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BSC Signatories, National Grid Company
and Other Interested Parties

Our Ref: MP No P177

Dear Colleague

Modification to the Balancing and Settlement Code ("BSC") – Decisions in relation to Modification Proposal P177: "Removal of Intertrip Provisions from the BSC"

The Gas and Electricity Markets Authority¹ has carefully considered the issues raised in the Modification Report² in respect of Modification Proposal P177 "Removal of Intertrip Provisions from the BSC".

The BSC Panel (the "Panel") recommended by majority that the Proposed Modification should not be made. However, the Panel unanimously agreed that, should the Authority determine that the Proposed Modification be made, the Implementation Date should be 25 Working Days following any such determination.

Having carefully considered the Modification Reports in respect of Proposed Modification P177, the Panel's recommendation and having regard to the Applicable BSC Objectives³ and the

¹ Ofgem is the Office of the Authority. The terms "Ofgem" and "the Authority" are used interchangeably in this letter.

² The draft and final Modification Report can be found on ELEXON's website at the following location:
<http://www.elexon.co.uk/ChangeImplementation/modificationprocess/modificationdocumentation/modProposalView.aspx?propID=191>.

³ The Applicable BSC Objectives, as contained in Standard Condition C3 (3) of National Grid Company's ("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.

Authority's wider statutory duties⁴, the Authority has decided to direct a Modification to the BSC to be made.

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

Background

The BSC contains compensation arrangements for Parties affected by the operation of an intertrip. An intertrip is a device that automatically trips a generator (or demand site) off the transmission system when it receives a specific signal. The signal is delivered if a fault on the system occurs. The requirement for an intertrip is usually identified at the time of a connection, and is specified within the Bilateral Connection Agreement (BCA) between NGT and the connecting Party.

Under paragraph Q5.1.5 of the BSC, the operation of an intertrip is treated as a Bid-Offer Acceptance (BOA) in the Balancing Mechanism. Therefore an intertrip would be remunerated at the prevailing Bid-Offer Price and the volumes associated with its operation entered into Settlement through the BOA.

The Modification Proposal

BSC Modification Proposal P177 was raised by National Grid Transco (NGT) on 4 October 2004. BSC Modification Proposal P177, in its simplest form, intends to remove paragraphs and references to intertrips being treated as BOAs in the BSC. In doing so, the intended effect of Modification Proposal P177 would be to remove these compensation arrangements, i.e. a BOA would no longer be issued in relation to the operation of the intertrip⁵.

BSC Modification Proposal P177 was raised as part of a wider cross-governance set of proposals to establish an enduring framework for arrangements for intertrips. The underlying rationale for Modification Proposal P177 is that the proposer considers that there is a defect in the current mechanism by which operational intertrips are compensated. As previously stated, the operation of an intertrip is currently classified as a BOA, and is therefore remunerated at the prevailing Bid-Offer price at the time of operation. The proposer considers that experience shows that Bid-Offer prices are often used to indicate operational inflexibility rather than a price at which a change in the Import and Export of the BM Unit is intended to be recompensed.

The proposer considers that there is a significant risk of high negative 'sleeper Bids' (which can be intended to indicate operational inflexibility), which could result in significant payment being made to the affected Party, resulting in significant consequential cash flows throughout the industry. The removal of existing arrangements for operational intertrips contained within the BSC, as proposed by P177, will remove the potential for such extreme cash flows.

⁴ Set out in Sections 3A to 3C of the Electricity Act 1989, as amended by the Energy Act 2004. 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 environment guidance provided by the government, to contribute to achievement of sustainable development and to have regard to the principles of best regulatory practice.

⁵ Furthermore, as part of industry document changes associated with operational intertrips, paragraph BC2.5.2.3 of the Grid Code is likely to be amended or removed. Assuming that such changes are approved under the Grid Code governance process, the link to the Grid Code contained within paragraph Q.5.1.5 of the BSC will be inaccurate and will lead to confusion and uncertainty as to its relevance.

The main focus of the proposed changes is the Connection and Use of System Code (CUSC). CUSC Amendment Proposal CAP076 "Treatment of System to Generator Intertripping Schemes", seeks to introduce a classification of operational intertripping schemes and associated compensation mechanisms into the CUSC. Modification Proposal P177 represents a complementary change to ensure that, in the event that CUSC Amendment Proposal CAP076 is approved, duplicate compensation arrangements do not exist following the operation of an intertrip – i.e. the existing BSC compensation arrangements which treat the operation of an intertrip as a BOA would be removed such that the affected Party would not receive compensation both under the CUSC and the BSC.

The proposer of Modification Proposal P177 considered that should CUSC Amendment Proposal CAP076 be approved by the Authority, there will be full, complete and appropriate compensation arrangements for operational intertrips defined in the CUSC. The proposer considered that the removal of intertrip compensation arrangements from the BSC is required to enable the efficient and economic implementation of the proposed arrangements for intertrip remuneration within other industry codes.

