



Direct Dial: 020 7901 7412

2 September 2003

National Grid Company, BSC Signatories and
Other Interested Parties

Our Ref: MP No P80

Dear Colleague

Modification to the Balancing and Settlement Code (“BSC”) - notice in relation to Modification Proposal P80: “Deemed Bid/Offer Acceptance for Transmission System Faults”

The Gas and Electricity Markets Authority (the “Authority”)¹ has carefully considered the issues raised in the Modification Report² in respect of Modification Proposal P80, “Deemed Bid/Offer Acceptance for Transmission System Faults”.

The BSC Panel (the “Panel”) recommended to the Authority that the original Modification Proposal should not be made. The Panel recommended that the Alternative Modification Proposal should be made.

The Panel recommended that the original Modification Proposal should be rejected and that the Alternative Modification Proposal should be implemented. The Panel recommended that if an Authority decision directing that the Alternative Modification Proposal should be made was received by 24 February 2003, that the Implementation Date should be 24 June 2003. If such an Authority decision was received after 24 February 2003 and before 4 July 2003, the Panel recommended that the Alternative Modification should be implemented on 4 November 2003. The last date for making a decision has therefore now passed. For this reason, the Authority is not able to direct that the original or the Alternative Modification Proposal be implemented, irrespective of their merits.

The remainder of this letter explains the background to the Modification Proposal and sets out the Authority’s position that in any event it would not have been minded to direct the implementation of the original Modification Proposal or the Alternative Modification Proposal had the last date for making a decision not been passed.

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

² ELEXON document reference P080RR, Version No. 1.0, dated 19 December 2002.

It should be noted that the following in no way fetters the Authority's discretion in relation to deciding whether it should direct the implementation of a similar or any other modification proposal which may come before it in the future. Such a modification proposal will be assessed in the usual way in light of the then prevailing market and trading arrangements situations.

Background

Under the BSC, Balancing Mechanism Units are exposed to Energy Imbalance Prices where their metered volumes do not match their notified contracted volumes. In the event of a Transmission System Fault, Balancing Mechanism Units can be prevented from either delivering or taking energy from parts of the Transmission System. In this situation, the affected Parties will be exposed to Energy Imbalance Prices if their metered volumes do not match their notified contractual volumes. If the Parties are unable to take action to adjust their contractual volumes they can be exposed to the Energy Imbalance Prices for the duration of the fault. If the physical dynamics of a Balancing Mechanism Unit prevent its immediate return to its notified contract position (i.e. if a generating plant requires warming prior to starting generation), Parties can be exposed to Energy Imbalance Charges beyond the duration of the Transmission System Fault if they are unable to adjust their contractual volumes.

British Energy Power & Energy Trading Ltd raised Modification Proposal P80: "Deemed Bid/Offer Acceptance for Transmission System Faults" on 1 May 2002. The Proposer considered that the Modification Proposal would better facilitate the achievement of Applicable BSC Objectives³ (a), (b) and (c).

The Proposer considered that it was not possible for Parties to manage the risks of Transmission System Faults and therefore that removing this risk would promote competition. In addition, the Proposer considered that for those Parties whose fixed costs represent a significant proportion of their costs, the risk of exposure to Energy Imbalance Prices in the event of a Transmission System Fault would be a competitive disadvantage.

³ The Applicable BSC Objectives, as contained in Standard 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;
- (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 Proposer considered that the Modification Proposal would promote efficiency of the Transmission Company by exposing it to the full costs of transmission failures.

The Panel considered the Initial Written Assessment at its meeting on 16 May 2002 and agreed to submit the Modification Proposal to a two month Definition Procedure. At its 18 July 2002 meeting, the Panel agreed to submit the Modification Proposal to a three month Assessment Procedure, which was later extended by one month to a total of four months.

