



Direct Dial: 020-7901-7412

22 November 2002

The National Grid Company, CUSC Signatories and
Other Interested Parties

Your Ref: CAP011
Our Ref: IND/COD/CUSC/CAP011

Dear Colleague

Amendment to the Connection and Use of System Code ("CUSC") - Decision and Direction in Relation to Proposed Amendment CAP011: "Changes to Frequency Response Payments to Reflect a Potential Change to the BSC"

The Gas and Electricity Markets Authority (the "Authority"¹) has carefully considered the issues raised in the Amendment Report² in respect of Proposed Amendment CAP011 "Changes to frequency response payments to reflect a potential change to the BSC".

The National Grid Company plc ("NGC") has recommended to the Authority that the Proposed Amendment be implemented if the Authority decides to approve Modification Proposal P34 or Alternative Modification Proposal P34 or any other Modification Proposal with the same effect. NGC has also recommended that the Alternative Amendment be implemented if the Authority decides to approve Modification Proposal P36 or Alternative Modification Proposal P36 or any other Modification Proposal with the same effect.

The Authority has decided to direct a modification to the CUSC in respect of the Proposed Amendment. This letter explains the background to the Proposed Amendment and sets out the Authority's reasons for its decision. In addition, this letter contains a direction to NGC to modify the CUSC in respect of Proposed Amendment CAP011.

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

² Amendment Report, Proposed Amendment CAP011 "Changes to frequency response payments to reflect a potential change to the BSC", dated 25 March 2002

This letter constitutes the notice by the Authority under Section 49A of the Electricity Act 1989 in relation to the direction.

Background to the proposal

NGC contracts with various Parties for the provision of Balancing Services such as frequency response, standing reserve, fast reserve and black start. The delivery of these Balancing Services can result in the provider generating or consuming different volumes of energy than they had contracted for and hence can result in providers incurring imbalance charges.

Generators are compensated via the Connection and Use of System Code ("CUSC") for the imbalance charges incurred under the BSC when providing Mandatory Frequency Response. An Amendment to the CUSC, CAP001³, altered the method used to calculate the response energy volume delivered or avoided by generators to more accurately reflect the energy volume delivered or avoided when providing Mandatory Frequency Response. In addition, it duplicated the BSC algebra used for calculating Non-Delivery Charges to compensate generators for Non-Delivery Charges incurred in the delivery Mandatory Frequency Response.

Modification Proposals P34, P36 and P71 under the BSC (described in more detail below and in Appendix 1) were raised to address the issue of providers of Balancing Services being exposed to imbalance charges when providing Applicable Balancing Services. In addition, Modification Proposal P36 sought to modify the mechanism used for remunerating service providers for the energy delivered when providing Applicable Balancing Services.

Modification Proposals P34, P36 and P71 and any of their Alternative Modifications or similar Modification Proposals with the same effect would remove Parties' exposure to imbalance charges as a consequence of providing Mandatory Frequency Response. NGC identified that if the Authority were to approve Modification Proposal P34 or any similar Modification Proposal with the same effect, changes to Section 4 of the CUSC would need to be considered to remove the compensation that is currently offered for exposure to imbalance charges associated with delivering Mandatory Frequency Response.

NGC submitted Amendment Proposal CAP011 "Changes to Frequency Response Payments to Reflect a Potential Change to the BSC" to the CUSC Amendments Panel on 11 January. The Proposer suggested that the Proposed Amendment will better facilitate achievement of the Applicable CUSC Objectives⁴.

³ The decision letter for Approved Amendment CAP001 can be found at <http://www.nationalgrid.com/uk/indinfo/cusc/>

⁴ The Applicable CUSC Objectives are contained in Condition C7F.1 of the Transmission Licence and are:
(a) the efficient discharge by the licensee of the obligations imposed upon it under the Act and by this licence; and

The Proposed Amendment

The Proposed Amendment seeks to remove, from Section 4 of the CUSC, the refund of BSC imbalance charges and non-delivery charges incurred when a generator delivers frequency response. Acceptance of Modification Proposal P34, P71 or a similar Modification Proposal under the BSC would remove Parties' exposure to imbalance and non-delivery charges incurred due to delivering Mandatory Frequency Response. Therefore, there would no longer be a need to pay compensation for these charges under the CUSC.

