



To BSC Parties and any other party who has an interest in the transmission arrangements

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Dear Colleague

**The Authority's decisions on the Balancing and Settlement Code (BSC) modification proposals on zonal transmission losses**

At its meeting of 24 May 2007, the Authority considered BSC modification proposals P198, the P198 Alternative, P200, the P200 Alternative, P203 and P204 ('the proposals'), all of which seek to alter the rules under which transmission losses are allocated to users of the electricity transmission system such that losses are allocated on a locational basis. At that meeting the Authority decided that it was minded to approve P203 and to reject the other proposals (this is referred to as 'the minded-to decisions' in this open letter). The Authority also decided that it would consult on its minded-to decisions.

On 26 June 2007 Ofgem issued a consultation ('the minded-to consultation')<sup>1</sup> which set out the minded-to decisions which the Authority reached at its May 2007 meeting and the Authority's reasons for those decisions.

In the minded-to consultation document, it was noted (at paragraph 8.4) that the Authority would consider any responses to that document before reaching its final decisions. It was further noted that it was the Authority's intention to publish its final decisions on each of the proposals by 20 September 2007.

At meetings on 30 August 2007 and 6 September 2007, the Authority gave further consideration to the proposals in the light of all relevant information available to it, including responses to the 26 June 2007 minded-to consultation.

Following that consideration, the Authority concluded that it would be appropriate, before it made its final decisions concerning the proposals, for a further review to be undertaken of the analysis which had been conducted in the course of the industry's assessment of the proposals. This analysis was provided to the Authority as part of the Final Modification Reports ('FMRs') on the proposals. The Authority noted that it would not be in a position to take its final decisions concerning the proposals on or before 20 September 2007. It also noted that, if the Authority were subsequently to decide to approve one of the proposals, it would probably be necessary to consult on and, if appropriate, direct an alternative implementation date to that proposed in the FMRs of 1 October 2008.

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<sup>1</sup> "Zonal transmission losses – the Authority's minded-to decisions", document reference 153/07. Available at [www.ofgem.gov.uk](http://www.ofgem.gov.uk)

The purpose of this open letter is to set out the Authority's reasons for deciding at this stage not to make its final decisions concerning the proposals together with some consequences of this decision and the proposed way forward.

### **Reasons for not making decisions by 20 September 2007**

As part of the industry assessment of the proposals under the governance of the BSC, Elexon commissioned analysis from Oxera and Siemens PTI. This analysis was taken into account by the modification group that assessed the proposals and was included in the FMRs that were submitted by the BSC Panel to the Authority for a decision. This analysis was also taken into account in the preparation of Ofgem's February 2007 impact assessment on the proposals ('the impact assessment')<sup>2</sup> and by the Authority in reaching its minded-to decisions.

A number of respondents<sup>3</sup> to the impact assessment considered that Ofgem had over-relied on Oxera's analysis for its assessment of the financial and environmental benefits of the proposals. Several respondents commented that they did not consider Oxera's analysis to be robust for reasons including that it used out of date input assumptions and a simplified modelling approach. The Authority set out in its minded-to consultation (at paragraphs 3.22 and 3.23) the reasons why it considered it had appropriately used Oxera's analysis and why it considered the issues raised by respondents did not undermine validity of the conclusions of that analysis in terms of the efficiency benefits of the proposals.

The Authority received a number of responses to its minded-to consultation which are available on Ofgem's website. Several respondents again raised concerns in relation to Oxera's analysis. In particular, Oxera's response summarised some of the key findings of its analysis and sought to address certain issues raised by respondents to the impact assessment concerning the modelling methodology used for the analysis. Oxera also stated that it considered that the Authority had placed more weight than appropriate on Oxera's analysis in arriving at its minded-to decisions.

The Authority took careful note of the many criticisms raised concerning the Oxera analysis. The Authority further noted Oxera's own comments made in response to the minded-to consultation. Although the Authority did not consider that the information now available to it, including Oxera's comments on its analysis and the Authority's use of that analysis, would necessarily cause it to alter its previous assessment of the proposals and the decisions it has stated it is minded to make, it considered that, in view of the concerns raised by Oxera, it would be appropriate for it to delay taking its final decisions concerning the proposals until a further review of Oxera's analysis, and the reliance placed upon it, had been undertaken.

The Authority noted that the FMRs for each of the proposals proposed an implementation date of 1 October 2008 if the Authority made its decision by 20 September 2007. The Authority recognised that, in the context of previous BSC modification proposals, it had taken the view that it did not have the power to take a decision concerning a modification proposal after the final date for that decision (if any) which is set out in the FMR. However, the Authority noted that this position could have surprising and undesirable consequences. Having taken further legal advice on this issue, the Authority concluded that it does have the power to make a decision concerning a modification proposal after the final date for that decision set out in the FMR.

The Authority, therefore, confirmed its intention to make its final decisions concerning these proposals after 20 September 2007. The Authority recognises that the proposed implementation date of 1 October 2008 would in these circumstances be very likely to require extension should any proposal be approved.

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<sup>2</sup> "Zonal transmission losses – assessment of proposals to modify the Balancing and Settlement Code", document reference 32/07. Available on Ofgem's website.

<sup>3</sup> All non-confidential responses are available on Ofgem's website.

## Way Forward

The Authority has requested Ofgem to review the analysis undertaken by Oxera in order to reassess the validity of the conclusions that may be drawn from that analysis. Ofgem will consider whether to appoint consultants to assist in this review and would expect to consult on the findings of the review. The Authority will take the findings of the review and responses to the proposed consultation into account in making its final decisions.

The Authority currently expects to be in a position to make its final decisions on the proposals in spring 2008. The Authority will suggest that the BSC Panel proposes an alternative implementation date that would be consistent with this timetable. Should the Authority decide to approve any of the proposals, it would consult with affected parties before directing an alternative implementation date.

Yours faithfully

A handwritten signature in black ink, appearing to read 'David Gray', written over a light grey rectangular background.

**David Gray**  
**Managing Director, Networks**