The Modification Proposal

The Modification Proposal seeks to modify the BSC to ensure that a Party would not be out of balance and exposed to Energy Imbalance Prices due to a Transmission System Fault. Under the proposal, the National Grid Company plc (“NGC”) would be obliged to compensate Balancing Mechanism Units affected by a Transmission System Fault. The compensation would be delivered by an ex-post amendment to Settlement data (“Settlement Correction”) via deemed Bid Offer Acceptances⁴. The compensation would be for the duration of the affected period when a Balancing Mechanism Unit is forced to deviate from its Physical Notification due to a Transmission System Fault. The affected period is the initial Balancing Mechanism Window Period⁵ and subsequent Settlement Periods, until both the fault is clear and the Party has been given sufficient time to return to its prevailing Physical Notification.

The Modification Group (the “Group”) recognised a concern expressed in the original Modification Proposal regarding the lack of competition in freely submitted Bid and Offer Prices in the circumstances of a Transmission System Fault. The Group therefore considered basing the Settlement Correction on a separate set of ex-ante submitted disconnection Bid and Offer prices rather than on freely submitted Bids and Offers. Although the Group developed this option further it believed it would be a difficult option to operate. For example, the Group considered that the administration would be complex as disconnection prices would need to be agreed and maintained for all Balancing Mechanism Units prior to any fault. As a result of the complex administration required, the Group decided that the costs associated with this option were significant in view of the rareness of Transmission System Faults. The Group therefore decided to develop an Alternative Modification Proposal.

The Group considered that in most circumstances delivering compensation to Consumption Balancing Mechanism Units, especially those associated with Supplier Volume Allocation, would be arbitrary due to the difficulty of quantifying the effect of a Transmission System Fault on Consumption Balancing Mechanism Units. The Group considered that it was difficult to demonstrate a causal link between a Transmission System Fault and the impact on a Supplier,

⁴ Balancing Mechanism Units may use the Balancing Mechanism to submit matching Bids (to decrease generation/increase demand) and Offers (to increase generation/decrease demand). Each Bid/Offer pair must contain data on both volume (MWh) and price (£/MWh). The System Operator may accept Bids and Offers to balance the Transmission System in real time.

⁵ In relation to a particular time, the Balancing Mechanism Window Period is the period from that time to the end of the Settlement Period for which Gate Closure has most recently occurred at that time. The Balancing Mechanism Window Period has a duration of between 1 and 1 ½ hours.

based on the data available within the central BSC Systems⁶. The Group noted that Consumption Balancing Mechanism Units would continue to receive System Sell Price for any resulting spill of electricity onto the Transmission System and considered that extra compensation could not be correctly determined. Therefore, the Group decided that the compensation mechanism under the Alternative Modification Proposal would be restricted to Central Volume Allocation registered Production Balancing Mechanism Units that submit Final Physical Notifications and do not have alternative arrangements for providing compensation in case of a Transmission System Fault. Consumption Balancing Mechanism Units would therefore not be eligible for compensation under the Alternative Modification Proposal.

Under the Alternative Modification Proposal, NGC would be responsible for notifying Elexon as soon as reasonably practical of the details of any incident, which in its reasonable opinion should be classified as a "Transmission System Fault", including the "Transmission System Fault-affected Balancing Mechanism Units" and the "Transmission System Fault-affected Settlement Periods". The Transmission System Fault-affected Settlement Periods include the initial Balancing Mechanism Window Period and subsequent Settlement Periods, until both the fault is clear and the Party has been given sufficient time to return to its prevailing Physical Notification.

The Alternative Modification proposes that Settlement Correction for the Transmission System Fault-affected Settlement Periods should be calculated using post-event contract notifications from NGC's Energy Account to cancel the affected Parties' Energy Imbalance. The notifications would not include any corrections for Transmission Loss Multipliers.

The Alternative Modification Proposal also introduces an additional compensation mechanism to Settlement Correction. Under this mechanism, Lead Parties of any Transmission System Fault affected Balancing Mechanism Unit may raise a claim to be determined by the Panel for an Extra Cashflow Compensation. This facility is also available should the Lead Party consider that, in their reasonable opinion, an eligible Balancing Mechanism Unit had been affected by a Transmission System Fault, although the Transmission Company had not previously identified it as a Transmission System Fault affected Balancing Mechanism Unit. It was envisaged that the Panel would determine the amount of Extra Cashflow Compensation based on the evidence presented to it by the Parties involved.

