

Modification proposal:	Balancing and Settlement Code (BSC¹) P264: Two-thirds majority Panel recommendation on licence originated Modifications		
Decision:	The Authority ² has decided to reject this proposal		
Target audience:	National Grid Electricity Transmission Plc (NGET), Parties to the BSC and other interested parties		
Date of publication:	20 July 2011	Implementation Date:	n/a

Background to the modification proposal

The BSC Panel³ collectively provides a recommendation to the Authority on whether a modification to the BSC should be approved or not. Ten Panel members⁴ may vote on a modification recommendation with the independent Panel chair holding a casting vote in the case of deadlock. The Panel's final recommendation to approve a modification requires a simple majority in favour of a proposal – one vote more in favour of a modification than against, excluding abstentions. Failure to achieve a simple majority leads to a Panel recommendation to reject.

Should the Authority's decision on a BSC modification differ from the Panel's majority recommendation, an aggrieved party who wishes to legally challenge that decision may seek to bring an Energy Code Modification Appeal to the Competition Commission (CC)⁵. The appeals process was introduced by the Energy Act 2004 and is underpinned by secondary legislation. The BSC is a designated code for the purposes of the CC's appeals process. The circumstances in which an appeal may be brought are circumscribed - an appeal on a BSC modification is excluded where the Authority's decision accords with a majority recommendation made by the Panel⁶. In these circumstances, an aggrieved party that wishes to challenge an Authority decision that accords with the Panel's recommendation may only do so by way of judicial review.

As a result of Ofgem's Code Governance Review (CGR)⁷, the Significant Code Review (SCR) process was introduced to allow Ofgem to initiate a discussion on significant changes to industry codes and licences which may be needed to address a specific issue with cross-code and cross-code/licence impact identified by Ofgem as a result of, amongst other things, its wider statutory duties. On the conclusion of a SCR process, the Authority may direct the relevant licensee to raise changes to relevant codes and the licensee is obliged to do so. In the case of the BSC, NGET would be obliged, at the Authority's direction, to raise a BSC modification(s) as a result of a SCR⁸. Once raised,

¹ NGET is obliged through its electricity transmission licence to establish and maintain the BSC, including the rules for making modifications to the BSC. This obligation is contained in Standard Licence Condition C3 of the electricity transmission licence: http://epr.ofgem.gov.uk/document_fetch.php?documentid=4151

² The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

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

⁴ The voting members of the Panel consist of 5 elected industry members, 1 other industry member appointed by the Panel chair should, in the chair's opinion, the 5 elected members not fully reflect industry interests, 2 independent members also appointed by the Panel chair and 2 members appointed by the relevant consumer body (Consumer Focus). Panel members must act impartially.

⁵ Details of the appeals process for energy code changes are set out on the Competition Commission website: <http://www.competition-commission.org.uk/appeals/energy/>

⁶ SI 2005/1646 Article 5 (1).

⁷ The Code Governance Review final proposals are available here:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=297&refer=Licensing/IndCodes/CGR>

⁸ Standard Licence Condition C3.4 (aa).

the modification would follow the normal industry process culminating in a Final Modification Report (FMR) being referred to the Authority for decision.

The modification proposal

The proposer, Drax Power Limited, raised P264 in August 2010. The proposal seeks to amend the BSC modification rules in the following way:

- any BSC modification which the licensee (NGET) has been obliged by its licence to raise (i.e. currently only a SCR directed modification) would require a two-thirds majority Panel recommendation in favour of approval, otherwise it would be recommended for rejection. In the case of the current Panel, at least 7 members (out of 10) would need to support approval of the modification, if all Panel members voted, to achieve a two-thirds majority

An alternative proposal (P264 Alternative) was developed by the Workgroup assessing the proposal. The alternative proposal would apply the two-thirds voting rule as above and also apply the rule to any modifications suspended or subsumed as a result of a live SCR process⁹.

In the proposer's view, the introduction of the SCR process allows the Authority to originate modifications (SCR directed modifications) which would place the Authority in the position of 'judge, jury and executioner' for those modifications. The raising of the voting threshold for Panel recommendations on SCR directed modifications would increase the checks and balances on the Authority by preserving the right of appeal to the CC when otherwise only a simple majority of Panel members' votes would be needed to approved these modifications.