Alternative Amendment

The CUSC Amendments Panel agreed that it would also be necessary to implement changes to the CUSC if the Authority were to approve Modification Proposal P36. Therefore, the CUSC Amendments Panel agreed the scope of the Proposed Amendment should be broadened to include an Alternative Amendment to address necessary changes to the CUSC if Modification Proposal P36 were to be implemented.

An Alternative Amendment was drafted and included in the consultation document for Proposed Amendment CAP011. The Alternative Amendment seeks to remove the refund of BSC imbalance charges and non-delivery charges incurred when a generator delivers frequency response from Section 4 of the CUSC. In addition, the Alternative Amendment also seeks to remove the payment under the CUSC for delivery or avoidance of delivery of energy due to a Party delivering frequency response as, under Modification Proposal P36, all payments would be covered by Bid/Offer Acceptances ("BOAs").

A number of BSC Modification Proposals and a modification to the Transmission Licence have been raised proposing changes to the arrangements for addressing a Party's imbalance exposure when providing Balancing Services. These are outlined in Appendix 1.

Respondents' views

NGC issued a consultation paper for the Proposed Amendment and the Alternative Amendment on 4 February 2002 and invited views by 11 March 2002.

NGC received eight responses to the consultation. Of the respondents, five supported implementation of the Proposed Amendment or the Alternative Amendment depending on whether the Authority approves Modification Proposal P34 or Modification Proposal P36. A

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- (b) facilitating effective competition in the generation and supply of electricity, and (so far as consistent therewith) facilitating such competition in the sale, distribution and purchase of electricity.

further two respondents expressed support for the Alternative Amendment but not for the Proposed Amendment. The remaining respondent provided comments but no firm opinions.

One of the respondents that supported the Alternative Amendment but not the Proposed Amendment stated that the Proposed Amendment would not deliver an adequate mechanism to compensate for residual volume risk that may arise from Modification Proposal P34.

One respondent queried whether the CUSC Amendment Process allows for more than one recommendation in respect of a Proposed Amendment to be submitted to the Authority.

Two respondents were of the opinion that the interactions on this issue between several Modification Proposals and Proposed Amendments suggested the Authority should consider all of these at the same time when reaching its decision.

Amendment Panel Members' views

NGC received no responses from CUSC Amendment Panel Members following circulation of the consultation document.

NGC's Recommendation

NGC recommended that if the Authority approves Modification Proposal P34, Alternative Modification Proposal P34 or any similar Modification Proposal with the same effect, the CUSC would need consequential changes and the Proposed Amendment should be approved. Furthermore, NGC recommended that if the Authority approves Modification Proposal P36, Alternative Modification Proposal P36 or any similar Modification Proposal with the same effect, the CUSC would need consequential changes and the Alternative Amendment should be approved.

NGC recommended that the Proposed Amendment or the Alternative Amendment be implemented coincident to the time-scales of either Modification Proposals P34, P36 or P71 or their respective Alternative Modification Proposals or any similar Modification Proposals with the same effect.

Ofgem's view

Ofgem considers, having had regard to its statutory duties, that the Proposed Amendment will better facilitate achievement of the Applicable CUSC Objectives. Ofgem considers that the Alternative Amendment will not better facilitate achievement of the Applicable CUSC Objectives. This conclusion has been reached, taking into consideration respondents' views on Modification Proposals P34, P36 and their Alternative Modification Proposals, Modification Proposal P71 as well as the responses to the associated consultation on a Transmission Licence

modification. Although the Authority has considered the issues raised in these Modification Proposals, and the Transmission Licence Modification consultation concurrently, each proposal is subject to separate Determination.

