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Direct Dial: 020 7901 7256

The National Grid Company, BSC Signatories and
Other Interested Parties

10 May 2005

Our Ref: MP No P176

Dear Colleague,

Modification to the Balancing and Settlement Code (“BSC”) - Decision and notice in relation to Modification Proposal P176: “Clarification of the Requirements for Estimation/Deeming of Meter Readings/Advances in Certain Circumstances to Facilitate Correction of Anomalies in Settlement Consumption”

The Gas and Electricity Markets Authority (the “Authority”)¹ has considered the issues raised in the Modification Report² in respect of Modification Proposal P176: “Clarification of the Requirements for Estimation/Deeming of Meter Readings/Advances in Certain Circumstances to Facilitate Correction of Anomalies in Settlement Consumption”.

The BSC Panel (the “Panel”) recommended to the Authority that Modification Proposal P176 should be made with an Implementation Date of 3 November 2005 if an Authority decision is received on or before 1 June 2005, or an Implementation Date of 2 March 2006 if the Authority decision is received after the 1 June 2005 but on or before 1 September 2005.

Having 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 to direct a Modification to the BSC in line with Modification Proposal P176.

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

² ELEXON document reference P176MR, Version No. 1.0, dated 14/03/05

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

The BSC permits that a Deemed Meter Advance can be calculated in certain circumstances where a Meter Advance Value cannot be obtained. These include, for example, where a meter has been changed or where a change of supplier has occurred but where no meter reading is available with which to calculate the advance. There are a number of other circumstances described in Code Subsidiary Documents ("CSDs")⁵ where deeming is permitted that are not provided for in the BSC itself and therefore precluded. The Supplier Volume Allocation Group (SVG) noted this apparent inconsistency and on 25 June 2004 Npower raised Issue 8 to consider it further.

The Volume Allocation Standing Modification Group ("the Group") met on 29 June 2004. It considered whether this situation constituted an inconsistency between the BSC and the CSDs. It also considered the comments raised by the Auditor that meter readings were being deemed in circumstances not permitted by the BSC and noted that, in many cases, such deeming was being carried out to try to improve Settlement accuracy. The Group determined that inconsistencies existed between the various documents (BSC, BSCP 504 and PSL 120) and, in addition, that these documents were not consistent with appropriate current practice. The Panel, on 8 July 2004, was presented with a summary of the Group's discussions under Issue 8.

In order to rectify this situation, Npower submitted Modification Proposal P176, "Clarification of the Requirements for Estimation/Deeming of Meter Readings/Advances in Certain Circumstances to Facilitate Correction of Anomalies in Settlement Consumption" on 4 October 2004.

The Modification Proposal

Modification Proposal P176 seeks to modify the BSC, BSCP 504 and PSL 120 so as to:

- consolidate the detailed information and calculations relating to deeming contained in Annex S-2 of the BSC
- document in Annex S-2 of the BSC how the Estimated Annual Consumption ("EAC") for a metering system can be calculated to ensure that future estimates are realistic following a Deemed Meter Advance
- remove the precise circumstances in which deeming is permitted from the BSC and PSL 120 and to include this information, together with additional permitted circumstances, in BSCP 504, and
- document the process of Gross Volume Correction within BSCP 504.

⁵ Specifically, these additional circumstances are set out in BSCP 504 and Party Service Line ("PSL") 120.

The current circumstances permitted for deeming a reading and the additional circumstances proposed are set out in the Modification Report. Also included is whether deeming should be optional or mandatory in each case.

The process of Gross Volume Correction (“GVC”) is not currently permitted under the BSC or the CSDs. However, it is currently being used, due to an operational workaround documented in a pre-NETA Circular⁶, as a technique to correct Settlement error. The Group noted that GVC is a complicated and manually intensive process but that it should be allowable to provide a mechanism for ensuring that the gross volume of energy for a supplier is correct. It therefore proposed to include documentation of the GVC process within BSCP 504.

The justification for the Modification Proposal was that it would better facilitate achievement of the Applicable BSC Objective C3 (3) (c) and (d).

The Group considered that Objective (c) would be better facilitated by reducing the issues associated with inaccurate meter readings or consumption history where a change of supplier has occurred. It believed that this could potentially have more impact on new suppliers. The Group also believed that the modification would reduce the number of BSC Audit issues and it considered that these are likely to be of greater significance to new or small suppliers.

