ELEXON and P361 Modification Proposal

13 March 2018

1. INTRODUCTION

1.1 We have been asked a series of questions by ELEXON relating to BSC Modification Proposal 361 "Revised treatment of BSC Charges for Lead Parties of Interconnector BM Units – proposal to exclude Interconnector Balancing Mechanism (BM) Units Credit Energy Volumes from Balancing and Settlement Code (BSC) Charges calculations in order to comply with the EU Third Package" ("P361 Modification Proposal").

1.2 The P361 Modification Proposal was submitted by Nord Spot Pool AS, who is a Nominated Electricity Market Operator ("NEMO") in Great Britain.

1.3 In Annex A to this paper, we have listed the materials we have reviewed in order to reach a view on the questions put to us.

1.4 In Annex B to this paper, we have set out our understanding of the relevant BSC charging arrangements as they relate to the recovery of BSC Charges from Interconnector Users. If our understanding is incorrect in any way, please let us know as it may affect our conclusions.

2. HELPFUL BACKGROUND

2.1 ***Previous Ofgem decisions*** **–** In our instructions, we were referred to four previous Ofgem decisions relating to the application of charges to Interconnector flows, being:

2.1.1 Approved CUSC Modification Proposal GB ECM-26 (published 4 October 2010), which removed TNUoS charges from Interconnector flows;[1]

2.1.2 Approved BSC Modification Proposal P278 (published 1 May 2012), which removed charges for GB transmission losses charges from Interconnector flows;[2]

2.1.3 Approved CUSC Modification Proposal (CMP) 202 (published 15 August 2012), which removed BSUoS charges from Interconnector flows;[3] and

2.1.4 Approved BSC Modification Proposal P285 (published 23 January 2013), which removed Residual Cashflow Reallocation Cashflow ("RCRC") from Interconnector flows.[4]

2.2 Although the charges considered in each of the above decisions are different to those under consideration as part of the P361 Modification Proposal (being BSC Charges), we consider that many of the points at issue in those decisions are also at issue here.[5] The key difference is that the

[1] https://www.ofgem.gov.uk/sites/default/files/docs/2010/10/ecm-26-decision-letter-published-041010.pdf

[2] https://www.elexon.co.uk/wp-content/uploads/2012/01/P278D.pdf

[3] https://www.ofgem.gov.uk/sites/default/files/docs/2012/08/cmp202-decision-letter_0.pdf

[4] https://www.elexon.co.uk/wp-content/uploads/2012/05/P285D.pdf

[5] Note that the issue of "precedent" decisions was recently opined on by the CMA in an appeal under section 173 of the Energy Act 2004. In that decision, the CMA noted that if GEMA had come to an erroneous view on the interpretation of EU law in one decision, it did not have to adhere to the incorrect interpretation in a later decision. We are not in any way suggesting that Ofgem's previous decisions may have been incorrect but simply make the point that the enquiry cannot stop simply because Ofgem has opined on similar issues before. See Appeal under section 173 of the Energy Act 2004, EDF Energy (Thermal Generation) Limited/ SSE Generation Limited v Gas and Electricity Markets Authority and National Grid Electricity Transmission PLC, Decision and Order, Notified 26 February 2018. Available at https://assets.publishing.service.gov.uk/media/5a95295de5274a5b849d3ad0/EDF-SEE-decision-and-order.pdf

BSC Charges relate to ELEXON's market operator role, whereas each of those other charges relate to system operation.

2.3 ***Role of ELEXON*** **–** The transmission licence held by National Grid Electricity Transmission plc ("NGET") requires NGET to establishing a Balancing and Settlement Code Company ("BSCCo" – referred to in this paper as "ELEXON") to provide and procure facilities, resources and services required for the proper, effective and efficient implementation of the BSC.[6]

2.4 The BSC, among other things, sets out the terms of the following balancing and settlement arrangements:[7]

2.4.1 Arrangements pursuant to which BSC Parties may make, and NGET may accept, offers or bids to increase or decrease the quantities of electricity to be delivered to or taken off the total system so as to assist NGET in co-ordinating and directing the flow of electricity onto and over the NETS and balancing the NETS; and for settlement of financial obligations (between BSC Parties or between BSC Parties and NGET) arising from the acceptance of such offers or bids; and

2.4.2 Arrangements for the determination and allocation to BSC Parties of the quantities of electricity delivered to and taken off the total system and which set, and provide for the determination and financial settlement of, obligations between BSC Parties, or (in relation to NGET's role in co-ordinating and directing the flow of electricity onto and over the NETS) between BSC Parties and NGET.

