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| Modification proposal: | <b>Balancing and Settlement Code (BSC) P330: Allowing Elexon to tender for the Uniform Network Code Gas Performance Assurance Framework Administrator (PAFA) role (P330)</b> |                      |             |
| Decision:              | The Authority <sup>1</sup> directs that this modification be made <sup>2</sup>   |                      |             |
| Target audience:       | National Grid Transmission Plc (NGET), Parties to the BSC, the BSC Panel and other interested parties  |                      |             |
| Date of publication:   | 25 May 2016  | Implementation date: | 2 June 2016 |

## Background

The Balancing and Settlement Code (BSC) was established pursuant to Standard Condition C3 of National Grid's Electricity Transmission Licence. The BSC sets out the powers, functions and constitution of the BSC Company (BSCCo); Elexon is the BSCCo. Elexon is a non-profit-making limited liability company established to facilitate the effective delivery, implementation and operation of the electricity balancing and settlement arrangements.

Section C of the BSC currently precludes Elexon from undertaking any business or activity which is not provided for in the BSC itself. Although Elexon has taken on non-BSC roles in recent years, namely administration of the Warm Home Discount scheme and as Electricity Market Reform (EMR) Settlement Service Provider (EMRS), both of these resulted from directions by the Secretary of State, not competitive tender.

Accurate settlement is a key requirement of both the electricity and gas industries. However, whilst electricity settlement has been subject to a performance assurance regime since the inception of the BSC in 1998, no equivalent has been established in gas. In December 2015 we accepted UNC506V<sup>3</sup>, which established the fundamentals of a Performance Assurance Framework (PAF) under the Uniform Network Code (UNC). In particular, a Performance Assurance Committee (PAC) will be established as a sub-committee of the UNC Committee (UNCC), supported by a PAF Administrator (PAFA). The PAFA role will be appointed following a competitive procurement exercise undertaken by the Gas Transporters (GTs).

## The modification proposal

Modification proposal P330 seeks to modify the BSC in order to enable Elexon to bid for the role of gas PAFA under the UNC.

The changes seek to ensure that Elexon would be ring-fenced from any enduring operational costs and risks associated with performing the role of gas PAFA, by creating a separate subsidiary specifically for that purpose. This would follow the model established for the EMRS.

The decision on whether or not to bid for the gas PAFA contract would be a matter for the BSCCo Board.<sup>4</sup>

<sup>1</sup> References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

<sup>2</sup> This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

<sup>3</sup> UNC520V: '[Gas performance assurance framework and governance arrangements](#)'

<sup>4</sup> The role, powers, functions and responsibilities of the BSCCo Board are set out in [Section C](#) of the BSC.

## **BSC Panel<sup>5</sup> recommendation**

At its meeting of 12 May 2016 the BSC Panel voted by a majority to recommend that P330 should not be made. While some panel members considered that none of the BSC relevant objectives would be further facilitated, two believed that it would better facilitate relevant objective d).

## **Our decision**

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 16 May 2016. We have considered and taken into account the responses to the industry consultation(s) which are attached to the FMR<sup>6</sup>. We have concluded that:

- implementation of P330 will better facilitate the achievement of the applicable objectives of the BSC;<sup>7</sup> and
- directing that the modification be made is consistent with our principal objective and statutory duties.<sup>8</sup>

## **Reasons for our decision**

We note that although the majority of the BSC Panel recommended that P330 be rejected, the workgroup and the majority of respondents were in favour of its implementation.

As mentioned by one of the BSC Panel members and noted in the FMR, we have previously considered the case for allowing Elexon to diversify its activities. In accepting BSC modification P284<sup>9</sup> in September 2012 we set out our view that whilst there might be benefits of diversification, robust arrangements had to be put in place to mitigate any additional risk to the BSC and BSC Parties. We considered that certain criteria would have to be met, as follows:

- BSC Parties should benefit from any diversification;
- the arrangements should not place disproportionate risk on BSC Parties;
- standards of service under the BSC should be maintained; and
- Elexon's BSC role should not give it any undue competitive advantage in a contestable activity.