Under the Alternative Modification Proposal, a Balancing Mechanism Unit can apply for extra compensation in the following areas:

1. avoidable costs as described in Section G2 of the BSC,
2. lost revenue from any potential actions for Balancing Services and BM activity, and
3. any Trading Charges incurred, for example Non-Delivery charges.

The extra compensation would be recovered as part of the Daily System Operator BM Cashflow.

⁶ Within Supplier Volume Allocation individual metering readings are not available and have been aggregated at the previous stage by a Supplier's Agent. In addition there is no reliable forecast at Grid Supply Point Group level for what the Supplier had intended prior to the Transmission System Fault.

The Group considered that both the original Modification Proposal and the Alternative Modification Proposal should be default arrangements within the BSC. The Group recognised that both the original Modification Proposal and Alternative Modification Proposal would impose administrative overheads on both the affected Party and NGC. Therefore, if the relevant Party and NGC reach a commercial bilateral agreement regarding the treatment of Transmission System Faults, the relevant Party would have the option to not make a claim for Settlement Correction or an Extra Cashflow Compensation.

The Group considered that the Alternative Modification would better facilitate the achievement of the Applicable BSC Objectives by exposing the Transmission Company to the economic consequences of Transmission System Faults and by removing an unmanageable risk to Parties.

The Panel met on 14 November 2002 and considered the Group's Assessment Report. The Panel made a provisional recommendation that the original Modification Proposal should not be made and that the Alternative Modification Proposal should be made. ELEXON published a Draft Modification Report on 22 November 2002, which invited respondents' views by 29 November 2002.

Respondents' views

ELEXON received 15 responses to the consultation on the Draft Modification Report. Nine respondents expressed support for the Panel's recommendation. Five respondents did not support the Panel's recommendation and one respondent was neither in favour nor opposed to the Panel's recommendation.

In general, respondents in support of the Panel's recommendation considered that market participants have no protection against the risk of imbalance due to Transmission System Faults and that the Alternative Modification Proposal provides a pragmatic solution to this. A number of respondents in support of the Panel's recommendation considered that Consumption Balancing Mechanism Units should also be compensated, but also recognised the difficulty in delivering non-arbitrary compensation. One of the respondents in support of the Panel's recommendation suggested that NGC should offer alternative arrangements to those not covered by the Modification Proposal.

Of those respondents that did not support the Panel's recommendation, two respondents considered that issues related to compensation for the lack of access to the Transmission System should be defined outside the BSC. The remaining three respondents considered the Alternative Modification Proposal to be discriminatory, as the demand side is equally exposed to the risk of imbalance in the event of a Transmission System Fault. These respondents pointed out that receiving System Sell Price for spilling energy will not be sufficient, as System Sell Price can be small or even negative. These respondents believed that equal access to compensation is required for Consumption Balancing Mechanism Units.

Panel's recommendation

The Panel met on 12 December 2002 and considered the Modification Proposal, the Draft Modification Report, the views of the Group and the consultation responses received.

The Panel recommended that the Authority should reject the original Modification Proposal and that the Alternative Modification should be made. As stated above, if an Authority decision directing that the Alternative Modification should be made was received by 24 February 2003, the Panel recommended that the Implementation Date should be 24 June 2003. If such an Authority decision was received after 24 February 2003 and before 4 July 2003, the Panel recommended that the Alternative Modification should be implemented on 4 November 2003.

The Panel considered that the Alternative Modification Proposal would better facilitate achievement of Applicable BSC Objective (b) by exposing the Transmission Company to the economic consequences of Transmission System failures. The Panel also recognised that the Transmission Company would be in the best place to manage the event and determine the correct trades to both balance the Transmission System, and take the affected Party out of imbalance.