2.5 Before the current trading arrangements were established, National Grid Company plc, as system operator, operated the settlement system.[8]

2.6 ***Treatment of Interconnectors under the EU Third Package***[9] **–** Under the Electricity Regulation (EC) 714/2009[10] ("Electricity Regulation") an Interconnector is defined as "a transmission line which crosses or spans a border between two Member States and connects transmission systems of Member States".[11] As a consequence, in the context of the EU Internal Market in Electricity, interconnector flows are neither classed as production (generation) nor consumption (demand), but part of the overall transmission infrastructure facilitating the wider market.

2.7 ***Description of "producers" and "customers" under the EU Third Package*** **–** Under the Electricity Directive, a "producer" is defined as "a natural or legal person generating electricity".[12] Likewise, a "wholesale customer" is defined as "a natural or legal person purchasing electricity for the purpose of resale inside or outside the system where it is established".[13] Hence, producers and customers on the one hand, and interconnectors on the other hand are different concepts – whereas producers and customers are natural or legal persons, interconnectors are equipment.

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[6] See Condition C3.1B

[7] See NGET's transmission licence, Condition C3.2.

[8] https://www.ofgem.gov.uk/ofgem-publications/78676/new-electricity-trading-arrangements-21-12pdf

[9] "EU Third Package" in this paper refers to Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC ("Electricity Directive") and the Electricity Regulation.

[10] Electricity Regulation (EC) No 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003

[11] See Article 2.

[12] Electricity Directive, Article 2(2).

[13] Electricity Directive, Article 2(8).

2.8 ***Interconnector BM Units*** **–** BSC Parties wanting to trade energy that flows over an Interconnector must register themselves as an Interconnector User. Each Interconnector User is allocated (and registered in respect of) two Interconnector BM Units in respect of the Interconnector, being:[14]

2.8.1 a Production BM Unit; and

2.8.2 a Consumption BM Unit.

2.9 Each Interconnector has an Interconnector Administrator and an Interconnector Error Administrator. For each Settlement Period, the Interconnector Administrator allocates a Metered Volume to either the Interconnector User's Production BM Unit or its Consumption BM Unit (the imports and exports are netted – the difference being applied to the relevant BM Unit). Hence, Interconnector flows are treated as production or consumption.

2.10 NEMOs are classified as Interconnector Users under the BSC.

3. QUESTIONS PUT TO US

3.1 In this section, we set out the various questions put to us, together with the other materials to which we were directed – these are bolded and italicised below – we then set out our comments on each issue.

3.2 ***Are BSC Charges on Lead Parties of Interconnector Balancing Mechanism (BM) Units contrary to the EU Third Energy Package?***

3.2.1 In our view, the better argument is that compliance with the EU Third Package would be better facilitated by exempting Interconnector BM Units from BSC Charges.[15]

3.2.2 The application of the EU Third Package to the current issues in question is not without difficultly – in part because the EU Third Package does not appear to have been drafted with the GB position in mind. That being, it seeks to regulate network owners and operators and does not explicitly provide for the GB situation where there is both a system operator (NGET) and a separate body (ELEXON) that provides some of the settlement and balancing mechanism functions. For example, the Electricity Regulation and the ITC Guidelines[16] impose restrictions relating to network access charges. Those laws refer to charging by the network operators/system operators – and not by a third party such as ELEXON. However, we have adopted a purposive interpretation of these provisions such that all charges for access to the network need to be compliant with the relevant provisions regardless of who recovers them. This is because, it would be a perverse situation if member states and/or operators were able to circumvent the intended restrictions by imposing such charges via a third party.

