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The National Grid Company, BSC Signatories and
Other Interested Parties

15 April 2004

Our Ref: MP No P156

Dear Colleague,

Modification to the Balancing and Settlement Code (“BSC”) - Decision and notice in relation to Modification Proposal P156 “Suspending the Implementation of the Zonal Allocation of Transmission Losses”.

The Gas and Electricity Markets Authority (the “Authority”)¹ has carefully considered the issues raised in the Modification Report² in respect of Modification Proposal P156, “Suspending the Implementation of the Zonal Allocation of Transmission Losses”.

The BSC Panel (the “Panel”) recommended to the Authority that P156 should not be made, but if the Authority determined that Proposed Modification P156 should be implemented, the implementation date should be 1 April 2004 if an Authority determination is received on or before 24 March 2004 or 5 Working Days after an Authority determination where an Authority determination is received after that date.

Having carefully considered the Modification Report and the Panel’s recommendation and having regard to the Applicable BSC Objectives³ and the Authority’s wider statutory duties,⁴ the Authority has decided not to direct a Modification to the 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 P156MR, Version No. Final/1.0, dated 16/02/04.

³ The Applicable BSC Objectives, as contained in Standard Condition C3 (3) of NGC’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) 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.

⁴ Ofgem’s statutory duties are wider than the matters that the Panel must take into consideration and include amongst other things a duty to have regard to social and environmental guidance provided to Ofgem by the government.

This letter explains the background and sets out the Authority's reasons for its decision.

This letter constitutes notice by the Authority under section 49A Electricity Act 1989 in relation to the direction.

Background

P82 'Introduction of Zonal Transmission Losses on an Average Basis' and P125 'Apportionment of the Scottish Interconnector Flows to the Northern and North Western GSP Groups for the Purposes of Calculating Losses' were approved in order to facilitate the introduction of Average Zonal Transmission Losses (AZTL) in England and Wales. The aim of these provisions was to send out long term economic signals to Generators and Suppliers. It was intended the modifications would be implemented together on 1 April 2004.

On 30 June 2003 P134 was proposed in order to halt all work and expenditure to implement approved BSC Modification P82 with immediate effect and undo all intended BSC documentation, system and process changes associated with it. P134 was rejected by the Authority in its decision of 18 September 2003 and P82 remained part of the legal baseline of the BSC.

On 21 January 2004 the Gas and Electricity Markets Authority submitted to judgment in judicial review proceedings, on the basis that its decision of 17 January 2003 approving Modification Proposal P82 "Introduction of Zonal Transmission Losses on an Average Basis" was procedurally flawed, and could not stand. A quashing order in respect of the 17 January 2003 decision was made, and the matter was remitted to the Authority for reconsideration.

On 30 January 2004 the Authority published a letter explaining that it had decided to formally reject Modification Proposal P82 on the grounds that the timetable proposed for its implementation had expired, and without expressing an opinion as to whether the Proposal would or would not better facilitate achieving the applicable BSC objectives by comparison with the current provisions of the BSC.

As a consequence of that decision, the Authority directed NGC to remove the modifications made to the BSC pursuant to the 17 January 2003 decision on Modification Proposal P82.

The rejection of P82 has as abrogated some of the provisions which P156 seeks to remove. Others were the subject of Approved Modification P165 "Housekeeping Modification – Removal of Approved Modification P125" which was approved by the Authority on 14 April 2004.

The Modification Proposal

Modification Proposal P156 seeks to modify the BSC so as to modify the BSC to prevent the implementation of the combined changes introduced by Approved Modifications P82 and P125.

The Proposer considered that implementation of AZTL, as approved by the Authority, would have several negative impacts on the achievement of the Applicable BSC Objectives and that the

implementation of AZTL should be reconsidered. According to the Proposer, by removing these provisions P156 would better facilitate the achievement of Applicable Objectives (a), (c) and (d).

Elxon BSCCo prepared an Initial Written Assessment (IWA), which was presented to the Panel at its meeting on 15 January 2004. By a majority, the Panel agreed with BSCCo's recommendation that P156 proceed directly to the Report Phase with a provisional recommendation that it should be rejected. A draft Modification Report was issued for consultation on 22 January 2004, with a response deadline of 4 February 2004.

Respondents' views

Ten responses were received. Three responses (representing 16 Parties and 0 non-Parties) expressed support for the Panel's provisional recommendation to the Authority that P156 should not be made, six responses (representing 20 Parties and 1 non-Party) opposed the Proposed Modification and the remaining response (representing 1 Party) provided a "no comment" response.

The majority of respondents either (a) did not support P156 on the basis that it had been rendered redundant by the revised Authority determination on P82 or (b) supported it as a mechanism to back out AZTL, necessary as a result of the revised Authority determination on P82.

Some of the responses were received prior to the 30 January 2004 decision to formally reject Modification Proposal P82, others were received after it. The respondents' views are summarised in the Modification Report for Modification Proposal P156, which also includes the complete text of all respondents' replies.

Panel's recommendation

The Panel considered the draft Modification Report, including the consultation responses received, on 12 February 2004. As a consequence of the 30 January 2004 Authority determination that P82 should not be made, the Panel made a unanimous recommendation that P156 should not be made on the basis that it was now redundant.

The Panel recommended that the Authority should reject the Proposed Modification, but should the Authority determine that Proposed Modification P156 should be implemented, the implementation date should be 1 April 2004 if an Authority determination is received on or before 24 March 2004 or, 5 Working Days after an Authority determination where an Authority determination is received after that date.

Ofgem's view

Ofgem has carefully considered P156 in the context of the Modification Report for the Proposed Modification, the Panel's recommendation, the Applicable BSC Objectives and its own Statutory Duties.

Ofgem considers that in light of the Authority's letter of 30 January 2004 formally rejecting Modification Proposal P82, and the Authority's Decision of 14 April 2004 approving P165, that P156 has been rendered redundant and as a result it is impossible for P156 to better facilitate the achievement of the Applicable BSC Objectives.

Ofgem notes the comments made by two respondents to the consultation on the draft P156 Modification Report to the effect that P156 should be implemented so as to back out the remaining provisions relating to AZTL introduced by P125. Ofgem considers that the intent of P156 was to prevent the implementation of the entire AZTL arrangements on the basis that a political development had altered the long-term cost-benefit analysis and that, in the circumstances of P156, it was not appropriate for the Proposed Modification to be used as a vehicle to remove the P125 changes alone.

If you have any questions, please contact me on the above number.

Yours sincerely,

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

Nick Simpson

Director of Industry Code Development

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