The Panel considered that the Alternative Modification Proposal would also better facilitate achievement of Applicable BSC Objective (c) by addressing the unmanageable risk to Parties that a fault on the Transmission System represents. In addition, the Panel considered that the degree of exposure to imbalance, and the difficulty and financial impact to a Party in having to quickly trade out of imbalance, would vary depending on the Party and the type of Plant. The Panel considered that for some types of Plant this could reduce their ability to compete.

The Panel noted that under the Alternative Modification Proposal some categories of Balancing Mechanism Units, including Consumption Balancing Mechanism Units, would not be eligible for compensation in the event of a Transmission System Fault. The Panel did not consider the Alternative Modification Proposal was setting a precedent. The Panel considered that a Party could raise a future Modification Proposal to cover compensation for Transmission System Faults for those Balancing Mechanism Units not covered by the Alternative Modification Proposal.

Ofgem's view

As stated above the deadline for making a decision on the original and the Alternative Modification Proposals has passed and for this reason, the Authority is not able to direct the implementation of either Modification Proposal. However, the Authority has considered the Modification Report regardless, and its view is explained below.

Having carefully considered the Modification Report and the Panel's recommendation, Ofgem considers that, having had regard to the Applicable BSC Objectives and its statutory duties, both the original Modification Proposal and the Alternative Modification Proposal do not better facilitate achievement of the Applicable BSC Objectives for the reasons set out below. Therefore even if the deadline for making a decision in respect of the original and Alternative Modification proposal had not passed, Ofgem would not have been minded to direct the implementation of either Modification Proposal. As stated above, this in no way fetters the Authority's discretion as

to whether to direct the implementation of a similar or any other modification proposal that may be proposed in the future.

Respective scope of the BSC and CUSC

As part of the introduction of the present England and Wales wholesale electricity transmission and trading arrangements, consultations were carried out as to, amongst other things, the governance structure of the arrangements. Following these consultations, the rules for electricity transmission, trading arrangements and related charges were set out in three main documents: the BSC, the Connection and Use of System Code ("CUSC") and NGC's Charging Methodologies and Statements under its licence.

The BSC's scope is defined in general terms in the Transmission licence. The BSC is a code that sets out the rules for the Balancing Mechanism and imbalance settlement process under the wholesale electricity trading arrangements. Broadly, the BSC sets down the arrangements in respect of:

- ◆ making, accepting and settling offers and bids to increase or decrease electricity delivered to, or taken off, the total Transmission System (NGC's Transmission System and the distribution systems) to assist NGC in balancing the Transmission System; and
- ◆ determining and settling imbalances and certain other costs associated with operating and balancing the Transmission System.

The CUSC is also a licence-based code, setting out the principal rights and obligations in relation to connection to and/or use of the Transmission System and to the provision of certain balancing services. NGC is also obliged by its licence to produce Charging Methodologies and Statements containing detailed information relating to its charges for Use of System and Connection⁷.

Reform of transmission access arrangements

Reforms to the access arrangements for the Transmission System have been considered for some time. Following publication of an Ofgem document in February 2002⁸ the CUSC Panel decided to form the Transmission Access Standing Group to establish a forum in which issues associated with access arrangements for the Transmission System could be examined further. Arising out of the work of the Transmission Access Standing Group, NGC raised Amendment Proposal CAP043 "Transmission Access - Definition" for consideration at the 20 September 2002 CUSC Panel meeting. The Authority considered that CAP043 more clearly defined existing rights to access the Transmission System and approved it on 6 February 2003⁹.

⁷ See Standard Licence Conditions C7, C7A and C7B of NGC's transmission licence.

