

Modification proposal:	Balancing and Settlement Code (BSC) P207: "Introduction of a new governance regime to allow a risk based Performance Assurance Framework (PAF) to be utilised and reinforce the effectiveness of the current PAF" (P207)		
Decision:	The Authority ¹ directs that this proposal be made ²		
Target audience:	National Grid Electricity Transmission Plc (NGET), Parties to the BSC and other interested parties		
Date of publication:	10 July 2007	Implementation Date:	10 September 2007

This letter sets out the Authority's views in relation to its decision to direct BSC P207 be made.

Background to the modification proposal

Modification P207 was raised by energywatch on 29 September 2006. It was a response to the Performance Assurance Framework (PAF) Review that concluded in August 2006.

The PAF aims to provide BSC Trading Parties with independent assurance regarding the integrity of imbalance settlement. It is designed to identify whether the obligations and performance standards placed on BSC Parties and Party Agents by the BSC are being met and to promote corrective actions to address any identified issues.

The market has changed significantly since the existing PAF was established in 1998. P207 is aimed at updating the PAF to reflect those changes, in particular to enable the Performance Assurance Board (PAB) to adopt more targeted and proportionate response to issues rather than having to treat all non-compliances as of equal severity.

The modification proposal

P207 intends to introduce a more flexible, risk based PAF. It is envisaged that it will allow the industry and PAB to focus more effectively on the most significant issues and risks to settlement. This will be achieved by introducing two distinct roles for the PAB – evaluation and assurance. As a consequence the PAB will be responsible for annually identifying, prioritising and consulting on all material risks and issues in settlement (evaluation) and then developing an Operating Plan explaining how risks and issues will be dealt with over the year (assurance). The Operating Plan will be the building block for developing individual participant's Risk Management Plans.

In order for the PAB to prioritise its work the modification will introduce two Supplier Volume Allocation (SVA) assurance objectives. The objectives require that the PAB shall have regard to "the efficient, equitable and accurate allocation of energy between Suppliers resulting from the aggregated consumption of Metering Systems for which each Supplier is responsible" and "the efficient, accurate and co-ordinated transfer of Metering Systems data by Performance Assurance Parties between Suppliers and Supplier Agents."

The modification will also introduce a mechanism through which Parties can raise queries against and appeal the Risk Management Plans they are set. If a Party on reasonable grounds disagreed with an element of or any changes to the Risk Management Plan they are set, they could lodge a query with the PAB. If following the PAB's determination the Party still disagreed with their Risk Management Plan then the Party could appeal the PAB's decision (in relation to the Risk Management Plan) to the Panel. The terms upon which a Party could appeal to the Panel are procedural only, eg correct procedures had not been followed or the PAB had misinterpreted all or some of the evidence submitted.

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 This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

The PAB will have a new ability to recommend to the BSC Panel new modifications to the BSC in relation to performance assurance. In particular the PAB will be able to recommend to the Panel that the BSC or its code subsidiary documents be modified to remedy any error, ambiguity, inconsistency or deficiency which emerges as a result of PAB carrying out its day to day business or establish a new performance assurance technique or modify an existing technique as set out in the BSC.

The Central Volume Allocation (CVA) market will continue to receive the same level of monitoring and remedial action as is applied under the current PAF, ie all risks and issues will be deemed to require the full attention of the PAF and all PAF techniques that are currently applied will continue to be applied.

BSC Panel³ recommendation

The Draft Modification Report⁴ was considered by the BSC Panel at its meeting on 10 May 2007. The Panel voted unanimously in favour of approving the Proposed Modification. They recommended the modification for approval on the grounds that it would better facilitate Applicable BSC Objectives c) and d) which are respectively in relation to promoting competition in the supply and generation of energy and efficiency in implementation and administration of the BSC arrangements. Please see section 5 of the Final Modification Report⁵ for full details of their views.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 11 May 2007. The Authority has considered and taken into account the responses to Elexon's⁶ consultation which are attached to the FMR⁷. The Authority has concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the BSC⁸; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties⁹.

Reasons for the Authority's decision

We consider that P207 will better facilitate the achievement of the BSC's relevant objectives and is consistent with the Authority's principal objective and statutory objectives. In particular the Authority considers that P207 will better facilitate the achievement of applicable BSC objectives c) and d).

The implementation of this modification is also consistent with our principal objective to protect the interests of consumers present and future through, wherever appropriate, the promotion of effective competition. By improving the level of assurance and compliance with BSC arrangements we consider that competition in the electricity market will be facilitated, which as described below should protect the interests of customers.

P207 is also consistent with our wider responsibilities toward Better Regulation. In particular, we consider that the proposal will improve the transparency of the assurance

³ The BSC Panel is established and constituted pursuant to and in accordance with Section B of the BSC.

⁴ The Draft Modification Report for P207 can be found at <http://www.elexon.com>

⁵ The Final Modification Report for P207 can be found at <http://www.elexon.com>

⁶ The role and powers, functions and responsibilities of Elexon are set out in Section C of the BSC.