The proposer considers that BSC Modification Proposal P177 better facilitates Applicable BSC Objective (a) "the efficient discharge by the licensee of the obligations imposed upon it by this Licence", as the proposer considers it is not appropriate that a Party be compensated for loss of transmission access through the BSC, when it is the CUSC that contains transmission access arrangements.⁶

The proposer also considers that P177 would better facilitate Applicable BSC Objective (b) "the efficient, economic and co-ordinated operation by the licensee of the licensee's transmission system", as if CUSC Amendment Proposal CAP076 is implemented, there will be duplicate and therefore inefficient provision of compensation arrangements for operational intertrips.

Finally, the proposer considers that P177 will better facilitate Applicable BSC Objective (c) "promoting effective competition in the generation and supply of electricity, and (so far as is consistent therewith) promoting competition in the sale and purchase of electricity" as the current mechanism of creating a deemed acceptance for operational intertrips results in market participants factoring the cost and potential risk of an intertrip operating into their Bid prices. This has the potential to distort the prices submitted into the Balancing Mechanism (BM) and creates a risk of unpredictable and high negative Bid prices feeding into cash out calculations and sending inappropriate signals to the market in relation to system length.

No formal alternative was put forward by the group tasked with consideration of P177, the Pricing Standing Modification Group (PSMG).

Relevant Modification Proposals

BSC Modification Proposal P177 has been submitted as a consequential change required to the BSC in the event of CUSC Amendment Proposal CAP076 being approved by the Authority. The PSMG noted that if CAP076 was approved and the existing BSC compensation arrangements not

⁶ In proposing transference of the provisions relating to operational intertrip compensation out of the BSC, the proposer quoted from Ofgem's decision letter on BSC Modification Proposal P87 which stated that "...the BSC is not the right forum for consideration of an issue that relates to the terms for transmission access" and that "...compensation for operational intertrips should be considered under the CUSC or Charging Methodology governance arrangements rather than under the BSC. This is because it relates to terms for transmission access rather than the details of the electricity trading arrangements."

removed, the operation of an intertrip would be subject to two compensation mechanisms – one in the BSC and one in the CUSC. Therefore, the PSMG concluded that the Implementation Date proposed for P177 should be such that it enables the Authority to direct simultaneous changes to the BSC and the CUSC so as to avoid this potential scenario.

In addition, the PSMG noted that CAP076 proposes compensation arrangements for System to Generator intertripping schemes, but does not address other types of operational intertripping schemes, for example, System to Demand intertripping schemes. Therefore were both CAP076 and P177 approved, there might still be the possibility that no compensation arrangements would exist for certain categories of intertrip schemes.

Pricing Standing Modification Group considerations

The Proposer considered that removing the provisions relating to intertrips from the BSC would better reflect the remits of the BSC and the CUSC, as set out in the Transmission Licence. However, the majority of PSMG members remained unconvinced by this view. These members noted that the operation of intertrips may result in consequential balancing actions and as a result are legitimate subject matter for the BSC. Therefore, Modification Proposal P177 would not unambiguously better facilitate achievement of Applicable BSC Objective (a).

The Proposer considered that should CUSC Amendment Proposal CAP076 be approved, BSC Modification Proposal P177 would have a positive impact on Applicable BSC Objective (b), as providing payment through a BOA for the automatic removal of access to the system when that loss of access has already been compensated under another governance framework, would be inefficient and uneconomic. On the other hand, the majority of PSMG members expressed the view that, as Modification Proposal P177 had to be considered against the current BSC baseline and without making assumptions about complementary changes to other governance arrangements; Modification Proposal P177 would have a negative impact on the achievement of this objective. These members were of the opinion that Modification Proposal P177's potential to distort Energy Imbalance Prices and flip the market from being long to short would send erroneous signals to the market and thus undermine the System Operator's ability to manage the system in an efficient manner.

The Proposer believed that, should CAP076 be approved, Modification Proposal P177 would have a positive impact on achievement of Applicable BSC Objective (c) as the current arrangements result in Parties with intertrip agreements factoring the cost and potential risk of an intertrip operating into their Bid-Offer prices. The Proposer considered this has the potential to distort prices submitted into the Balancing Mechanism and creates a risk of unpredictable and high negative Bid prices feeding into Energy Imbalance Price calculations, and sending inappropriate signals to the market in relation to system length. The removal of intertrip compensation arrangements from the BSC would remove the potential for costs associated with the provision of system actions to distort Energy Imbalance Prices. By ensuring that Energy Imbalance Prices remain appropriate should an intertrip operate, effective competition within the Balancing Mechanism would be better facilitated. The majority of the PSMG however, believed that Modification Proposal P177, considered in isolation from associated changes proposed to other industry documents, would have a negative impact on Applicable BSC Objective (c). These members believed that Modification Proposal P177 would undermine competition by distorting Energy Imbalance Prices and market length, and in addition, removing compensation for Parties affected by an intertrip and exposing them to imbalance.