⁸ "Transmission access and losses under NETA, Revised Proposals", Ofgem, February 2002

⁹ The decision letter for CAP043 is available at

http://www.nationalgrid.com/uk/indinfo/cusc/mn_consultation_index.html. On 14 February 2003, Ofgem approved modifications UoSCM-M-09 and CCM-M-06 to NGC's Charging Methodologies that were related to the CAP043 Amendment Proposal. These decision letters are available at http://www.nationalgrid.com/uk/indinfo/charging/mn_modifications.html

More recently, during the development of the NGC System Operator incentive scheme for 2003/04¹⁰, NGC committed to use all reasonable endeavours to review and, if appropriate, bring forward proposals for reform of the contractual framework and Charging Methodologies, for implementation in April 2004. NGC's commitment included, among other things, the provision of firm transmission access rights, compensation for disconnection and remedies for breach of access rights. NGC is currently in the process of reviewing its Charging Methodologies as part of the process of fulfilling its commitments. The Transmission Access Standing Group is also continuing to explore ways of reforming the access arrangements to the Transmission System. Finally, First Hydro Company raised CAP048 "Firm Access and Temporary Physical Disconnection"¹¹ for consideration by the CUSC Panel at its 21 March 2003 meeting. The CAP048 Working Group has assessed the Amendment and provided its report to the CUSC Panel at its meeting on 25 July 2003. CAP048 is currently out for industry wide consultation.

Applicable BSC Objective (d) – promoting efficiency in the implementation and administration of the balancing and settlement arrangements.

In general, Ofgem considers that transmission related issues, such as access arrangements to the Transmission System and compensation following faults on the Transmission System, naturally belong within the governance structure of the CUSC and/or the transmission Charging Methodologies. As discussed above, these governance structures have been agreed through a number of industry consultations prior to the introduction of the present England and Wales wholesale electricity transmission and trading arrangements. Ofgem agrees with the two respondents who argued that the compensation for Transmission Faults should be defined outside of the BSC. It is Ofgem's view that compensation following disconnection from the Transmission System relates to NGC's transmission use of system arrangements and hence should be set out in the CUSC or NGC's Charging Methodologies and Statements rather than under the BSC.

Ofgem considers that defining the compensation mechanism for faults on the Transmission System within the BSC could result in duplication between the BSC, the CUSC, the Charging Methodologies and the transmission licence and could ultimately lead to inconsistencies between them and hence reduce the overall efficiency in the administration of the balancing and settlement arrangements. Ofgem considers, that in general, duplication and confusion between governance structures should be avoided, as far as possible.

As outlined above, work is already being undertaken, under the CUSC and NGC's Charging Methodologies, to introduce enduring arrangements for access to the Transmission System, including arrangements to address compensation for disconnection from the Transmission System. Ofgem therefore considers that implementing either the original Modification Proposal or the Alternative Modification Proposal may cause nugatory work to be undertaken. Ofgem also notes that the Group considered that both the original and the Alternative Modification Proposal would impose administrative overheads on both the affected Party and the

¹⁰ See "NGC system operator incentive scheme from 1 April 2003 – 31 March 2004", Final Proposals and Statutory Licence Consultation, Ofgem, March 2003

¹¹ More information on CAP048 is available from NGC's website at <http://www.nationalgrid.com/uk/indinfo/cusc/>

Transmission Company. Ofgem considers that these costs would be significant in view of the proposals to introduce enduring arrangements for access to the Transmission System being considered under the CUSC and charging statements. For these reasons, Ofgem considers that both the original and the Alternative Modification Proposal would be detrimental to better facilitating the achievement of Applicable BSC Objective (d).

Applicable BSC Objective (b) - the efficient, economic and co-ordinated operation by the licensee (NGC) of the licensee's Transmission System.

Ofgem agrees with the Panel that, in general, exposing the Transmission Company to the economic consequences of Transmission System failures could better facilitate achievement of Applicable BSC Objective (b). Ofgem is equally concerned that the correct incentives are in place on market participants to encourage them to make efficient use of the Transmission System. Under the original Modification Proposal and the Alternative Modification Proposal, the Transmission Company would be exposed to some economic consequence of Transmission System failures. However, Ofgem considers that these consequences would be arbitrary and not complete (for example, there will be no compensation for Demand Side participants). Ofgem is concerned that the implementation of either the original Modification Proposal or the Alternative Modification Proposal may prove a dis-incentive to developing the enduring arrangements for access to the Transmission System, within the CUSC. This is because Parties covered by the proposed compensation mechanism would already have a route to claim some compensation.