The Workgroup considered that the alternative proposal expands the scope of the checks and balances by extending the introduction of a higher voting threshold to modifications subsumed or suspended during a SCR process (and which re-enter the process after the conclusion of a SCR) as they would have been subsumed or suspended as a direct result of the launch of a SCR and would relate to the same issue or defect.

In the Workgroup's view, the alternative proposal would better facilitate the achievement of Applicable BSC Objectives (a), (c) and (d). Objective (a) would be better met as NGET would rely on the approval of SCR directed (and subsumed/suspended) modifications by a higher voting threshold to reduce the risk of appeal, creating a more efficient process for progress of these modifications. Objective (c) would be better met as there would be more certainty for BSC parties that the use of a higher voting threshold would preserve their rights of appeal. Objective (d) would be met by ensuring that fewer legal challenges would result on SCR directed (and subsumed/suspended) modifications because of the higher voting threshold, increasing the overall efficiency of implementing modifications.

BSC Panel recommendation

On 9 June 2011, the BSC Panel considered the draft FMR for P264 and the responses to it. The Panel recommended by a majority that the alternative Modification be made. The

⁹ As a result of the CGR changes to the BSC, a proposal raised after a SCR is launched which may fall within the scope of the SCR can be suspended by the proposer or subsumed within the SCR on the direction of the Authority and may re-enter the codes process at the conclusion of the SCR process. The Authority may exempt a proposal from being subsumed within the SCR so that it can follow the standard modification process.

Panel considered that the Alternative better facilitates Applicable BSC Objectives (a), (c) and (d). A minority of the Panel considered that neither the proposed nor the alternative Modifications better facilitate the applicable BSC objectives. The Panel's views can be found in full in the FMR.

The Authority's decision

The Authority has considered the issues raised by the modification proposal, the alternative proposal and the FMR dated 15 June 2011. The Authority has considered and taken into account the responses to Elexon's¹⁰ consultation on the modification proposal and the alternative proposal which are attached to the FMR¹¹.

The Authority has concluded that implementation of either the modification proposal or the alternative proposal will not better facilitate the achievement of the applicable objectives of the BSC¹².

Reasons for the Authority's decision

We note the initial views expressed by Panel members when making their provisional recommendation and subsequently when making their final recommendation. We also note the views expressed by consultation respondents throughout the progress of P264.

Applicable BSC Objective (a): the efficient discharge by the licensee of the obligation imposed upon it by its licence

We do not agree that the proposal would better facilitate this objective. NGET's role under its licence obligation is to raise a BSC modification(s) in line with the SCR directions made by the Authority – it would be a matter for NGET to determine how to frame the SCR directed modification(s) it raises, taking account of the Authority's decision. The Authority's SCR direction may be high level principles or more detailed in scope¹³. Once raised, the SCR directed modification(s) would follow the standard modification process and a Panel recommendation would be made to the Authority. It would be the Panel's recommendation and the Authority's subsequent decision that would give rise to any right of appeal to the CC. It is not clear how a higher voting threshold for SCR directed modifications will make it more likely that the transmission company will raise a well considered robust modification as a result of an SCR direction. Equally, it is unclear how a higher voting threshold will lead to a lower risk of appeal. We do not consider the proposal provides any assurance to NGET one way or another that it has discharged its licence obligation efficiently.

Applicable BSC Objective (c): promoting effective competition in the generation and supply of electricity

We note the views of some respondents that SCR directed modifications may deal with contentious issues and therefore may be more susceptible to appeal because of their impact and that the right of appeal should be preserved as a result. We also note the concerns of some respondents that Ofgem will be acting as 'judge, jury and executioner'

¹⁰ The role and powers, functions and responsibilities of Elexon are set out in Section C of the BSC.

¹¹ BSC modification proposals, modification reports and representations can be viewed on the Elexon website at www.elexon.co.uk

¹² As set out in Standard Condition C3(3) of NGET's Transmission Licence - see link at footnote 1.

