

Modification proposal:	<b>Balancing and Settlement Code (BSC) P262: Code Governance Review: Significant Code Reviews, Self-Governance and Code Administration Code of Practice</b>		
Decision:	The Authority <sup>1</sup> directs that the alternative proposal be made <sup>2</sup>		
Target audience:	National Grid Electricity Transmission Plc (NGET), Parties to the BSC and other interested parties		
Date of publication:	10 December 2010	Implementation Date:	31 December 2010

## Background to the modification proposal

In November 2007 the Authority launched a review of the arrangements for governing the main gas and electricity industry codes, including the Balancing and Settlement Code<sup>3</sup>. The aim of the review was to ensure that those industry codes remain fit for purpose given the wide range of changes that have occurred since the introduction of the codes and given the scale of challenge the industry faces over the coming decade.

The Code Governance Review (CGR) Final Proposals<sup>4</sup> published in March 2010 pulled together various initiatives that had previously been consulted upon through various CGR work strands. Those initiatives seek to make the industry code governance processes more transparent and accessible, particularly to small participants and consumer groups. The CGR also redefined a role for Ofgem with respect to significant changes to the industry codes, while also allowing us to step back from those parts of the governance arrangements that have minimal impact upon consumers or our wider statutory duties.

The Authority subsequently modified the Standard Conditions of the Electricity Transmission licence, amongst others, in order to give effect to the CGR Final Proposals. These modifications were made on 5 July 2010, but come into effect 31 December 2010, allowing licensees opportunity to bring the codes for which they are responsible into line with the modified licence requirements by that time.

## The modification proposal

The proposer (NGET) raised P262 in August 2010 to give effect to most of the above licence changes. P262 has three elements:

1. Significant Code Reviews (SCR) – the Authority will be able to lead a review process (known as an SCR) in areas of work which the Authority considers:
  - have a significant impact on the Authority's principal objective, statutory functions or relevant obligations imposed by EU law; and in particular:
    - have significant impacts on consumers or competition; and/or
    - have significant impacts on the environment, security of supply or sustainable development; or
  - create significant cross code or cross licence issues.

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

<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> The open letter initiating the Code Governance Review (Doc Ref. 284/07) appears on the Ofgem website: <http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/Open%20letter%20announcing%20governance%20review.pdf>.

<sup>4</sup> The final proposals appear at:

[http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/CGR\\_Finalproposals\\_310310.pdf](http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/CGR_Finalproposals_310310.pdf).

The Authority would initially consult on whether it is appropriate to progress a particular issue through an SCR process. This would generally be done through the annual Corporate Planning exercise. Subject to the conclusions of this consultation, the Authority may decide to initiate an SCR through a launch statement. This will set out the scope of, the reasons for and the proposed timetable and resources needed to complete the SCR. After completing the SCR, the Authority would publish its conclusions on the SCR. If appropriate, it may issue directions to the relevant licensees to raise modification proposals giving effect to the SCR conclusions. These modification proposals would subsequently follow the standard change process.

2. Self-Governance – This element of the proposal reflects changes made to the Transmission licence which allows for modifications to be made to the BSC without having to come to the Authority for a decision. This will be limited to those proposals which satisfy the self-governance criteria set out in the licence.

The effect of this modification will be that the BSC Panel is able to make a determination on whether or not a proposal should follow a self governance route. The Authority will be able to veto this decision if it feels that the self-governance criteria have not been satisfied. New evidence may also come to light during the development or consultation process which suggests the proposal is not immaterial. If the Authority does not veto the proposal following the self-governance route, the panel will ultimately vote on whether they consider the proposal better facilitates the relevant objectives than the prevailing baseline. However, the outcome of that vote would now be a decision rather than simply a recommendation to the Authority.

The proposal also provides for a right of appeal to the Authority if a code Party considers that the Panel did not properly consider the relevant objectives, or that the implementation of the proposal would have a discriminatory effect upon them.

