that the original Modification Proposal should be rejected and that the Alternative Modification Proposal should be accepted. The Panel recommended that the Alternative Modification Proposal should be implemented on 1 December 2002.

The Authority has decided not to direct a modification to the BSC. This letter explains the background to the Modification Proposal and sets out the Authority's reasons for its decision.

**Background to the proposal**

NGC contracts with various Parties for the provision of Balancing Services such as frequency response, standing reserve, fast reserve and black start. The delivery of these Balancing Services

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

<sup>2</sup> ELEXON document reference MR034, version No. 1.0, dated 18 March 2002

can result in the provider generating or consuming different volumes of energy than they had contracted for and hence can result in providers incurring imbalance charges.

Generators are compensated via the Connection and Use of System Code ("CUSC") for the imbalance charges incurred under the BSC when providing Mandatory Frequency Response. An Amendment to the CUSC, CAP001<sup>3</sup>, altered the method used to calculate the response energy volume delivered or avoided by generators to more accurately reflect the energy volume delivered or avoided when providing Mandatory Frequency Response. In addition, it duplicated the BSC algebra used for calculating Non-Delivery Charges to compensate generators for Non-Delivery Charges incurred in the delivery of Mandatory Frequency Response.

On 14 August 2001, NGC raised Modification Proposal P34 "Transfer of Imbalances caused by Balancing Services to the Transmission Company Energy Account". The Proposer suggested that the Modification Proposal will better facilitate achievement of Applicable BSC Objective<sup>4</sup> (b) as set out in Condition C3.3 of NGC's Transmission Licence.

The Proposer considered that it is inappropriate to charge imbalance prices to Parties who have assisted in System Balancing. It was suggested that providers were reluctant to offer Balancing Services to the Transmission Company and some providers were potentially withdrawing these services. This could result in an increase in the costs of System Balancing by NGC having to purchase more expensive Balancing Services. The Proposer also stated that reductions in the availability of Balancing Services could lead to degradation in the security of the System.

NGC made a request to the Panel that the Modification Proposal be treated as an Urgent Modification Proposal. The Panel did not agree with this request, but recognised that the process for this Modification Proposal should be expedited where possible.

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<sup>3</sup> The decision letter for Approved Amendment CAP001 can be found at

<http://www.nationalgrid.com/uk/indinfo/cusc/>

<sup>4</sup> The Applicable BSC Objectives are contained in Condition C3.3 of NGC's Transmission Licence and 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.
- (e) without prejudice to the foregoing objectives and subject to paragraph 3A, the undertaking of work by BSCCo (as defined in the BSC) which is:
  - (i) necessary for the timely and effective implementation of the proposed British Electricity Trading and Transmission Arrangements (BETTA); and
  - (ii) relevant to the proposed GB wide balancing and settlement code;

and does not prevent BSCCo performing its other functions under the BSC in accordance with its objectives.

## **The Modification Proposal**

This Modification Proposal seeks to transfer any energy imbalance volumes associated with the provision of certain Balancing Services (“Applicable Balancing Services”) from the Energy Account of the service provider to the Energy Account of the Transmission Company thereby removing this energy from exposure to imbalance charges.

The Transmission Company will be required to determine the energy volume associated with the provision of Applicable Balancing Services for each Balancing Mechanism Unit (“BMU”) per Settlement Period within two working days of the event (i.e. in time for the Interim Information Settlement Run). These volumes will be reported to the Balancing Mechanism Reporting Agent (“BMRA”) for publication on the Balancing Mechanism Reporting Service (“BMRS”) and to the Settlement Administration Agent (“SAA”) for use in settlement calculations.

The energy volumes associated with providing Applicable Balancing Services will then be transferred from the Energy Account of the Balancing Services provider to the Energy Account of the Transmission Company. This results in no payments being made via the BSC for the provision of the Applicable Balancing Services. Instead, all relevant payment would be dealt with via the CUSC and/or Ancillary and Commercial Services Agreements with the Transmission Company.

The Modification Proposal proposes that the methodology for determining the energy volumes associated with the provision of Applicable Balancing Services, and the list of Balancing Services that this Modification Proposal is to apply to, be defined outside the provisions of the BSC.

Balancing Services providers would be able to “opt out” of the energy volume transfer process. The Lead Party of a BMU would be able to instruct the Transmission Company not to notify energy volumes attributable to the provision of Applicable Balancing Services and therefore remain exposed to imbalances accruing from the provision of Applicable Balancing Services.

