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Direct Dial: 020-7901 7435

6 November 2003

The National Grid Company, BSC Signatories and  
Other Interested Parties

Our Ref : MP No: P143

Dear Colleague,

**Modification to the Balancing and Settlement Code (“BSC”) - Decision and Notice in relation to Modification Proposal P143: “Revision of P99 to Halt the progression of the Performance Assurance Reporting Monitoring System (PARMS) Serials, Standards and Supplier Charge Elements”**

The Gas and Electricity Markets Authority (the “Authority”)<sup>1</sup> has carefully considered the issues raised in the Modification Report<sup>2</sup> in respect of Modification Proposal P143, “Revision of P99 to Halt the progression of the Performance Assurance Reporting Monitoring System (PARMS) Serials, Standards and Supplier Charge Elements”.

The Balancing and Settlement Code Panel (the “Panel”) recommended to the Authority that Proposed Modification P143 should not be made, but in the event that the Authority determines that the Proposed Modification should be made, the Implementation Date should be 2 Working Days after the Authority’s decision.

Having considered the Modification Report and the Panel’s recommendation and having regard to the Applicable BSC Objectives and the Authority’s wider statutory duties, the Authority has decided not to direct a Modification to the BSC.

This letter explains the background and sets out the Authority’s reasons for its decision.

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<sup>1</sup> Ofgem is the office of the Authority. The terms “Ofgem” and “the Authority” are used interchangeably in this letter.

<sup>2</sup> ELEXON document reference P143RR, Version No. 1.0, dated 10 October 2003



## **Background to the proposal**

A review of the Performance Assurance Framework (PAF) within the trading arrangements was initiated in September 2001 by the Balancing and Settlement Code Panel ('the Panel') which used the Risk Assessment Group (RAG) to oversee the review. Phase 1 of the PAF Review focussed on the techniques of Accreditation, Audit, Entry Processes and Serials and Standards. Each technique was analysed by an expert group comprised of industry participants representing a range of market roles, and the findings of the analysis were reported to the RAG and then presented to the Panel for approval on 18 April 2002. The Panel agreed with the recommendations of the PAF Review and requested that these findings be issued to industry for formal consultation.

The majority of industry responses to the consultation supported the PAF Review's recommendations. Relevant expert groups discussed the queries and suggestions raised by respondents to the consultation and where appropriate, actions were taken to modify the PAF review recommendations accordingly.

On 2 September 2002, British Gas Trading raised a Modification Proposal, P99, to further the implementation of the recommendations of the PAF Review. Modification Proposal P99 was aimed at delivering the results of Phase 1 of the PAF Review in a single package. The Initial Written Assessment for Modification Proposal P99 was presented to the Panel on 12 September 2002 and the Panel agreed to submit Modification Proposal P99 to a two-month Assessment Procedure conducted by the Volume Allocation Standing Modification Group (the Group).

During the Assessment Procedure of Modification Proposal P99 the Group met to discuss the responses to the consultation and impact assessment. While the responses were supportive of the Modification Proposal in principle, they highlighted that many respondents required a further level of technical detail before they would be able to provide an assessment of the detailed impact on their organisations. Consequentially the Group concluded that additional analysis was required and at the Panel meeting on 14 November 2002 the Group requested and was granted, a one-month extension to the Assessment Procedure. As part of the assessment during this extra month additional technical details were specified and the Group also sought to assess the perceived costs and benefits introduced by Modification Proposal P99. These factors were used this in the Group's assessment of proposed modification P99 against the Applicable BSC Objectives.

The Group set out its estimates of the costs likely to be incurred by industry to incorporate Modification Proposal P99. This estimate identified one off industry wide costs (i.e. costs to Trading Parties, Party Agents, BSC Agents and BSCCo) in the range £1m to £3m. The Group also estimated the potential benefit to industry at between £2m and £5m per annum. Whilst cost benefit analysis in itself is not an Applicable BSC Objective, the Group used this information to form part of its overall assessment when determining whether Modification Proposal P99 better facilitated the achievement of the Applicable BSC Objectives. The final Assessment Report was presented to the Panel at its meeting on 12 December 2002 and the Panel endorsed the VASMG's recommendation that Proposed Modification P99 should be made because it better facilitates achievement of the Applicable BSC Objectives. Following confirmation of the Panel's provisional recommendation during

the Report Phase a Modification Report was presented to the Authority on 24 January 2003. On 26 February 2003, the Authority directed that Modification Proposal P99 should be made with an Implementation Date of 20 January 2004.

Following the initiation of the Modification Proposal P99 development project, BSCCo identified the need for more extensive development of the central PARMS necessitating a re-procurement and a significant increase in project costs. This in turn precipitated a review of the PARMS functionality and the rules within the BSC. This identified a number of issues that required further clarification and resolution prior to implementing the solution. BSCCo consequently requested that the Panel seek an extension to the Implementation Date as the clarification of these issues would require additional time to implement Modification Proposal P99. The Authority subsequently granted an extension to 1 May 2004.