3.2.3 In addition, given:

(a) the stated intent of the EU Third Package (which creates a new regulatory framework to integrate national markets and create and promote a single European electricity market);

[14] Section K, 5.5.5

[15] The balancing and settlement arrangements set out in the BSC must comply with the Electricity Regulation. This is reflected in BSC Objective (e) (as set out in Standard Condition C3(3) of NGET's Transmission Licence), which states that any changes proposed to those arrangements should facilitate compliance with the Electricity Regulation and any relevant legally binding decision of the EC and/or the ACER.

[16] Commission Regulation (EU) No 838/2010 of 23 September 2010 on laying down guidelines relating to the inter-transmission system operator compensation mechanism and a common regulatory approach to transmission charging.

(b) the characterisation of interconnectors as part of the transmission system under the Electricity Regulation (as opposed to production or consumption);

(c) Ofgem's previous decisions to exempt interconnector flows from transmission losses charges, TNUoS charges, BSUoS charges and RCRC;

(d) the possible effect that recovering BSC Charges from Interconnector BM Units may have on competition;[17]

in our view, the better argument is that compliance with the EU Third Package would be better facilitated by exempting Interconnector BM units from BSC Charges.

In this context, we draw external counsel's attention to the following:

- ***Are BSC Charges a network access charge under Regulation 714/2009 or are they simply a charge for providing a service which is apportioned between BSC Parties on the basis of how much they use BSC services?***

3.2.4 The Electricity Regulation aims to facilitate a competitive and integrated energy market across the EU.[18] It sets out a series of common objectives for transmission network access charges in Europe including, among other things, promotion of transparency, the need to take into account network security, and tariff structures which reflect actual/efficient costs, are non-discriminatory, non-distance related and, where appropriate, provide locational signals.

3.2.5 Article 14 of the Electricity Regulation sets out rules for setting charges for access to networks.

3.2.6 The terms "network access charge" and "charges for access to networks" are not defined in the Electricity Regulation[19] but Article 14(2) makes it clear that such charges include "the amount of network losses and congestion caused, and investment costs for infrastructure". In its previous decisions relating to charges for transmission losses, TNUoS charges, BSUoS charges and RCRC, Ofgem found/agreed that those charges should not be levied on interconnector flows. In our view, despite the fact that BSC Charges are charged by ELEXON, BSC Charges could be seen to be a type network access charge. This is because Parties cannot use the system without being Party to the BSC and hence being liable for BSC Charges, which for Interconnector BM Units are calculated, in part, based on Credited Energy Volume.[20]

3.2.7 Article 14(2), which expressly foresees that network access charges may be born by consumers and producers, and Recital 14 when taken together suggest that network access charges may be recovered from generation and consumption – not from Interconnectors or Interconnector Users.

3.2.8 The drafting and construction of Article 14 of the Electricity Regulation raises the same interpretative issues as those referred to in paragraph 3.2.2 above (it refers network

[17] Note that we have not undertaken a quantitative analysis on the possible impact of competition. We note the views of the P361 Working Group in this area (as set out in paragraph 4 of our instructions) and would make the comment that there is at least a perception that the recovery of BSC Costs from Interconnector Users would limit competition in the internal market for electricity.

[18] The Electricity Regulation is directly applicable in GB.

[19] Note the European Commission is currently considering a recast of the Electricity Regulation, which will add the following text to Article 14(1): Charges applied by network operators for access to networks, including charges for connection to the networks, charges for use of the networks, and, where applicable, charges for related network reinforcements, shall be transparent … (see https://ec.europa.eu/energy/sites/ener/files/documents/1_en_act_part1_v9.pdf)

[20] Noting that some BSC Parties do have Production and Consumption BM Units with zero-metered volumes.

access charges in the context of charges applied by network operators yet ELEXON is not a network operator). However, again it would be perverse for a member state and/or an operator to be able to circumvent the restrictions by using a third party to recover equivalent charges. Accordingly, in our view a purposive interpretation should be applied such that BSC Charges are charges for network access within the meaning of Article 14. This means that BSC Charges should not be recovered from Interconnector Users.