As set out in various consultation papers¹², Ofgem considers, in the context of its statutory duties, that the development of appropriate new arrangements for access to NGC's transmission system is important. This is because Ofgem considers that new arrangements for access to the Transmission System are necessary to ensure that proper incentives are in place on NGC to develop and maintain an efficient Transmission System and on market participants to encourage them to make efficient use of the Transmission System.

Overall, therefore, Ofgem considers that the implementation of new transmission access arrangements is likely to result in NGC operating the transmission system in an efficient, economic and co-ordinated manner to a greater extent than would be the case if new arrangements were delayed but the original or the Alternative Modification Proposal were implemented. Thus, whilst the implementation of either the original or the Alternative Modification Proposal could better facilitate achievement of Applicable BSC Objective (b), it would not be consistent with the discharge of the Authority's statutory duties.

Other reasons for Ofgem's views

Leaving aside the issue of whether the BSC is the correct place for arrangements for compensation due to Transmission System Faults, Ofgem does not consider that the

¹² See for example "Transmission access and losses under NETA, Revised Proposals", Ofgem, February 2002, "NGC system operator incentive schemes from April 2003, Initial Proposals", Ofgem, December 2002 and "NGC system operator incentive scheme from 1 April 2003 – 31 March 2004", Final Proposals and Statutory Licence Consultation, Ofgem. March 2003

Modification Proposal, or the Alternative Modification Proposal better facilitates the Applicable BSC Objectives, and would be in opposition to Ofgem's statutory duties, for the following reasons.

Applicable BSC Objective (d) – promoting efficiency in the implementation and administration of the balancing and settlement arrangements.

Ofgem does not consider it appropriate for the BSC Panel to determine compensation claims following a disconnection from the Transmission System as set out in the Alternative Modification Proposal. As stated in section B.1.2 of the BSC, the role of the BSC Panel is to administer the BSC and its change process, having regard to the Applicable BSC Objectives. Ofgem therefore considers this an additional reason for why the Alternative Modification Proposal would be detrimental to better facilitating achievement of Applicable BSC Objective (d) and to the discharge of the Authority's statutory duties.

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 agrees with the principle of removing imbalance exposure for the period of the disconnection or the Balancing Mechanism Window Period, whichever is shorter, as, during this time, Parties are unable to manage their imbalance exposure risk. However, Ofgem also considers that competition will be enhanced if all Parties are exposed to those imbalance exposure risks that they are able to manage. Ofgem considers that Parties should be able to manage at least part, if not all, of their risk beyond the Balancing Mechanism Window Period, through renegotiating contracts. Ofgem considers that providing relief beyond the Balancing Mechanism Window Period will disincentivise Parties from taking action to manage their risk and hence increase the costs to all BSC Parties. This would also reduce the number of trades being carried out and have a negative impact on effective competition. Consequently, Ofgem considers that both the original and the Alternative Modification Proposal would be detrimental to better facilitating the achievement of Applicable BSC Objective (c).

Applicable BSC Objective (a) - the efficient discharge by the licensee (NGC) of the obligations imposed upon it by this licence.

NGC has a range of statutory duties and licence obligations which include ensuring the efficient, economic and co-ordinated operation of the Transmission System, the facilitation of effective competition¹³ and non-discrimination¹⁴. As set out above, Ofgem considers that both the original and the Alternative Modification Proposal will be detrimental to NGC's discharge of the first two of these obligations.

Ofgem also considers the Alternative Modification Proposal would be detrimental to NGC's discharge of its non-discrimination obligation since it only applies to Central Volume Allocation

¹³ Section 9 (2) (b) of the Electricity Act 1989.