A retrospective implementation date of 23 August 2001 is recommended for the original Modification Proposal.

### *Alternative Modification Proposal*

During its assessment of the Modification Proposal, the Modification Group developed an Alternative Modification Proposal. This Alternative Modification Proposal is based on the original Modification Proposal although it changes the governance for the definition of the Applicable Balancing Services and also the implementation date.

The Alternative Modification Proposal defines the Applicable Balancing Services and the methodology for determining the energy volumes in a framework document linked to the BSC. The BSC will include reference to the framework document and to the requirement for the contents to be approved by the Authority. This framework document would be operated by the Transmission Company and approved by the Authority following a mandatory consultation. The governance for payments of such services would remain under existing arrangements, namely the CUSC, Ancillary Service Agreements and Commercial Services Agreements.

An implementation date of 1 December 2002 is recommended for the Alternative Modification Proposal.

A number of BSC Modification Proposals, CUSC Amendment Proposals and a modification to the Transmission Licence have been raised proposing changes to the arrangements for addressing a Party's imbalance exposure when providing Balancing Services. These are outlined in Appendix 1.

### **Respondents' views**

ELEXON issued a draft Modification Report for Modification Proposal P34 on 22 February 2002, which invited respondents' views prior to the Panel meeting of 14 March 2002. The report recommended that the Modification Proposal be rejected and that the Alternative Modification Proposal be approved.

In total, ELEXON received 10 responses to the consultation. Of these, five expressed support for the recommendations and four respondents did not support the recommendations. One respondent did not express a view either in favour or in opposition to the recommendations in the draft Modification Report.

Several respondents agreed in principle that providers of Balancing Services should not be exposed to imbalance charges for the provision of those services.

One respondent believed that neither Modification Proposal fully addressed the issues and supported the rejection of both. Another respondent stated that both options transferred the payment for energy from the BSC to the CUSC, thereby treating it differently to all other balancing energy. This respondent therefore supported neither the original nor the Alternative Modification Proposal.

Several respondents cited the retrospective implementation date as a reason for rejecting the original Modification Proposal. It was suggested that retrospective changes may have commercial impacts representing unmanageable risk, which should be avoided.

One respondent supported the Alternative Modification Proposal based on the belief that the governance for defining the Applicable Balancing Services and the methodology with which to calculate the energy delivered when providing these services should be included in the BSC as this would increase transparency in the arrangements surrounding the provision of Balancing Services.

### **Panel's Recommendation**

The Panel met on 14 March 2002 and considered the original Modification Proposal and the Alternative Modification Proposal, the Modification Report, the views of the Modification Group and the consultation responses received.

The Panel recommended to the Authority that the original Modification Proposal should be rejected and that the Alternative Modification Proposal should be approved. The Panel recommended that, if approved, the Alternative Modification Proposal should have an implementation date of 1 December 2002.

The Panel supported the principle of the Modification Proposal and believed that the removal of exposure to imbalance charges for energy associated with the delivery of Balancing Services better facilitates the achievement of the Applicable BSC Objectives. However, the Panel recommended that the original Modification Proposal be rejected due to its retrospective nature and it having a governance structure that falls under the Transmission Licence/CUSC.

### **Legal drafting errors**

On 25 July 2002 all BSC Parties were made aware of some errors in the legal text to implement Modification Proposals P34, P36, P71 and their respective Alternative Modifications. ELEXON believed these errors to be both minor and inconsequential and that they did not alter the intent or effect of any of the Modification Proposals.

ELEXON issued a short consultation on proposed changes to the legal text to correct these errors on 25 July 2002, requesting responses back by 2pm on 26 July 2002. ELEXON received five responses, none of which objected to the proposed changes.

Subsequently, ELEXON wrote to Ofgem on 1 August 2002 to provide the Authority with supplements to the Modification Reports. The supplements contained the amended legal text for Modification Proposals P34, P36, P71 and their respective Alternative Modification Proposals.

### **Ofgem's view**

Ofgem considers, having had regard to its statutory duties, that the original Modification Proposal and the Alternative Modification Proposal do not better facilitate the achievement of the Applicable BSC Objectives. This conclusion has been reached, taking into consideration respondents' views on Modification Proposals P36 and P71, Proposed Amendments CAP009, CAP010, CAP011 and all related Alternative Modification Proposals and Alternative Amendments as well as the responses to the associated consultation on a Transmission Licence modification. Although the Authority has considered the issues raised in these Modification Proposals, Amendment Proposals and the Transmission Licence Modification consultation concurrently, each proposal is subject to separate Determination.