One PSMG member was sceptical that Modification Proposal P177 would result in a general reduction in Bid prices, and considered that Parties factor in a wide range of variables when setting Bid prices, such that the effect of removing any intertrip premia would have a minimal impact upon prices available to the System Operator.

Respondents' views

ELEXON published its draft Modification Report for consultation on 19 January 2005 with responses sought by 28 January 2005. Eight responses, representing 55 Parties, were received.

All but one respondent considered that Proposed Modification P177 should not be made, however this was on the basis that no assumption could be made as to the status of CUSC Amendment Proposal CAP076. Several respondents noted that if CUSC Amendment Proposal CAP076 was made, that BSC Modification Proposal P177 would better facilitate the Applicable BSC Objectives. The majority of respondents considered that the governance of the BSC allows only for the consideration of Modification Proposals as stand-alone proposals and as such, on its own merits, Modification Proposal P177 would not better facilitate the Applicable BSC Objectives. One such respondent noted that Modification Proposal P177 proposes to remove the remuneration the registrant of the intertripped BM Unit would receive whilst also exposing the registrant to Imbalance Charges. This respondent went on to state that when considering Modification Proposal P177 as a stand-alone change it is difficult to see how the proposal can better facilitate the Applicable BSC Objectives.

One respondent noted the ongoing work on Amendment Proposal CAP076 and believed that the outcome of this work needs to recognise the true economic value of intertrips, including the potential for serious damage and consequential losses which may occur as the result of a trip. This respondent was not in support of Amendment Proposal CAP076, and stated that going forward, if an alternative to Amendment Proposal CAP076 could be developed that can achieve these critical aspects, it would be supportive of this and the associated changes designed to place system actions under the correct governance. However, bearing in mind the Applicable BSC Objectives in the context of the scope permitted by the BSC, this respondent was unable to see how the removal of intertrip compensation (as a stand-alone change) can better meet any of the objectives. Another respondent felt that when considered in isolation, Modification Proposal P177 clearly introduces a significant risk to parties who may be affected by an intertrip, both in terms of removing compensation and exposing that Party to imbalance.

Most respondents considered that the removal of the intertrip provisions from the BSC risks leaving affected parties unrewarded for (and disadvantaged by) the provision of this service and considered that this worked to the detriment of the Applicable BSC Objectives.

Panel's recommendation

The Panel met on 10 February 2005 and considered the draft Modification Report and consultation responses. The majority of respondents supported the Panel's provisional recommendation and therefore the Panel confirmed its recommendation that Modification Proposal P177 should not be made. The Panel agreed that, should the Authority direct that Proposed Modification P177 be made, an implementation date of 25 Working Days after an Authority decision was appropriate.

Ofgem's view

Ofgem notes the discussions of the PSMG members that as Modification Proposal P177 must be considered against the current BSC baseline, and without making assumptions about complementary changes to other governance arrangements, BSC Modification Proposal P177 would have a negative impact on the achievement of the Applicable BSC Objectives. However, while the vires of the PSMG and the Panel are restricted to assessment of Modification Proposal P177 under the BSC only, the Authority can consider Modification Proposal P177 against the Applicable BSC Objectives in the context of the wider proposals outside the BSC, given its statutory duties. In this context, it is important to note that the Authority has today (10 June 2005) approved CUSC Amendment Proposal CAP076.

Having carefully considered the Modification Report, the respondents' views and the Panel's recommendation, Ofgem, having regard to the Applicable BSC Objectives, is of the view that Modification Proposal P177 better facilitates achievement of the Applicable BSC Objectives. In addition, Ofgem considers that this decision is consistent with its wider statutory duties.

Applicable BSC Objective (b) – the efficient, economic and co-ordinated operation by the licensee of the licensee's transmission system

Ofgem considers that following the implementation of Approved CUSC Amendment Proposal CAP076, there are two sets of compensation arrangements in existence concurrently, and that approving BSC Modification Proposal P177 would address this situation, and better facilitate the economic operation of the transmission system. Were an intertrip to operate under circumstances where there are two sets of compensation arrangements in force, the affected Party would be entitled to compensation under two different sets of governance arrangements which would be detrimental to the efficient, economic and co-ordinated operation of the transmission system. In addition, if a deemed Bid-Offer Acceptance were to be created if an intertrip fired in accordance with the current BSC provisions alongside the provisions associated with CUSC Amendment Proposal CAP076, there is the potential for substantial confusion as to the effects this would have on system length and the balancing actions that NGC would need to take to resolve imbalances on the system. Ofgem therefore considers that Modification Proposal P177 would better facilitate Applicable BSC Objective (b).