- ***Do BSC Charges, as they are applied to Lead Parties of Interconnector BM Units, constitute an 'additional cost of hosting cross-border flows of electricity' under Regulation 838/2010?***

3.2.9 Article 13 of the Electricity Regulation provides for a compulsory inter-transmission system operator compensation mechanism ("ITC Mechanism"), which is established under the ITC Guidelines. The ITC Mechanism is the mechanism under which transmission system operators are compensated for the costs incurred as a result of hosting cross-border flows of electricity on their networks.[21] That compensation is paid by the system operators from which the cross-border flows originated and the systems where they end.[22]

3.2.10 The ITC Guidelines require Ofgem to ensure that transmission system operators in GB participate in the ITC Mechanism, and that "no additional charges for hosting cross-border flows of electricity are included in charges applied by transmission system operators for access to networks."[23] That is, system operators cannot recover costs related to hosting cross-border flows of electricity other than via the ITC Mechanism.

3.2.11 The term "cross-border flow" is defined in the Electricity Regulation as "a physical flow of electricity on a transmission network of a Member State that results from the impact of the activity of producers and/or consumers outside that Member State on its transmission network". BSC Charges, as they relate to Interconnector Users could be seen as an "additional charge" and hence be contrary to the ITC Guidelines.

3.2.12 Again, the drafting and construction of Article 13 of the Electricity Regulation and the ITC Guidelines raise the same interpretative issues as those referred to above (in that they refer to system operators yet ELEXON is not a system operator). However, again it would be perverse for a member state and/or an operator to be able to circumvent the restrictions by using a third party to recover equivalent charges. Accordingly, in our view, a purposive interpretation should be applied.

- ***Some of the costs of ELEXON's operation relate to functions which are required under the EB GL. These BSC costs are recoverable through the EB GL, and need to be approved by Ofgem in accordance with Directive 2009/72 i.e. BSC costs substantially fall within scope of the Electricity Regulation and one of the network codes.***

3.2.13 Noted.

[21] See Article 13(1) of the Electricity Regulation.
[22] See Article 13(2) of the Electricity Regulation.
[23] See Annex, Part A, point 2.1.

3.2.14 The Secretary of State has assigned certain balancing tasks/obligations to ELEXON under the Electricity Balancing Guideline ("EB GL").[24] Had those tasks not been assigned to ELEXON or another third party, they would have been undertaken by NGET as the system operator.

3.2.15 Article 8 of the EB GL deals with the recovery of costs. Ofgem assesses ELEXON's costs of carrying out the obligations assigned to it under the EB GL and costs that are considered reasonable, efficient and proportionate by Ofgem are recovered through network tariffs or such other appropriate mechanism as determined by Ofgem. We understand that ELEXON recovers its costs via the existing charging arrangements set out in Section D of the BSC.

- ***In line with Directive 2009/72, Ofgem provides the European Commission with an annual regulatory authorities report. This report includes a section on network tariffs for connection and access and on cross border issues. The report refers explicitly identifies connection charges, Transmission Network Use of System (TNUoS) and Balancing Services Use of System (BSUoS) as falling with the scope of 'network tariffs for connection and access' but makes no reference to BSC Charges which suggests that these charges are not considered to be 'network access charges'.***

3.2.16 Section 5ZA of the Utilities Act 2000 requires Ofgem to prepare a regulatory authority report that includes a general survey of the steps taken and results achieved by Ofgem in the performance of its functions in accordance with Article 37 of the Electricity Directive. As well as publishing the report, Ofgem must give a copy to the European Commission.

3.2.17 Ofgem's 2017 report (given jointly with the Northern Ireland Utility Regulator),[25] includes a section titled "Network tariffs for connection and access", which identifies three types of transmission charges in GB: connection charges, TNUoS charges and BSUoS charges. Although that section of the report does not refer to BSC Charges, we do not think this is determinative. The report gives an indication of Ofgem's thinking on the charges to be reflected given their treatment but it does not impact on our legal analysis of the central question put to us – namely, whether the recovery of BSC Charges from Interconnector Users is contrary to the EU Third Package.