It was argued that Objective (d) would be better facilitated through defining mechanisms for the rectification of anomalies in consumption data. This could minimise costs, delays and uncertainties created by the need for Post Final Reconciliation Runs or Extra-Settlement Determinations.

The Panel considered the Initial Written Assessment at its meeting of 14 October 2004 and agreed to submit Modification Proposal P176 to the Assessment Procedure. The Group met to consider the Modification Proposal on 21 October, 10 November and 8 December 2004. Additionally, it issued a consultation on 23 November 2004. At its meeting on 9 December, the Panel agreed to extend the Assessment Procedure for a further month so that a second consultation could be carried out. The second consultation was issued on 23 December 2004 and the Group met for the final time on 18 January 2005.

Responses to ELEXON Consultation

ELEXON published a draft Modification Report on 14 February 2005, which invited respondents’ views by 25 February 2005. Nine responses were received. Nine responses (representing 52 Parties and two non-Parties) expressed support for the Proposed Modification, Zero responses opposed the Proposed Modification.

Two consultations were issued. In response to the initial Assessment Consultation for Modification Proposal P176, ELEXON received ten responses. Eight responses (representing 44 Parties and one non-Party) expressed support for the Proposed Modification, no responses opposed the Proposed Modification and the remaining two (representing six Parties) did not express an opinion.

Respondents expressed the view that deeming meter reads where no actual read was available would reduce data quality problems as a realistic deemed reading would facilitate the validation

⁶ CEO00557 – “Erroneous EAC/AA Data Cleansing Guidance”

and processing of subsequent readings. A number of views were expressed on each of the proposed circumstances in which it was proposed that deeming would be permitted.

The Group considered the responses to this consultation and, taking into account the views of some respondents who did not feel they had been given sufficient time to consider the issues in detail, decided that a further consultation should be issued. Included with this second consultation were the proposed textual changes to the BSC, BSCP 504 and PSL 120.

Eight responses were received to this second consultation. Seven responses, representing 41 parties and three non-parties, supported the proposed modification. One respondent, representing five BSC parties, did not support the proposed modification. This respondent believed that the use of the EAC to derive a deemed reading was not necessarily appropriate in all cases. They believed that, in the event of a change of supplier, an estimated reading agreed by the two suppliers was likely to be more accurate. They noted that the Customer Transfer Programme ("CTP") has made recommendations about revising the change of supplier meter reading process and, specifically, that a reading agreed between the suppliers would be quicker and less prone to error than a reading deemed by the new supplier's data collector. They therefore did not support P176 as it would permit only an EAC-generated deeming reading.

The Group, in considering the responses, noted that Modification Proposal P183 was considering recommendations of the CTP and the ability to use a supplier estimated reading on change of supplier. The Group noted that the two modifications were not contingent on each other.

The majority of respondents to the second consultation considered that the drafted changes to the BSC and CSDs accurately captured the requirements of the Modification Proposal and provided adequate controls for the deeming of meter reads.

The respondents' views are summarised in the Modification Report for Modification Proposal P176, which also includes the complete text of all respondents' replies.

Panel's recommendation

The Panel met on 10 March 2005 and considered Modification Proposal P176, the draft Modification Report, the views of the Modification Group and the consultation responses received.

The Panel recommended that the Authority should approve the Proposed Modification and that, if approved, the Proposed Modification should be implemented on 3 November 2005 if an Authority decision is received on or before 1 June 2005 or 2 March 2006 if an Authority decision is received after this date but on or before 1 September 2005.

Ofgem's view

Having considered the Modification Report and the Panel's recommendation, Ofgem considers, having regard to the Applicable BSC Objectives and its statutory duties, that Proposed Modification P176 will better facilitate achievement of Applicable BSC Objectives. In particular, Ofgem agrees with the views of the Group that inaccurate meter readings or consumption histories can negatively impact Parties where customers switch supplier. It considers that

strengthening the ability of suppliers to correct these errors would better facilitate achievement of Applicable BSC Objective (c).

Ofgem notes the view of the Group that there are current inconsistencies between the provisions of the BSC and the CSDs in respect of deeming. It considers that such inconsistencies should be removed and supports the principle of rationalising the permitted circumstances for deeming into a single document. It notes the view of the Group that BSCP 504 is an appropriate document to set out the precise circumstances in which deeming is permitted.