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

As identified by the Proposer of Modification Proposal P177, Ofgem agrees that the current operational intertrip compensation mechanism, whereby the generator is paid at its prevailing Bid-Offer price, presents the industry with the real risk of inappropriate, disproportionate costs to ultimately be incurred by all users of the GB transmission system. Although Approved BSC Modification Proposal P172⁷ has removed from cash out Parties' exposure to Emergency Instructions taken for System Balancing reasons, the current arrangements would not prevent the full costs of operational intertrips feeding through into cash out, and is reliant on the effectiveness of the tagging methodologies used to differentiate between System and Energy Balancing actions. Ofgem considers that this could distort cash out prices and, therefore, expose

⁷ For more information on this Modification Proposal please visit the following address:
<http://www.elexon.co.uk/changeimplementation/ModificationProcess/ModificationDocumentation/modProposalView.aspx?propID=183>

market participants to cash out prices which are unrepresentative of the SO's Electricity Balancing actions, which would be to the detriment of Applicable BSC Objective (c).

In relation to the issue of the differentiation between Electricity and System Balancing actions, Ofgem considers, as outlined in its decision letter in relation to Modification P172, that further consideration should be given to whether or not there should be increased reliance on the discretion of the SO to make the distinction between Electricity and System Balancing actions rather than mechanistic rules. Ofgem also notes that whilst the System Operator has a limited liability (within the constraints of the incentive scheme cap/floor and sharing factors) for the costs imposed by the operation of an intertrip through its external SO incentive scheme⁸, there could be a substantial impact on market participants in the event that an intertrip fires.

In addition, with financial recompense for operational intertrips now in the CUSC, the problem of disproportionate imbalance prices feeding through into cash out should an intertrip operate is compounded without the provision of Modification Proposal P177 in place, as an intertrip provider may be eligible for payment under both the provisions of the BSC and the CUSC. Ofgem considers that this would put intertrip providers at an inappropriate advantage compared to those Parties that are not service providers, and considers that the detrimental effect this would have on competition would be addressed by Modification Proposal P177. Ofgem therefore considers that removing intertrip provisions from the BSC as detailed in Modification Proposal P177 would prevent disproportionate prices feeding through into cash out and undue discrimination in favour of Parties with the ability to provide an operational intertripping service, and would therefore better facilitate achievement of Applicable BSC Objective (c).

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

Ofgem also considers that it is not appropriate for the details of the compensation arrangements for operational intertripping schemes to be provided for in the BSC. This view was set out in Ofgem's decision document on BSC Modification Proposal P87⁹. Ofgem therefore considers that, as there is now provision for compensation of operational intertripping schemes laid out in the CUSC, it is inappropriate for there to be further provisions in the BSC. Ofgem therefore considers that removing intertrip provisions from the BSC as proposed under Modification Proposal P177 would better facilitate achievement of Applicable BSC Objective (d).

Ofgem notes that the BSC currently contains reference to paragraph BC2.5.2.3 of the Grid Code. As the Authority has today approved Grid Code change A/05, it is appropriate for section Q.5.1.5 of the BSC to be amended under BSC Modification Proposal P177, to prevent the potential for there to be an inaccurate reference in the BSC to provisions in the Grid Code. Ofgem therefore considers that Modification Proposal P177 better facilitates achievement of Applicable BSC Objective (d) by enhancing the efficiency of the administration of the balancing and settlement arrangements.

⁸ The impact of Amendment Proposal CAP076 and Modification Proposal P177, in terms of its potential for reduced exposure to the costs of intertrips, may need further consideration to ensure that NGC's SO Incentive Schemes continue to be appropriate.

⁹ For more information on this Modification Proposal please visit the following address:

<http://www.elexon.co.uk/changeimplementation/ModificationProcess/ModificationDocumentation/modProposalView.aspx?propID=92>

Other issues

In addition, to the views expressed above, Ofgem agrees that it is appropriate for the volume associated with an operational intertrip to be included in the calculation of market length for an appropriate period, as would be the case under the proposed complementary changes to the Balancing Services Adjustment Data (BSAD) Methodology Statement, in conjunction with the Applicable Balancing Services Volumes Data (ABSVD) Methodology Statement. The Authority has today issued its decision in relation to these proposed changes.

The Authority's decision

Following consideration of the views of the Panel and respondents to the various consultations, and having regard to the views above, Ofgem considers that Proposed Modification P177 would better facilitate achievement of the Applicable BSC Objectives, and should therefore be made.

If you have any queries please contact me on the number above, or David Hunt on 020 7901 7429.

Yours sincerely

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

Sonia Brown

Director, Wholesale Markets

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