3.3 ***If the answer to question 1 is an affirmative, is there another mechanism through which ELEXON can recover its costs associated with Interconnector BM Units? By way of background, if Interconnector BM Units are relieved of these costs then the charges will need to be reallocated across all other BSC Parties.***

We note that an Inter-TSO Compensation Mechanism exists. Would ELEXON's costs (as they relate to Interconnector BM Units) fall within the scope of costs that are recoverable through this mechanism?

3.3.1 The key issue in relation to the use of the ITC Mechanism as a vehicle for recovering BSC Charges as they relate to Interconnector BM Units is that the mechanism is a mechanism between transmission system operators.

3.3.2 For BSC Charges to be recovered under the ITC Mechanism either:

[24]Commission Regulation (EU) 2017/2195 of 23 November establishing a guideline on electricity balancing. See also https://www.elexon.co.uk/wp-content/uploads/2017/12/BEIS-Notice-of-assignment-for-Implementation-of-the-Electricity-Balancing-Guideline-18Dec2017-.pdf

[25] https://www.ofgem.gov.uk/system/files/docs/2017/08/new_donagh_report.pdf

(a) ELEXON would need to become a party to the ITC Mechanism; or

(b) The BSC Charges would somehow need to be recovered via NGET's participation in the ITC Mechanism.

3.3.3 It is not clear to us whether either or both of these would be possible. In the case of ELEXON becoming a party to the ITC Mechanism, we are not aware of a third party such as ELEXON (i.e. one who is not a system operator) being a party to the mechanism and so a threshold question is whether ELEXON is eligible to participate. If participation were possible, analysis would then need to be carried out about the desirability of participation (including risks and obligations etc.). If you would like us to consider this further, please do let us know. In relation to possible recovery via NGET's participation in the ITC Mechanism, this would require the cooperation of NGET and the agreement of Ofgem. As a starting point, we suggest that the issues be discussed with Ofgem.

3.4 ***If the answer to question 1 is an affirmative, is there another way of structuring BSC Charges in terms of how they apply to Interconnector BM Units, such that they would comply with the EU Third Energy Package? For example, if Interconnector BM units were liable to BSC Charges that were fixed rather than based on their market share (which is based on energy volumes)?***

3.4.1 If the current recovery of BSC Charges from Interconnector BM Units is contrary to the EU Third Package, recovering them on the basis of fixed tariffs (rather than on the basis of metered volumes) will not make them EU Third Package compliant. In particular, if BSC Charges are a type of network access charge, calculating these on a fixed basis rather than on the basis of metered output, will not change the fact that network access charges should not be levied on interconnector flows.

CMS Cameron McKenna Nabarro Olswang LLP

13 March 2018

ANNEX A

1. MATERIALS RELATING TO P361 MODIFICATION PROPOSAL

1.1 P361 Proposal Form (https://www.elexon.co.uk/wp-content/uploads/2017/10/P361-Proposal-Form-V1.0.pdf).

1.2 P361 Initial Written Assessment (https://www.elexon.co.uk/mod-proposal/p361/).

1.3 Request to treat P361 as an Urgent Modification Proposal (https://www.elexon.co.uk/wp-content/uploads/2017/10/P361-Proposer-request-for-urgency-PUBLIC.pdf).

1.4 Panel P361 Urgency Recommendation * https://www.elexon.co.uk/mod-proposal/p361/).

1.5 Ofgem P361 Urgency Decision (https://www.elexon.co.uk/wp-content/uploads/2017/10/P361-Ofgem-urgency-decision-final.pdf).

2. PAST OFGEM DECISIONS

2.1 Approved CUSC Modification Proposal GB ECM-26 (published 4 October 2010), which removed TNUoS charges from Interconnector flows (https://www.ofgem.gov.uk/sites/default/files/docs/2010/10/ecm-26-decision-letter-published-041010.pdf).

2.2 Approved BSC Modification Proposal P278 (published 1 May 2012), which removed GB transmission losses charges for Interconnector Users (https://www.elexon.co.uk/wp-content/uploads/2012/01/P278D.pdf).