Ofgem agrees with the Panel that providers of certain Balancing Services should have the option of not being exposed to imbalance risk as a result of imbalance volumes created by the provision of Balancing Services. Ofgem considers that participation from the demand side in providing Balancing Services may be particularly inhibited as demand side participants do not have any compensation mechanism for the imbalance incurred as a consequence of providing Balancing Services<sup>5</sup>.

Whilst Ofgem supports the principle of the original Modification Proposal, it does not consider that this Modification Proposal should be implemented retrospectively from 23 August 2001. Ofgem considers that retrospective changes to the BSC, in general, may damage market confidence in the trading arrangements unless they can be reasonably anticipated. The introduction of a retrospective modification to the treatment of Balancing Services would

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<sup>5</sup> The CUSC contains provisions for generators to be reimbursed for imbalance costs incurred when providing Mandatory Balancing Services.

provide greater uncertainty amongst providers of Balancing Services, to the detriment of promoting efficient competition in the generation and supply of electricity. Ofgem considers that there are generally accepted and well understood legal reasons why retrospective modifications are to be avoided except in certain circumstances. Ofgem has previously outlined example criteria that would be applied when considering retrospective changes. Ofgem's views on retrospective changes to the BSC and CUSC were discussed in more detail in the decision letters for Modification Proposal P19 and Proposed Amendment CAP001<sup>6</sup>.

Although the Alternative Modification Proposal does not propose a retrospective implementation date, Ofgem does not consider that the definition of "Applicable Balancing Services" and the associated methodology for calculating the volume of these actions should fall under the governance of the BSC. Currently the definition of Balancing Services is contained within the Transmission Licence and Procurement Guidelines, whilst the contractual mechanisms for mandatory Ancillary Services are described within the CUSC. This governance structure has been agreed through a number of industry consultations prior to the introduction of NETA. Ofgem considers that placing this methodology under the governance of the BSC could result in duplication between the BSC, the CUSC and the Transmission Licence and could ultimately lead to inconsistencies between the BSC, the CUSC and the Transmission Licence. Ofgem therefore considers this would be detrimental to the achievement of Applicable BSC Objective (d) as set out in Condition C3.3 of NGC's Transmission Licence.

### **The Authority's decision**

The Authority has therefore decided not to direct that the Modification Proposal or the Alternative Modification Proposal should be made and implemented.

Having regard to the above, the Authority, in accordance with Section F1.1.4 of the BSC, hereby notifies NGC that it does not intend to direct NGC to modify the BSC as set out in the Modification Report for Modification Proposal P34.

Please contact me on the above number if you have any queries in relation to the issues raised in this letter. Alternatively contact Richard Ford on 020 7901 7411.

Yours sincerely



**Sonia Brown**

**Director, Electricity Trading Arrangements**

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

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<sup>6</sup> The Authority's decision letters in respect of Modification Proposal P19 and Proposed Amendment CAP001 can be viewed and downloaded from Elexon and NGC's webpages respectively. These webpages can be found at <http://www.elexon.co.uk/ta/modifications/> and <http://www.nationalgrid.com/uk/indinfo/cusc/>

## Appendix 1 - Related decisions

*Modification Proposal P36 "The generation of Bid/Offer Acceptances relating to energy delivered as a result of providing Applicable Balancing Services"*

This Modification Proposal sought to address similar issues as Modification Proposal P34.

Under this Modification Proposal, the Transmission Company would be required to determine the energy volumes associated with the provision of Applicable Balancing Services for each BMU per Settlement Period. These energy volumes would be treated as Bid/Offer Acceptances ("BOAs"), but would be explicitly excluded from Energy Imbalance Price calculations as these BOAs are deemed to be due to System Balancing rather than Energy Balancing actions. As a result of these BOAs, the service provider would have any energy associated with the provision of Applicable Balancing Services cashed out at the Bid/Offer price and would not be exposed to imbalances due to these energy volumes. The Modification Proposal requires that the methodology for determining the energy volumes associated with the provision of Balancing Services, and the list of Balancing Services that it applies to, be held under the provisions of the BSC.