Ofgem also notes that the Group gave detailed consideration both to the suitability of the current permitted circumstances in which a reading can be deemed and to other circumstances not currently permitted. It considers that where a meter reading is required in a particular situation, such as on change of supplier, change of meter, change of measurement class etc, but is not available, it is sensible and pragmatic to deem a meter reading as accurately as possible based on the data available. Ofgem notes that, in many cases, deeming a meter reading can prevent or correct anomalies in consumption data and prevent future errors. This includes the process of Gross Volume Correction that requires the deeming of meter readings to correct consumption data to ensure that the gross energy volume over a given period is realistic. Ofgem therefore supports the principle of deeming meter readings in certain defined circumstances.

Ofgem supports the principle of modifying Annex S-2 of the BSC to document how the EAC for a metering system can be calculated, following a Deemed Meter Advance, to ensure that future consumption estimates are realistic. This is an important step where a reading has been deemed to reduce the likelihood of creating an error in Settlement.

In addition, Ofgem notes and supports the recommendation of the group that the process of GVC should be documented within BSCP 504 so as to make it consistent with an Operational Workaround and current practice. GVC provides parties with the ability to correct a supplier's gross energy volume and thereby increase the accuracy of Settlement. However, Ofgem has concerns that, as a complicated and manually intensive process, there is the potential for errors to be created during the process. It considers that GVC should be used only where the circumstances reasonably require it and suggests that the industry considers monitoring its use.

While Ofgem does not disagree with the proposed circumstances where deeming would be permitted, it does however have some concerns that the deeming of meter readings should not become commonplace as a convenient substitute for obtaining an actual meter reading. Deemed meter reads may be required for certain processes where there is no actual reading, but they do not provide the same level of certainty of consumption as actual readings. It shares the concern expressed by the one Panel member that the incentive to obtain actual meter readings could be affected by the Modification Proposal. It considers that the circumstances in which deeming is permitted should be prescriptive and activity monitored against them to ensure that deeming becomes the last resort and only where a party has exhausted other options for obtaining an actual reading. It notes and welcomes that the Group has included process steps in the draft BSCP 504, considered as part of this modification, to require parties to make attempts to get an actual reading before deeming.

The BSC Auditor recorded in the 2004 Audit Report that meter readings were being deemed in circumstances other than those currently permitted by the BSC by twelve of the thirteen Non-Half-Hourly Data Collectors. Ofgem notes that one purpose of the proposed modification is, where the rules do not currently permit deeming but where it would be appropriate for them to do so, to align the rules with current practice and thereby reduce the incidence of incorrect deeming reported by the Auditor. Ofgem considers that the use of deemed readings should

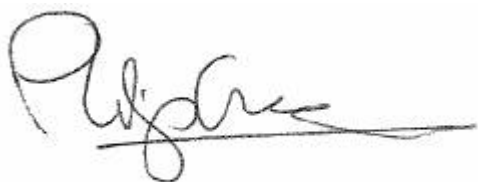
continue to be monitored against the revised process steps in BSCP 504 to ensure that sufficient efforts have been made to obtain actual readings. It therefore welcomes the conclusion of the Group that data collectors should retain information for audit purposes to demonstrate that the specified criteria for deeming were met and the view expressed by ELEXON to the Panel that any non-compliance would be registered and monitored.

Ofgem notes that a deemed reading is based on an EAC value but, for the purpose of Settlement, will have the status of an Annualised Advance ("AA"). It considers that an increase in the permitted circumstances for deeming, as proposed by P176, is likely to lead to more deemed meter readings being processed. This could have the effect of artificially inflating a supplier's performance against Serials such as SP08a⁷ without providing any greater certainty of the accuracy of consumption entering Settlement. This could lead to reduced Supplier Charges and application of assurance techniques under the Performance Assurance Framework to improve Settlement performance. Ofgem considers that the Performance Assurance Board may wish to take the use of the deeming mechanism into consideration when assessing supplier performance against the relevant Serials.

Ofgem notes the comments expressed by one respondent about deeming meter readings on a change of supplier and the measures proposed by the CTP to improve the availability of a suitable change of supplier reading. It also notes that the measures proposed by the CTP were given consideration by the Group and that, in their view, the changes proposed under P176 are consistent, as far as possible, with those proposed by the CTP. While Ofgem must consider this modification proposal in the context of the current industry baseline, it welcomes the fact that the Group has given consideration to its potential impacts on other proposed measures.

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

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Philip Davies', with a long horizontal flourish extending to the right.

Philip Davies

Director, Consumer Markets

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

⁷ SP08a requires suppliers to settle a certain proportion of their NHH energy based on AAs at each reconciliation run.