In accepting P284 we allowed for these criteria to be met by establishing, subject to a decision of the BSCCo Board, a 'contract model', whereby Elexon would become distinct from, and provide services under contract to, the BSCCo.<sup>10</sup> However, we also suggested that there might be other, more proportionate, means of meeting the criteria where the extent of risk was more limited. We also stated that it would be appropriate for the BSC

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<sup>5</sup> The BSC Panel is established and constituted pursuant to and in accordance with Section B of the BSC and Standard Special Licence Condition C3 of the Electricity Transmission Licence available at: [www.epr.ofgem.gov.uk](http://www.epr.ofgem.gov.uk)

<sup>6</sup> BSC modification proposals, modification reports and representations can be viewed on the Elexon website at [www.elexon.co.uk](http://www.elexon.co.uk)

<sup>7</sup> As set out in Standard Condition C3(3) of NGET's Transmission Licence: <https://epr.ofgem.gov.uk>

<sup>8</sup> 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.

<sup>9</sup> P284: Expansion of Elexon's role via the 'contract model'

<sup>10</sup> The BSCCo Board decided not to proceed with establishing the contract model.

Board and BSC Parties more generally to give further consideration to a more limited diversification under the existing structure.<sup>11</sup>

We agree with the BSC Panel that P330 should be assessed against relevant objective d) only, and that there will be a neutral impact upon the other BSC objectives. We consider that the first three of the criteria set out above are captured under relevant objective d), whereas the fourth extends beyond the BSC objectives and is suitably considered as part of our wider statutory duties, as set out below.

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

We agree with those respondents who commented that P330 is merely an enabling modification, giving discretion to the BSC Board on whether to submit a tender for the PAFA role; it does not require them to do so. Nor would the BSC Board, if Elexon is selected as a preferred bidder, be compelled to enter into contract if they are not convinced that it is in the best interests of Elexon and BSC Parties to proceed.

As set out in the FMR, any subsidiary created to bid for the PAFA role would be financially ring-fenced from other Elexon operations, in much the same way as the EMRS. However, if the tender is successful, the subsidiary would be expected to make a contribution to Elexon's fixed costs, such as rent. This would generally improve the efficiency of Elexon and reduce the costs to be recovered from BSC funding parties.

We also agree with the assertions in the FMR that there should be other synergies arising from Elexon undertaking the PAFA role. For instance, it should be beneficial to parties to have a single point of contact of performance assurance matters across both gas and electricity. There is also greater opportunity to test different approaches and adapt as lessons are learnt. For instance we have been clear that we do not expect the gas PAF to simply assure compliance with prevailing standards, but to actively seek opportunities to achieve the same, or comparable, outcomes at lower cost for parties. To the extent that this shared knowledge has a reciprocal effect on both the gas and electricity regimes, it should contribute to the efficiency of the balancing and settlement arrangements.

We see no reason why taking on the gas PAFA role would have any adverse impact on the standards of service Elexon provides to BSC Parties. However, we note the suggestion that additional Key Performance Indicators and reporting could be employed if further assurance of this is required. Ultimately, this is a matter for the BSC Board to manage and satisfy itself of before committing Elexon to any diversification.

***Our statutory duties***

Whilst the benefits of Elexon's participation in the gas PAFA tender may not directly be a consideration for the BSC objectives, we consider that the existence of additional bidders should improve the extent and quality of competition for that contract and is therefore consistent with our wider statutory duties. However, we have no views on the relative merits of Elexon to undertake this role in comparison with any other bidder, and note that this will be a matter for the relevant UNCC sub-committee charged with undertaken the procurement exercise on behalf of GTs.

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<sup>11</sup> Since our September 2012 decision on P284, and in the course of industry consideration of other potential Elexon expansion models, it was highlighted that a change to the electricity transmission licence was needed to facilitate potential Elexon expansion. In March 2015, we issued our decision to modify SLC C3 of the electricity transmission licence to enable the industry to explore options for potential expansion of Elexon's role, if appropriate: [www.ofgem.gov.uk/publications-and-updates/modification-standard-licence-condition-c3-national-grid-electricity-plc-s-electricity-transmission-licence](http://www.ofgem.gov.uk/publications-and-updates/modification-standard-licence-condition-c3-national-grid-electricity-plc-s-electricity-transmission-licence)

## **Decision notice**

In accordance with Standard Condition C3 of NGET's Transmission Licence, the Authority hereby directs that modification proposal BSC P330: *Allowing Elexon to tender for the Uniform Network Code Gas PAFA* role be made.

**Angelita Bradney**  
**Head of Smarter Markets**

Signed on behalf of the Authority and authorised for that purpose