

Modification proposal:	Balancing and Settlement Code (BSC) P277: Allow interconnector BM Units to choose their P/C status		
Decision:	The Authority ¹ has decided to reject this proposal		
Target audience:	National Grid Electricity Transmission Plc (NGET), Parties to the BSC and other interested parties		
Date of publication:	22 May 2012	Implementation Date:	n/a

Background to the modification proposal

Under the Balancing and Settlement Code (BSC), all parties that participate in the Balancing Mechanism have one or more generation or consumption units, known as Balancing Mechanism (BM) Units, which are used to trade within the Balancing Mechanism. Licensed BM Units have a production/consumption (P/C) status which is fixed. Energy from the production BM Unit is assigned to the party's production energy account and energy from the consumption BM Unit is assigned to their consumption energy account. Any energy or contract volumes assigned to one account do not influence the other.

In accordance with sections K5.5 and K3.5 of the BSC, parties that participate in the Balancing Mechanism and wish to trade across an interconnector are assigned two interconnector BM Units per relevant interconnector they trade across in the following manner: a BM unit with a fixed P/C status of production for energy that enters GB over the interconnector and a BM Unit with a fixed P/C status of consumption for energy that leaves GB over the interconnector.

When a party imports energy into GB via one interconnector with the intention to export the same amount of energy via another interconnector, they might face risk of imbalance in both of their energy accounts, even though the export and import flows across the two interconnectors are equal and opposite. This is because each of the two trades would end up in separate energy accounts².

Parties can remove this imbalance risk by setting up an Energy Contract Volume Notification (ECVN)³ between their two energy accounts for each settlement period. At the end of each settlement period, the net metered volumes in each energy account are compared to the net position of the ECVN made against that account. The difference between these is the imbalance volume.

The modification proposal

Vattenfall Energy Trading raised modification P277 on 30 September 2011. The proposer considers that under the current BSC arrangements, those parties that transit energy through GB via interconnectors face the risk of imbalance even if their export and import

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

² The energy which enters GB over one interconnector would be allocated to the party's production account and the energy which leaves GB would be allocated to the party's consumption account. If the party has excess energy in their production account, they would be paid System Sell Price (SSP) for this amount and if they have a shortfall in their consumption account, they would be charged System Buy Price (SBP) on that amount. SBP is always greater than or equal to SSP, so the party would be left with a net imbalance charge.

³ Energy Contract Volume Notifications (ECVNs) are the mechanism by which a BSC party notifies the volumes of energy purchased from or sold to another party and must be submitted before gate closure for each settlement period.

flows across interconnectors are actually balanced. The imbalance issue can be resolved by setting up an ECVN between the two energy accounts. However, the proposer argues that this is an additional administrative burden and is also subject to human error. Without additional contracts, if a party's net metered volumes and ECVNs are not aligned to the same account, the party will be exposed to imbalance charges on both accounts.

The proposed modification would allow interconnector users and Interconnector Error Administrators (IEAs) to have one BM Unit per relevant interconnector and elect whether its P/C status is production or consumption. This would replace the existing requirement to have two interconnector BM Units per relevant interconnector and allow them to net all their export and import flows over interconnectors in one energy account.

The proposer believes that the proposal will better facilitate the achievement of applicable BSC Objectives (c), (d) and (e)⁵ as highlighted below:

Applicable BSC Objectives	Proposer's views
<i>(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</i>	<p>Allowing interconnector BM Units to choose their P/C Status:</p> <ul style="list-style-type: none"> • Would reduce notification risk for interconnector users • Would make nominations easier and more transparent. • No consolidation benefits as interconnector metered volumes are not subject to volume volatility (as licensed generation and supply), and interconnector users can already net firm volumes through the use of ECVNs. • Would remove possible market entry barriers for interconnector users and therefore facilitate cross-border trade and promote competition in the GB market and provide trading opportunities for GB participants.
<i>(d) Promoting efficiency in the implementation of the balancing and settlement arrangements</i>	<p>The proposal would reduce the complexity in the GB arrangements for interconnector users as it would reduce the need for parties trading over interconnectors to submit ECVNs, and the associated administrative effort.</p>
<i>(e) Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency</i>	<p>The proposal would facilitate movement towards harmonisation across Europe and the objective of a single European energy market.</p>

BSC Panel⁴ recommendation

⁴ The BSC Panel is established and constituted pursuant and in accordance with Section B of the BSC.