⁷ BSC modification proposals, modification reports and representations can be viewed on the Elexon website at www.elexon.com

⁸ As set out in Standard Condition C3(3) of NGET's Transmission Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=4151

⁹ The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Electricity Act 1989.

framework, as well as ensuring that any remedial actions taken are more proportionate and targeted upon cases where action is needed. In addition, we note that it is consistent with the same risk based assurance principles that are embodied in Approved Modification P197.

Generally we consider that P207 updates the PAF so as to enable it to become more effective, transparent and fit for purpose. The modification will achieve this by focusing the PAB and SVA market participant's work on those issues that are considered to have the most material effect to the accuracy and integrity of settlement. Below is a more detailed summary of why we think the modification will better facilitate the applicable BSC objectives (c) and (d).

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

The accuracy and integrity of settlement is important for the promotion of competition in the electricity market, in particular because improvements in settlement accuracy and integrity should result in amongst other things lower costs and improved market certainty. In addition to the benefits existing participants derive, an improvement in assurance and settlement accuracy is likely to reduce barriers to entry for prospective participants, which will exert further positive competitive effects on the market.

Settlement accuracy and integrity is determined in part by market participants overall compliance with the BSC and its subsidiary documents. That is, generally the greater the level of compliance, the more accurate settlement should be. With this in mind the Authority considers the PAF is a valuable device that provides an impartial mechanism for monitoring compliance with the BSC and risks and issues to settlement. It also provides for the resolution/mitigation of such non-compliances, risks and issues.

Furthermore, we note the findings of the PAF Review which said that an assurance framework is justified because the result of errors in settlement can be significant when compared to a supplier's margins and that the very nature of the BSC arrangements mean that participants share settlement volumes and errors.

The Authority considers that by implementing P207, a risk based assurance framework should more effectively tackle risks and issues to settlement and therefore improve the level of settlement accuracy and integrity. The proposed framework will more effectively maintain and improve settlement accuracy and integrity by more systematically tackling issues that are considered most material to settlement. This will be achieved by using processes that gather information from a wide range of sources, including directly from market participants. Using this information the PAB will be able to make more informed, effective and targeted decisions in relation to prioritising its work and effectively tackling those risks and issues that are most material to settlement. In addition P207 will ensure that the PABs work is more transparent which improves certainty but will also allow participants to more effectively prioritise their own work.

One respondent was disappointed that under P207 Party Agents would not have the opportunity to directly appeal decisions made in relation to their Risk Management Plans. Instead they will have to raise concerns through an associated Party (eg a supplier). The Authority notes the Respondent's concerns but consider that it is appropriate for Party Agents to raise their concerns via an associated supplier in order to maintain the Supplier Hub Principle.

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

Promoting efficiency in the implementation and administration of the BSC is important so as to ensure value for money. A more efficient assurance framework should pass on

benefits to BSC Parties and customers by providing better value for money from their investment in this framework. This increase in value will result from the resources in the framework being better focused on resolving the performance issues that really matter.

Under P207 central efficiency in the administration and implementation of the BSC arrangements will be promoted because the PAF, Elexon and market participants will be able to better focus their work and resources on those issues and risks that have the greatest material impact on settlement. That way settlement issues and risks will be more efficiently dealt with.

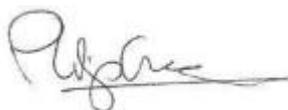
Some modification group members and industry participants raised concerns at the increased level of bureaucracy that P207 could introduce. In particular they referred to the introduction of processes that would require the PAB to produce more periodic consultation documents and reports as well as develop and maintain in conjunction with participants individual Risk Management Plans. They expressed the view that this increased level of bureaucracy would increase the costs of operating and participating within the PAF and would ultimately result in a less efficient and effective framework. Whilst we recognise that P207 will introduce more formal consultation and reporting, the intention of this is to improve the involvement of industry in the PAF, particularly in relation to prioritising work and maintaining focus. We also consider that over time as the PAB and participants become familiar with the proposed PAF, processes will become more efficient. Furthermore, all participants have the opportunity to raise modifications to the BSC to improve the arrangements; indeed under P207 the PAB will also be able to recommend changes to the PAF to improve efficiency and effectiveness.

P207 intends to maintain the level of assurance provided to the CVA market, ie all risks and issues in the CVA market, irrespective of materiality, will be dealt with in the same way they are at present. The Modification Group decided to exclude the CVA market from having its risks and issues assessed and prioritised because it was considered that the PAF Review had not developed its conclusions with the CVA market in mind. As a consequence the Modification Group did not feel it was appropriate for P207 to apply to the CVA market. The Authority notes the rationale behind the Modification Groups decision.

One Respondent, and several Panel members, suggested that the modification may benefit from an ex-post review to assess how successfully the new PAF had been adopted and to see whether any follow up work was necessary. We consider that it may be appropriate for the Panel to review the implementation and ongoing performance of the PAF under P207. However we note that the timing, scope and necessity of such a review will be at the discretion of the Panel to determine.

Decision notice

In accordance with Standard Condition C3 of NGET's Transmission Licence, the Authority, hereby directs that modification proposal BSC P207: "Introduction of a new governance regime to allow a risk based Performance Assurance Framework (PAF) to be utilised and reinforce the effectiveness of the current PAF" be made, with an implementation date of 10 September 2007.



Philip Davies
Director of GB Markets

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