2.3 Approved CUSC Modification Proposal (CMP) 202 (published 15 August 2012), which removed BSUoS charges/payments from Interconnector BM Units (https://www.ofgem.gov.uk/sites/default/files/docs/2012/08/cmp202-decision-letter_0.pdf).

2.4 Approved BSC Modification Proposal P285 (published 23 January 2013), which removed Residual Cashflow Reallocation Cashflow ("RCRC") for Interconnector BM Units (https://www.elexon.co.uk/wp-content/uploads/2012/05/P285D.pdf).

3. EU LAWS

3.1 Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC ("Electricity Directive").

3.2 Electricity Regulation (EC) No 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003 ("Electricity Regulation").

3.3 Commission Regulation (EU) No 838/2010 of 23 September 2010 on laying down guidelines relating to the inter-transmission system operator compensation mechanism and a common regulatory approach to transmission charging ("ITC Guidelines").

3.4 Commission Regulation (EU) 2015/1222 of 24 July 2015 establishing a guideline on capacity allocation and congestion management.

3.5 Commission Regulation (EU) 2017/2195 of 23 November establishing a guideline on electricity balancing ("EB GL").

4. BSC

4.1 Section D.

4.2 Section K.

4.3 Section R.

4.4 Section T.

4.5 Annex X-1.

5. OTHER

5.1 NGET’s transmission licence.

ANNEX B – BSC COST RECOVERY

1. ELEXON, BSC COSTS AND COST RECOVERY

1.1 ***BSC Costs –*** ELEXON recovers its costs ("BSC Costs") from BSC Parties via monthly charges known as "BSCCo Charges". BSC Costs include all costs, expenses and other outgoings of ELEXON and its subsidiaries and other amounts for which ELEXON or any of its subsidiaries may be liable, net of recoverable VAT, plus bad debt amounts but does not include certain costs which are specifically excluded (for example, costs relating to ELEXON's EMR functions).[26]

1.2 ***Recovery of BSC Costs –*** Section D of the BSC deals with the recovery of BSC Costs and participation charges.

1.3 Some of the BSC Costs are recovered on a tariff-style basis, which are fixed at a per unit price (known as "Specified BSC Charges"), and the remainder are based on a party's "Funding Share".

1.4 The P361 Modification Proposal was initially concerned with those BSC Costs that are recovered based on a party's "Funding Share", especially the "Annual Net Main Costs" and the "Annual Production-Charging SVA Costs"[27] but we understand that the remit of the proposal has been extended to include all BSC Costs recovered from Interconnector Users.

1.5 ***Annual Net Main Costs and Annual Production-Charging SVA Costs –*** Each month, a party is liable to pay, among other amounts, its contribution to the:[28]

1.5.1 Monthly Net Main Costs, calculated based on its Main Funding Share; and

1.5.2 Monthly Production-Charging SVA Costs, calculated based on its SVA (Production) Funding Share.

1.6 ***Calculation of Main Funding Share and SVA (Production) Funding Share –*** A party's Main Funding Share is determined in accordance with Part 1 of Annex D-1 and a party's SVA (Production) Funding Share is determined in accordance with Part 3 of Annex D-1. Each reflects the party's proportionate share of aggregate "Credited Energy Volumes".[29]

1.7 ***Calculation of Credited Energy Volumes, including Metered Volume –*** Credited Energy Volume (QCE_{iaj}) is the allocation of "Metered Volume" from BM Unit i to Energy Account a in Settlement Period j, taking account of Transmission Loss Multipliers and applying any Metered Volume Reallocation Notices that are in force. It is calculated in accordance with Section T.4.5.1.

1.8 For an Interconnector BM Unit, the BM United Metered Volume is the total Active Energy determined by the Interconnector Administrator under Section R.7.4.1(c) – this is a deemed value based on the nominations made by the Interconnector User to the Interconnector Operator rather than the actual amount that flowed.

[26] See Section D.2.1.1

[27] See page 3, "What is the proposed solution?"

[28] See Section S.4.2.1.

[29] See Annex D-1, Parts 1 and 3.