The Final Modification Report (FMR)⁵ was considered by the BSC Panel at its meeting on 12 April 2012. The Majority view of the Panel was that P277 would not better facilitate the Applicable BSC Objectives. The views of the Panel are set out in the FMR.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and FMR⁶ dated 16 April 2012. The Authority has considered and taken into account the responses to Elxon's⁷ consultation on the modification proposal which are attached to the FMR.

The Authority has concluded that implementation of the modification proposal will not better facilitate the achievement of the applicable objectives of the BSC⁸.

Reasons for the Authority's decision

We consider that the modification proposal does not better facilitate objective (c), (d) and (e) and is neutral with regard to objectives (a) and (b). Our assessment of P277 against the Applicable BSC Objectives is set out below.

(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

The proposer considered that the modification proposal would reduce notification risk, simplify nominations and remove a potential market entry barrier for interconnector users.

However, most Workgroup Members and respondents to the consultation disagreed with this view. They considered that existing BSC arrangements for the P/C status do not constitute a barrier to cross-border trade as non-GB companies are already entering the market. Furthermore they considered that all GB participants face the same notification risk and the existing arrangements to set up ECVNs are not perceived as a barrier.

Some Workgroup Members were of the view that the modification proposal would simplify the arrangements for interconnector users and particularly for those parties that trade over interconnectors but have no other physical generation or supply assets.

However, the majority of the Workgroup Members and respondents to the consultation expressed the view that removing notification risk for interconnector users but not other parties would represent undue discrimination and preferential treatment for interconnector users over the other transmission connected parties.

We believe that removing notification risk for interconnector users would only benefit those parties that trade power over interconnectors and particularly those that transit

⁵ The FMR can be viewed at the following link:

<http://www.elxon.co.uk/mod-proposal/p277-allow-interconnector-bm-units-to-choose-their-pc-status/>

⁶ BSC modification proposals, modification reports and representations can be viewed on the Elxon website at www.elxon.com

⁷ The role and powers, functions and responsibilities of Elxon are set out in Section C of the BSC.

⁸ As set out in Standard Condition C3(3) of NGET's Transmission Licence, see:

<http://epr.ofgem.gov.uk/Pages/EPRIInformation.aspx?doc=http%3a%2f%2fepr.ofgem.gov.uk%2fEPFiles%2fElectricity+Transmission+Full+set+of+standard+licence+conditions+consolidated+as+at+05.03.2012+-+Current+Version.pdf>

energy through GB, thus applying different treatment to parties operating only in the GB market (generators or suppliers). Interconnector users are in competition with GB generators and suppliers as trading parties, and interconnector users who trade across GB borders still take up physical positions in GB. Therefore treating them differently, with respect of removing notification risk for interconnector users, could be viewed as undue discrimination. However, it is not clear that the benefits (and therefore the extent of any discrimination) are significant.

BSC modification proposal, P282 has been raised⁹ to allow to allow energy reallocated via a Metered Volume Reallocation Notification (MVRN)¹⁰ to be reallocated to either a Production or Consumption Energy Account regardless of the BM Unit's P/C Status. This would remove the current restriction that energy can only be reallocated from a production BM Unit to a production energy account, or from a consumption BM Unit to a consumption energy account, thus allowing parties to net their position.

Finally, and as discussed by the workgroup, it is worth noting that each Member State has its own market arrangements and therefore the different arrangements in GB should not necessarily be considered a barrier in itself. Therefore, overall, we believe that the proposed modification would not better facilitate Objective (c).