Ofgem has decided to approve Modification Proposal P71. When Modification Proposal P71 is implemented, Parties will no longer be exposed to imbalance charges arising from the delivery of Applicable Balancing Services. Parties will therefore no longer be exposed to imbalance charges associated with the delivery of Mandatory Frequency Response and therefore providers should no longer receive compensation under the CUSC when providing this service for an imbalance that will no longer be incurred. This will ensure that the signals of the costs of these services, to both the System Operator and the market, are not distorted. Therefore, Ofgem believes that the Proposed Amendment will better facilitate the achievement of Applicable CUSC Objectives (a) and (b) as set out in Condition C7F.1 of NGC's Transmission Licence.

Ofgem considers that the Alternative Amendment would be detrimental to the achievement of Applicable CUSC Objectives (a) and (b) as set out in Condition C7F.1 of NGC's Transmission Licence as the Alternative Amendment would also remove the payment for the energy delivered as part of providing the Mandatory Frequency Response service. Without this payment, service providers would not be remunerated for the costs related to energy when providing Mandatory Frequency response. Ofgem considers that this would distort the signals of the costs of this service to the System Operator and the market.

Ofgem considers that the CUSC does not prohibit more than one recommendation to be made in respect of an Amendment Proposal. Furthermore, in this instance, providing the Authority with more than one recommendation in relation to the Proposed Amendment and the Alternative Amendment facilitated an efficient consideration of Modification Proposals P34, P36, P71 and their respective Alternative Modification Proposals as well as Proposed Amendment CAP011 and the Alternative Amendment by the Authority.

The Authority's decision

The Authority has therefore decided that Proposed Amendment CAP011, as set out in the Amendment Report, should be made and implemented.

Direction under Condition C7F.7(a) of NGC's Transmission Licence

Having regard to the above, the Authority, in accordance with Condition C7F.7(a) of the licence to transmit electricity treated as granted to NGC under Section 6 of the Electricity Act 1989 as amended (the "Transmission Licence"), hereby directs NGC to modify the CUSC in respect of Proposed Amendment CAP011, as set out in the Amendment Report.

The modification is to be implemented and take effect from 25 February 2003, the same day as Modification Proposal P71 is to be implemented.

In accordance with Condition C7F.7(b) of NGC's Transmission Licence, NGC shall modify the CUSC in accordance with this Direction of the Authority.

Please contact me on the above number if you have any queries in relation to the issues raised in this letter. Alternatively, contact Richard Ford on 020 7901 7411.

Yours sincerely

A handwritten signature in black ink, appearing to read "Sonia Brown". The signature is written in a cursive style with a large initial 'S'.

Sonia Brown

Director, Electricity Trading Arrangements

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

Appendix 1 – Related decisions

Modification Proposal P34 “Transfer of imbalances caused by Balancing Services to the Transmission Company Energy Account”

This Modification Proposal seeks to remove exposure to imbalance charges for providing Balancing Services.

The Modification Proposal requires that the methodology for determining the energy volumes associated with the provision of Balancing Services, and the list of Balancing Services that this Modification Proposal is to apply to (“Applicable Balancing Services”), be defined outside the provisions of the BSC. The Modification Proposal enables Balancing Services providers to “opt out” of the energy volume transfer process. The Modification Proposal has a retrospective implementation date of 23 August 2001.

During the assessment of the Modification Proposal, the Modification Group also developed an Alternative Modification Proposal. This Alternative Modification Proposal is based on the original Modification Proposal. The difference compared to the original Modification Proposal is that the Alternative Modification Proposal requires that the definition of Applicable Balancing Services and the methodology for calculating energy volumes associated with these Balancing Services are contained in a framework document linked to the BSC. The implementation date for the Alternative Modification Proposal is 1 December 2002.