3. Code Administration Code of Practice (CACoP) – Code Administrators will be required to have regard to the principles set out in the CACoP. This requires, amongst other things that the Code Administrator acts as a critical friend to the proposer of a modification, particularly small parties, in order to assist them through the modification process.

More generally, the Code of Practice seeks to reduce the complexity of the modification process and introduce a degree of standardisation across the main industry codes. This will again facilitate a greater degree of participation in the code modification process.

The Alternative proposal differs from the original in only one respect. It requires Elexon to obtain the permission of the BSC panel before proposing any changes to the CACoP. Elexon has stated that if the original proposal were to be implemented, it would still discuss with the Panel any change it proposes to make to the CACoP.

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

At its meeting of 11 November 2010, a majority of the BSC panel voted to recommend the implementation of the P262 Alternative proposal. Further details of the BSC panel vote are set out in the Final Modification Report<sup>6</sup>.

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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.

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

## **The Authority's decision**

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 12 November 2010. The Authority has considered and taken into account the responses to Elexon's<sup>7</sup> consultation which are attached to the FMR. The Authority has concluded that:

1. implementation of either the original or the alternative proposal will better facilitate the achievement of the relevant objectives of the BSC<sup>8</sup>; and
2. directing that the **alternative modification** be made is consistent with the Authority's principal objective and statutory duties<sup>9</sup>.

## **Reasons for the Authority's decision**

The majority of respondents to the P262 consultation consider the Alternative proposal should be approved. They noted the changes that had been made to NGETs Transmission licence and agreed that these changes would efficiently discharge the obligations set out in that licence. However, we share the disappointment of the Panel Member who considered that the working group had been unduly focused on this objective alone, and had not given full consideration to the effects on the proposals on efficiency and competition. Our rationale against these objectives is set out below.

*Applicable objective (a) 'efficient discharge by the licensee of the obligations imposed on it by the Act and by its licence'*

We agree with the majority of the panel and respondents to the P262 consultation that the proposal better meets this objective. The proposal would align the BSC modification procedures with the licence obligations placed on NGET through its Transmission Licence.

We note that there was a significant amount of discussion on whether the Alternative proposal is consistent with the Transmission licence, with opposing conclusions being drawn. Some respondents suggested that had the Authority intended a role for the panel in the change process for the CACOP we would have made it explicit in the drafting, whereas others took the omission of any reference as implicitly allowing such a role. For the avoidance of doubt, we consider that no such conclusion should be drawn from the existing drafting alone. A role for the BSC Panel was simply not envisaged, and therefore not dealt with either way in our Final Proposals.

*(b) the efficient, economic and co-ordinated operation of the GB transmission system*

We consider that changes introduced by the CGR Final Proposals will facilitate the timely implementation of proposals which do contribute to the efficient, economic and co-ordinated operation of the GB transmission system. These have been explored as part of our Impact Assessment for those Final Proposals. Therefore, whilst we do consider this objective to be pertinent, an assessment would more appropriately be made of the future proposals which benefit from these facilitating changes, and should not be pre-empted or double-counted by inclusion in this decision.

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<sup>7</sup> The role and powers, functions and responsibilities of Elexon are set out in Section C of the BSC.

<sup>8</sup> As set out in Standard Condition C3(3) of NGET's Transmission Licence, see: <http://epr.ofgem.gov.uk/index.php?pk=folder97241>

<sup>9</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.

*(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*

We agree with the minority panel view that this objective could be supported as the modification would improve the decision making process. This would be achieved through decisions being based on better analysis and assessment of the proposal.

We note that some respondents considered that the SCR process would be detrimental to competition as it would increase regulatory uncertainty; in particular, parties would not know whether modification proposals would be progressed or subsumed during the SCR phase. We do not agree with this assessment. The matters which are likely to be reviewed as part of an SCR process would in any case have fallen under our regulatory purview. We consider that the SCR process is more transparent and efficient than those which have previously been available. We also consider that the ability to formally subsume modification proposals at an early stage, together with the publication of reasons for doing so, will provide greater certainty to stakeholders and prevent the inefficient use of resources on the development of proposals which may soon afterwards be superseded.