Modification Proposal P143, "Revision of P99 to Halt the progression of the Performance Assurance Reporting Monitoring System (PARMS) Serials, Standards and Supplier Charge Elements", was submitted by Centrica on 1 September 2003.

### **The Modification Proposal**

P143 was raised following an increase in the estimated costs of implementing Approved Modification P99 "Changes to Accreditation and the PARMS Serials and Standards, resulting from the Performance Assurance Framework (PAF) Review (Phase 1)".

Modification Proposal P99 included the requirement to implement changes to three elements of the PAF: Accreditation; Entry Processes; and Serials and Standards. P143 proposes that work continues on two of these elements, Accreditation and Entry Process, in time for an Implementation Date of 1 May 2004 whilst work on the development of IT systems and processes associated with Serials and Standards elements of Modification Proposal P99 is halted. The Proposed Modification suggested that:

- Supplier Charges are excluded from the implementation of Modification Proposal P99<sup>3</sup>;
- Revised Serials are removed from the implementation of Modification Proposal P99;
- a further review is undertaken relating to the complexity of Serials that are in part responsible for some of the increased costs attributable to the implementation of Modification Proposal P99<sup>4</sup>; and
- the results of this review be included within a "holistic Modification following a review of Supplier Charges".

The issue or defect with the Balancing and Settlement Code ('the Code') that P143 is aimed to address has been cited as being the complexity of the Serials that Modification Proposal P99 introduced to the BSC.

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<sup>3</sup> It should be noted that P99 modified the Serials defined within the Code and that it was not intended to change the way in which Supplier charges operate, other than to apply them to the revised Serials as appropriate.

<sup>4</sup> For the avoidance of doubt a Modification Proposal is not required to instigate a review of Serials within the Code

Further clarification was sought from the Proposer about the intended effect of the Proposal. The Proposer confirmed that the legal text with respect to Serials should revert to the pre-P99 version of the text and that a subsequent Modification Proposal should be raised to deliver any further changes to the definition of Serials within the BSC. This clarification was given in the IWA presented to the Panel.

At its meeting on 9 October 2003, the Panel considered the draft Modification Report together with the responses to the consultation on that Report.

### **Respondents' views**

ELEXON received nine responses to the consultation on Modification Proposal P143. Of the responses, three respondents (representing 16 Parties) expressed support for the Proposed Modification, four respondents (representing 20 Parties and 1 Non-Party) opposed the Proposed Modification and the remaining two respondents (representing 12 Parties) expressed no opinion regarding the desired outcome of the Proposed Modification.

The arguments expressed by one respondent in favour of the Panel's recommendation were that if the cost benefit analysis undertaken by the Modification Group assessing Modification Proposal P99 is correct, then Modification Proposal P99 as a whole will reach break even point within 3 years.

Comments were expressed by those who disagreed with the Panel's provisional recommendation. These included a proposal that a new review be undertaken to determine the mechanism and measures that should be used ensure that a cost efficient PARMS solution is implemented. Others commented that the costs of Modification Proposal P99 have increased and there is no guarantee that there will be no further cost increases. Further comments noted that other significant industry pieces of work are underway, that any revisiting of the Modification Proposal P99 solution after its Implementation Date will result in further costs and a decision on whether or not to proceed with Modification Proposal P99 should be made after an industry workshop has been held (scheduled for 10 October 2003).

Several respondents noted the need to receive a decision in respect of P143 prior to 5 November 2003. These respondents recognised the need for a decision before any contract is signed with the P99 PARMS developer.

One respondent stated that there may be a significant number of other issues with the definition of Serials, reports and the surrounding business processes, unresolved at the end of the PAF review and the P99 decision process, which could result in a significant delay to P99 PARMS. This respondent has been contacted to determine whether or not they were able to identify any such issues and they confirmed that other than those currently in the public domain the respondent was not aware of any. This respondent also pointed out a number of minor typographical errors that have been corrected in later drafts of the report.

One respondent expressed concern about a number of issues associated with the P99

Implementation Project and also made a number of comments on the content of the draft Modification Report.

The respondents' views are summarised in the Modification Report<sup>5</sup> for Modification Proposal P143, which also includes the complete text of all respondents' replies.

### **Panel's Recommendation**

The Panel concluded by majority that achievement of the Applicable BSC Objectives would not be better facilitated by the introduction of P143. A minority of the Panel, however believed that the achievement of Applicable BSC Objective (d) would be better facilitated by the introduction of P143 as it would reduce the cost and therefore increase the efficiency of the balancing and settlement arrangements.

The Panel recommended to the Authority that Proposed Modification P143 should not be made, but in the event that the Authority determines that the Proposed Modification should be made, the Implementation Date should be 2 Working Days after the Authority's decision.