(d) Promoting efficiency in the implementation of the balancing and settlement arrangements

The majority of the Workgroup Members considered that the proposed modification would not better facilitate Objective (d). Most Workgroup Members and consultation respondents were of the view that the proposed modification would result in high implementation costs as per Elexon's estimate¹¹ without any material cost savings other than eliminating notification risk, for which there are already procedures in place to manage by setting up ECVNs.

We recognise that the proposed modification would reduce the burden to maintain multiple accounts for interconnector users and especially for those transiting energy through GB. Furthermore it would eliminate notification risk for interconnector users as they would no longer have to set up ECVNs to deal with the dual accounts and reduce the notification risk.

However we believe that the administrative benefit is difficult to quantify as there are existing arrangements in place and the benefit from reducing notification risk is not easy to quantify. The central implementation costs for P277 as per Elexon's estimate therefore appear high relative to the benefits. Furthermore, there may be further changes required as market coupling¹² is introduced which risks any impact of this modification being short lived.

⁹ P282 was raised by Statkraft on 26 March 2012. P282 is currently undergoing an Assessment Procedure by a Workgroup, and the Panel will consider the Workgroup's report and recommendations at its meeting on 11 October 2012.

¹⁰ Meter Volume Reallocation Notifications (MVRNs) are the mechanism by which the lead party of a BM Unit allocates some or all that BM Unit's Credited Energy Volumes to another party (known as the subsidiary party)

¹¹ According to Elexon's estimates, the central implementation cost is £62k, comprising £50k in Central Registration Agent (CRA) and Settlement Administration Agent (SAA) costs and £12k in Elexon effort. Party costs range from up to £35k for interconnectors users to up to £100k for IEAs.

¹² Market coupling is the method chosen to integrate European wholesale electricity markets. With market coupling, the daily cross-border transmission capacity between the various areas is not explicitly auctioned among the market parties, but is implicitly made available via energy transactions on the power exchanges on either side of the border. Market coupling is the key element in the target model for capacity allocation and congestion management.

Therefore we agree with the majority view that the proposed modification is not likely to promote efficiency in the implementation of the balancing and settlement arrangements.

(e) Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency

The proposer believes that P277 would facilitate movement towards harmonisation across Europe and therefore facilitate the objective of a single European energy market.

Some Workgroup Members considered that the proposed modification could benefit cross-border trade and competition in the wider European context of developing a single market in electricity. However, the majority view was that it is still too early to measure the impact on Objective (e) as the European guidelines and policy are still being formulated.

We welcome changes to facilitate cross-border trade in line with the wider European objective of developing a single market in electricity¹³. We believe that the proposed modification aligns with the spirit of developing a single market in electricity as it would make trading arrangements easier for non-GB participants.

However we are of the view that the main benefit of reducing imbalance risk for interconnector users is time-limited. Moving toward an integrated electricity market, the market coupling process will determine the use of interconnector capacity, and should reduce the exposure of interconnector users to imbalance risk.

Finally, and as mentioned above, we do not believe that this benefit to interconnector users is material, or that it is justified given the potential for discrimination between GB and non-GB trading parties.

Therefore we do not see that the proposed modification would better facilitate Objective (e) to any significant extent.

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

Martin Crouch,

Partner, European Wholesale

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

¹³ The Third Package has been transposed into GB legislation by the Electricity and Gas (Internal Markets) Regulations 2011 (the Domestic Regulations). The Third Package creates a new regulatory framework and new institutions to integrate national markets and promote the development of a competitive and secure internal market in electricity. The Domestic Regulations have amended the Authority's principal objective under section 3A of the Electricity Act 1989 (the Electricity Act). The Authority's principal objective is to protect the interests of existing and future consumers. The interests of consumers now include their interests in the fulfilment by the Authority, when carrying out its functions as designated regulatory authority for GB, of the objectives set out in the Electricity Directive. These include promoting a competitive, secure and environmentally sustainable internal market in electricity within the Community and eliminating restrictions on trade in electricity between Member States