The Authority has issued a decision to reject the Modification Proposal and the Alternative Modification Proposal concurrently with this letter.

Modification Proposal P36 “The generation of Bid/Offer Acceptances relating to energy delivered as a result of providing Applicable Balancing Services”

This Modification Proposal sought to address similar issues as Modification Proposal P34.

Under this Modification Proposal, the Transmission Company would be required to determine the energy volumes associated with the provision of Applicable Balancing Services for each BMU per Settlement Period. These energy volumes would be treated as Bid/Offer Acceptances (“BOAs”), but would be explicitly excluded from Energy Imbalance Price calculations as these BOAs are deemed to be due to System Balancing rather than Energy Balancing actions. As a result of these BOAs, the service provider would have any energy associated with the provision of Applicable Balancing Services cashed out at the Bid/Offer price and would not be exposed to imbalances due to these energy volumes. The Modification Proposal requires that the methodology for determining the energy volumes associated with the provision of Balancing Services, and the list of Balancing Services that it applies to, be held under the provisions of the BSC.

The Modification Group developed an Alternative Modification Proposal where energy volumes associated with the provision of Applicable Balancing Services would be notified in two different ways:

- as a BMU Applicable Balancing Services BOA (essentially the same mechanism as original Modification Proposal P36); or
- as a BMU Applicable Balancing Services volume, which will be removed from the Energy Account of the Balancing Service provider and transferred to the Energy Account of the Transmission Company (the mechanism set out in Modification Proposal P34).

The Alternative Modification Proposal was developed to cover all aspects of Balancing Services provision, as the original Modification Proposal effectively excluded Balancing Services providers who are not the Lead Party of the BMU and/or are not active participants in the Balancing Mechanism.

The Authority has issued a decision to reject the Modification Proposal and the Alternative Modification Proposal concurrently with this letter.

Modification Proposal P71 "Transfer of imbalances caused by Balancing Services to the Transmission Company Energy Account"

This Modification Proposal is identical to Modification Proposal P34, except it has a prospective implementation date. The Modification Proposal was granted Urgent status by the Authority on the grounds of efficiency as many of the issues had been discussed and consulted on within the industry during the extended Assessment Phase for Modification Proposals P34 and P36.

The Authority has issued a decision to approve the Modification Proposal concurrently with this letter. The Modification Proposal is to be implemented on 25 February 2003.

Modification to the National Grid Company's Transmission Licence: Applicable Balancing Services Volume Data ("ABSVD") Methodology Statement

Modification Proposal P34 and Modification Proposal P71 both require an ABSVD Methodology Statement to be introduced under the governance of the CUSC/Transmission Licence. Ofgem issued a consultation on a modification to NGC's Transmission Licence on 23 September 2002 seeking to introduce a requirement for NGC to put in place an ABSVD Methodology Statement that would define:

- services for which a service provider would be allowed to transfer any imbalance volume caused by the delivery of the service to NGC's Energy Account, and
- the methodology by which such transferred imbalance volumes would be calculated.

In addition, the licence modification would also place an obligation on NGC to provide the Authority with information on the level of energy volumes that had been transferred to NGC's Energy Account via the mechanism defined in the ABSVD Statement.

The Authority has issued a decision to approve the modification to NGC's Transmission Licence concurrently with this letter.

Applicable Balancing Services Volume Data ("ABSVD") Methodology Statement consultation

NGC issued a consultation on establishing an ABSVD Methodology Statement on 1 October 2002 which invited views from respondents by 29 October 2002. NGC issued its report on the consultation to the Authority on 5 November 2002. In the report NGC recommended that a revised version of the ABSVD Methodology Statement should be approved if Ofgem decides to direct the necessary modification to NGC's Transmission Licence.

Ofgem is currently considering the findings of the report and the views expressed by interested parties. Ofgem will make its decision to approve or reject the proposed ABSVD Methodology Statement in due course.