We consider that the introduction of the CACoP should enhance competition to the extent that it makes the BSC modification procedures more transparent and accessible to all parties, including those who are newer to the market or have fewer resources to dedicate to code issues. This will enhance both their ability to assess the impacts of modifications upon their business and respond accordingly, but also bring forward proposals of their own. These benefits cannot be quantified, being dependent upon the number and nature of future proposals. However, the availability of such support is of itself a benefit to competition as it will give such parties greater confidence in the code arrangements and greater certainty over their investment. This could be expected to reduce risk and encourage further investment and entry.

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

We consider that all three elements of P262 could be expected to promote efficiency in the BSC governance arrangements. As set out in our Final Proposals, we consider that the Significant Code Review process will lead to major issues being dealt with in an overall more expedient and holistic manner than has been achieved in the past. These views were echoed by some of the respondents to the P262 consultation. Some respondents do not agree with this view, though many of the arguments made against SCRs have previously been made in relation to the licence modifications and given full consideration. To the extent that these comments relate to the underlying SCR process rather than the specific elements of P262 which seek to complement that process, we consider that they are out of scope and not pertinent to this decision. We have therefore sought to focus on those which are specific to P262.

Some responses seem to be based on a misunderstanding of how the SCR process will work. For instance, one respondent suggested that inappropriate modifications could be made to the BSC if the licensee, made subject to an SCR direction, were to raise a modification proposal on a matter where they do not have the necessary expertise. Concerns of an asymmetry of information and knowledge could apply equally to the existing process, which is why the modification rules allow for development and assessment by a much wider pool of expertise than may be available to the proposer. Nothing in the SCR process prevents such development appropriately being carried out,

or indeed an Alternative proposal being raised if it is considered to better facilitate the relevant objectives than the baseline and the original proposal.

The majority of respondents support the introduction of self-governance into the BSC and consider that this will reduce the administrative burden upon BSC parties, the BSC Panel and the Authority. While it is not at this stage possible to quantify the efficiency gains that could be expected from this element of the proposal, being entirely subject to the number and nature of future BSC modification proposals, it is clear that there are no substantive costs from the introduction of this option.

It is also important to note that we expect the process to be no less robust. The BSC Panel will still be required to make an assessment on the benefits of the proposal against the relevant objectives, but where appropriate that will form a determination on whether a proposal should be implemented or not, rather than a recommendation.

The BSC Panel has no vires beyond that provided for in the BSC rules. We therefore agree with the proposer that the BSC Panel should have no direct role in approving changes to the CACoP. However, we also agree with those respondents, many of whom supported the Alternative proposal, who suggested that it is appropriate for elexon to be accountable to the BSC Panel. Parallels have been drawn with the equivalent CUSC proposal CAP185. There is a relevant difference between the two Codes in that National Grid is able to bring forward a CACoP proposal in its own right, even if the CUSC Panel does not agree to it doing so in its capacity as the CUSC Code Administrator.

One respondent raised the issue of whether the BSC or the CACoP should take precedence, and noted views that had been expressed throughout the development of the CGR modification proposals. We consider that it is clear from the legal text of P262, the modified Transmission licence and the CACoP itself, that the prevailing Code must take precedence. However, we would expect the licensee and the Code Administrator to identify and address any inconsistencies in order to ensure that the Code is brought into line with the principles set out in the CACoP.

Given the minimal difference between the original and the Alternative proposal, we consider that there is no discernible difference in the extent to which either would better facilitate the relevant objectives. However, we note the BSC Panel's preference and in the absence of any counter arguments have concluded that the Alternative proposal should be implemented.

### **Decision notice**

In accordance with Standard Condition C3 of NGET's Transmission Licence, the Authority, hereby directs that modification proposal P262: Code Governance Review: '*Significant Code Reviews, Self-Governance and Code Administration Code of Practice*' be made.

**Mark Cox**

**Associate Partner, industry Codes and Licensing**

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