The Modification Group developed an Alternative Modification Proposal where energy volumes associated with the provision of Applicable Balancing Services would be notified in two different ways:

- as a BMU Applicable Balancing Services BOA (essentially the same mechanism as original Modification Proposal P36); or
- as a BMU Applicable Balancing Services volume, which will be removed from the Energy Account of the Balancing Service provider and transferred to the Energy Account of the Transmission Company (the mechanism set out in Modification Proposal P34).

The Alternative Modification Proposal was developed to cover all aspects of Balancing Services provision, as the original Modification Proposal effectively excluded Balancing Services providers who are not the Lead Party of the BMU and/or are not active participants in the Balancing Mechanism.

The Authority has issued a decision to reject the Modification Proposal and the Alternative Modification Proposal concurrently with this letter.

*Modification Proposal P71 "Transfer of imbalances caused by Balancing Services to the Transmission Company Energy Account"*

This Modification Proposal is identical to Modification Proposal P34, except it has a prospective implementation date. The Modification Proposal was granted Urgent status by the Authority on the grounds of efficiency as many of the issues had been discussed and consulted on within the industry during the extended Assessment Phase for Modification Proposals P34 and P36.

The Authority has issued a decision to approve the Modification Proposal concurrently with this letter. The Modification Proposal is to be implemented on 25 February 2003.

*Proposed Amendment CAP009 "Mandatory frequency response"*

This Proposed Amendment proposes changes to the methodology used for calculating frequency response volumes.

The Authority is minded to accept the Proposed Amendment. However, Ofgem considers it is important that the Proposed Amendment is not implemented prior to Modification Proposal P71 being implemented. The Amendment Report in respect of the Proposed Amendment contained a recommendation to implement the Proposed Amendment 10 business days after the Authority's decision. The Authority expects to issue its decision in relation to the Proposed Amendment on or after 12 February 2003.

*Proposed Amendment CAP010 "Mandatory response imbalance exposure"*

This Proposed Amendment seeks to better reflect generating Units' costs when providing frequency response by replacing the current reference price with a mechanism that uses Bid prices for high frequency response and Offer prices for low frequency response.

The Authority has issued a decision to reject Proposed Amendment CAP010 concurrently with this letter.

*Proposed Amendment CAP011 "Changes to frequency response payments to reflect a potential change to the BSC"*

This Proposed Amendment seeks to address the necessary changes to the CUSC if Modification Proposal P34 or any other Modification Proposal with the same effect were to be implemented. The CUSC Panel recognised that there would also need to be changes to the CUSC if Modification Proposal P36 or any other Modification Proposal with the same effect were to be implemented. An Alternative Amendment was therefore drafted to address the changes needed if Modification Proposal P36 or any other Modification Proposal with the same effect were implemented.

The Authority has issued a decision to accept the Proposed Amendment and reject the Alternative Amendment concurrently with this letter. The Proposed Amendment is to be implemented on 25 February 2003, the same day as Modification Proposal P71 is to be implemented.

*Modification to the National Grid Company's Transmission Licence: Applicable Balancing Services Volume Data ("ABSVD") Methodology Statement*

Modification Proposal P34 and Modification Proposal P71 both require an ABSVD Methodology Statement to be introduced under the governance of the CUSC/Transmission Licence. Ofgem issued a consultation on a modification to NGC's Transmission Licence on 23 September 2002 seeking to introduce a requirement for NGC to put in place an ABSVD Methodology Statement that would define:

- services for which a service provider would be allowed to transfer any imbalance volume caused by the delivery of the service to NGC's Energy Account, and

- the methodology by which such transferred imbalance volumes would be calculated.

In addition, the licence modification would also place an obligation on NGC to provide the Authority with information on the level of energy volumes that had been transferred to NGC's Energy Account via the mechanism defined in the ABSVD Statement.

The Authority has issued a decision to approve the modification to NGC's Transmission Licence concurrently with this letter.

*Applicable Balancing Services Volume Data ("ABSVD") Methodology Statement consultation*

NGC issued a consultation on establishing an ABSVD Methodology Statement on 1 October 2002 which invited views from respondents by 29 October 2002. NGC issued its report on the consultation to the Authority on 5 November 2002. In the report NGC recommended that a revised version of the ABSVD Methodology Statement should be approved if Ofgem decides to direct the necessary modification to NGC's Transmission Licence.

Ofgem is currently considering the findings of the report and the views expressed by interested parties. Ofgem will make its decision to approve or reject the proposed ABSVD Methodology Statement in due course.