¹⁴ Condition C7C of the Transmission Licence.

registered Production Balancing Mechanism Units. Ofgem understands that demand side Balancing Mechanism Units can also be exposed to Imbalance Prices in the event of a Transmission Fault. Although the Group argued that demand side participants would receive System Sell Price for spilling energy, Ofgem agrees with the respondents who argued that this would not be sufficient as the System Sell Price can be small or even negative. Ofgem understands the problems associated with developing a compensation mechanism for the demand side. Ofgem also notes the Panel's view that Parties could raise a future Modification Proposal to develop a compensation mechanism for those Balancing Mechanism Units not covered by the solution proposed under the Alternative Modification Proposal. However, Ofgem does not consider the difficulties associated with compensating Demand Side Participants to be such as to warrant arrangements where compensation is available for Central Volume Allocation registered Production Balancing Mechanism Units but not for Demand Side Participants in view of the fact that Transmission System Faults can affect both categories of BSC Parties. Ofgem therefore agrees with those respondents who suggested that the Alternative Modification would be unduly discriminatory.

Ofgem also notes that any Extra Cashflow Compensation awarded to Central Volume Allocation registered Production Balancing Mechanism Units would be recovered from all CUSC Parties via the Daily System Operator BM Cashflow. Ofgem considers this would constitute a subsidy from all Parties that contribute to the Daily System Operator BM Cashflow but that are excluded from the proposed compensation mechanism (Supplier Volume Allocation registered Balancing Mechanism Units and Central Volume Allocation registered Consumption Balancing Mechanism Units) to those Parties that are covered by the proposed compensation mechanism (Central Volume Allocation registered Production Balancing Mechanism Units). For all of these reasons, Ofgem considers the Alternative Modification Proposal would be detrimental to better facilitating achievement of Applicable BSC Objective (a).

Summary of Ofgem's view

In summary, Ofgem considers that the issue of compensation for transmission failures should be considered under the CUSC or Charging Methodology governance arrangements rather than under the BSC since it relates to terms for transmission access rather than the details of the electricity trading arrangements. Ofgem also notes that this issue is being progressed by NGC and the industry via the review of NGC's Charging Methodologies and the work of the Transmission Access Standing Group. Moreover, Ofgem considers both the original and the Alternative Modification Proposal would be detrimental to better facilitating achievement of Applicable BSC Objectives (c), and (d), and that the Alternative Modification Proposal also would be detrimental to better facilitating achievement of Applicable BSC Objective (a). In addition, Ofgem considers that both the original and the Alternative Modification Proposal would be inconsistent with its wider statutory duties. Whilst Ofgem accepts that the original or the Alternative Modification Proposal might better facilitate the achievement of Applicable BSC Objective (b), Ofgem does not consider that this justifies the adoption of the original or the Alternative Modification Proposal given their detrimental effects in facilitating achievement of other Applicable BSC Objectives and the Authority's wider statutory duties.

Both the original and the Alternative Modification Proposal set out that the mechanism for compensation should be a default arrangement but that the relevant Party and NGC would have

the option of agreeing a commercial bilateral agreement, which could operate instead of the default arrangements. Ofgem considers that such bilateral agreements could provide an appropriate, cost-effective, interim solution while the framework for the new arrangements for access to the Transmission System is being progressed within the governance of the CUSC and the Charging Methodologies. This should minimise any costs that would otherwise be incurred in administering the arrangements under either the original or the Alternative Modification Proposal. In entering into these Bilateral Agreements, NGC would obviously need to give consideration to its licence obligations relating to the efficient, economic and co-ordinated operation of the Transmission System, the facilitation of competition and non-discrimination.

The Authority's decision

For the reasons set out above, the Authority is not able to direct the implementation of either the original or Alternative Modification Proposal.

Without fettering its discretion in relation to a similar or any other modification proposal in the future, the Authority would not, in any event, have been minded to direct that this Modification Proposal be implemented even if the deadline for making a decision had not passed.

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

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

Yours sincerely

A handwritten signature in black ink, appearing to read 'Sonia Brown'.

Sonia Brown

Director, Electricity Trading Arrangements

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