### **Ofgem's view**

Having carefully considered the Modification Report and the Panel's recommendation, Ofgem considers, having regard to the Applicable BSC Objectives and its statutory duties, that Modification Proposal P143 will not better facilitate achievement of Applicable BSC Objective (d).

On 26 February 2003 the Authority directed that Proposed Modification P99 should be made and implemented. This modification sought to progress changes proposed following a review of the Performance Assurance Framework. It proposed changes to Accreditation, Entry Processes and PARMS Serials and Standards and followed considerable work by various expert groups and the Volume Allocation Standing Modification Group (VASMGM). It was Ofgem's view that Modification Proposal P99 better facilitated the achievement of Applicable BSC Objectives (c) and (d).

Ofgem noted in its decision letter that, during the consultation process, some respondents expressed concerns about the justification of the costs of Modification Proposal P99 and whether they outweighed the anticipated benefits. Ofgem noted the results of the cost/benefit analysis conducted by the VASMGM, in consultation with Parties, which estimated that benefits worth £2m-£5m per year were expected, compared to the industry costs of implementation of between £1m and £3m. Ofgem acknowledged that this analysis reflected an overall decrease in the cost of performance assurance brought about by Modification Proposal P99 and that not all of the revised techniques in isolation would bring about cost savings.

It was Ofgem's view that the changes to the accreditation and entry process requirements would place a smaller burden on new entrants to the market and thereby better facilitate achievement of Applicable BSC Objective (c).

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<sup>5</sup> ELEXON document reference MR P143RR, Version No. 1, dated 10 October 2003

In addition, Ofgem noted that, of the 63 Serials used to measure performance before Modification Proposal P99, 50 were not used as, for example, it was not possible to collect accurate data for monitoring purposes. Removing these unused Serials, adding new ones to address areas of assurance not previously covered by existing Serials and revising the arrangements for submitting data to Elexon would, in Ofgem's view, better facilitate achievement of Applicable BSC Objective (d).

The proposal P143 was raised following information that the cost of implementing Modification Proposal P99 had increased since the modification was approved. The Modification Report for P143 states that the new estimated cost for Elexon to introduce systems to support P99 has increased to £1.8m.

It is stated in the Modification Proposal P99 Assessment Report that the VASMG agreed the various assurance techniques considered by the PAF review should be approved as a whole rather than submitted in separate modification proposals. The group felt that it was the intention of the PAF Review to propose a balanced package of assurance techniques together for approval. To halt implementation of one aspect of Modification Proposal P99 and subject it to a further review would not be consistent with this decision taken by the VASMG that the change to Serials be presented as one aspect of a balanced package of proposed changes.

The modification report for P143 states that the proposer confirmed it was the intention of the modification proposal that the BSC reverts back to the pre-P99 legal text in relation to Serials. This would require retaining the 50 Serials that were deemed to be unusable. The new Serials were developed after extensive work by expert groups, who determined that the proposed P99 Serials would better facilitate achievement of the BSC Objectives.

The issue of the appropriateness of the current mechanism for supplier charges is under review by the VASMG following a concern about its effectiveness being raised by energywatch. Modification Proposal P143 states that the revised Serials and Standards approved under Modification Proposal P99 should be halted from progressing further pending the outcome of this review. It is at present unclear what modifications, if any, this review will recommend to the supplier charges mechanism. In addition, the options for a new incentive mechanism to replace the current supplier charges do not, in most cases, recommend or require any change to the Serials approved under Modification Proposal P99. Ofgem notes the statement in the Modification Report that the new PARMS system has been specified to have sufficient flexibility to accommodate most combinations of incentive mechanisms considered by the VASMG. Ofgem therefore does not consider the current review of supplier charges to be a relevant consideration to its decision on Modification P143.

In a similar way, it is not clear what the output of the Customer Transfer Programme mentioned by one respondent will be and when any resulting changes will be implemented. Ofgem does not believe that the introduction of Serials and Standards recommended by the PAF review into

the BSC and supporting documents should be suspended in anticipation of the results of this programme.

Ofgem notes the view expressed in the Modification Report and by one of the respondents that the cost/benefit analysis, even if the worst case benefits anticipated by the VASMG were realised, shows a financial benefit to the industry within three years. No evidence has been presented to Ofgem that the basis on which these benefits were calculated should be considered deficient.

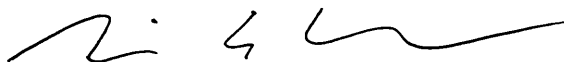
### **The Authority's decision**

The Authority has therefore decided not to direct that Proposed Modification P143, as set out in Modification Report P143RR dated 10 October 2003, should be made and implemented.

Having regard to the above, the Authority, in accordance with Section F1.1.4 of the BSC, hereby notifies NGC that it does not intend to direct NGC to modify the BSC as set out in Modification Report P143RR.

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the above number.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Iain Osborne', with a long horizontal flourish extending to the right.

**Iain Osborne**  
**Director, Supply**

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