¹³ See paragraph 1.51 of Appendix 1 to our CGR Final Proposals dated 31 March 2010:

http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/CGR_Finalproposals_310310.pdf

by initiating a SCR, making SCR directions on its conclusion (should directions result from the SCR process) and reaching decisions on any SCR directed modifications. We further note concerns from some respondents that some materially affected parties who may not have the resources to engage with the SCR process may find themselves disadvantaged once SCR directions are made and SCR directed modifications are raised.

We do not agree that the proposal would better facilitate this objective. The SCR process is intended to be open, transparent and accessible to all parties. One of our concerns when initiating the Code Governance Review was that it was the lack of transparency and inclusivity of code change processes that may deter new entrants and small participants from involvement in energy markets. While the Authority leads the SCR process, we are committed to ensuring that each SCR is carried out in an open and inclusive manner and that all interested parties can engage with the process to address the issues highlighted by the Authority.

Similarly, at the conclusion of a SCR process, the Authority would, based on the evidence gathered during the process, determine whether any SCR directed modification(s) is needed. There is no requirement on the Authority to direct code changes and those changes which are directed may allow the relevant licensee some flexibility within the scope and intent of the direction, allowing for further development of proposals through the code governance processes. Ofgem would keep an open mind on the development of any SCR directed modifications prior to the delivery of the FMR.

Ofgem has recently launched two SCRs¹⁴. As neither has concluded, it is too early to say whether our and parties' expectations of the SCR process have been borne out. We will keep the present arrangements under review and have indicated that external factors may affect the future development of the code governance processes¹⁵. We consider that the arguments in favour of the proposal give rise to benefits that appear at best to be tenuous when compared against the applicable BSC objectives and do not consider that the proposal addresses a genuine issue at this time. However, should we consider it appropriate to refine the SCR process further in light of experience, we would be willing to undertake a review with industry at the relevant time.

The CGR licence changes make it clear that any Authority direction(s) to a transmission licensee to raise a SCR directed modification do not fetter the voting rights of the BSC Panel members¹⁶ - the licence and the BSC explicitly preserves the status quo in this regard. In light of this, no strong case has been presented that there is an obvious defect in the current governance arrangements and we can see no justification at this time to consider making it more difficult for the Panel to achieve a majority recommendation for licence directed modification proposals and for treating such proposals differently to other modification proposals with regard to voting thresholds.

¹⁴ A gas Security of Supply SCR was launched in January 2011 and Project TransmiT was launched as a SCR in July 2011. Details of both are available on the Ofgem website: <http://www.ofgem.gov.uk/>

¹⁵ E.g. We referred to the implementation of the Third Package in CGR final proposals.

¹⁶ Standard Licence Condition C3(4C) "The Authority's published conclusions and directions to the licensee shall not fetter the voting rights of the members of the panel or the recommendation procedures informing the report described at paragraph 4(b)(v)". Also, BSC Section F, paragraph 5.3.1.(d) states "the Authority's Significant Code Review Conclusions (if any) or direction in respect of the SCR Modification Proposal shall not fetter the views of the relevant Workgroup, the voting rights of the Panel or the recommendation of the Modification Report in respect of such SCR Modification Proposal."

BSC Panel members are under a duty to act impartially and not represent any interests¹⁷. It is accepted that all BSC modification proposals ought to be judged on their respective merits and whether a proposal better facilitates one or more of the applicable BSC objectives. The recommendation made by the Panel should reflect this approach rather than a desire to preserve a party's ability to appeal a proposal by making it more difficult to achieve a majority recommendation.

Applicable BSC Objective (d): promoting efficiency in the implementation and administration of the balancing and settlement arrangements

We note the views of respondents that the requirement for a higher voting threshold to approve SCR directed modifications would ensure that the Authority makes more robust decisions on these modifications which would make the SCR process more efficient. We also note the view that more decisive Panel recommendations to approve would be delivered by a higher voting threshold for SCR directed modifications and would reduce the risk of a recommendation to approve on the casting vote of the Panel chair, potentially closing off the right to appeal to the CC.

We do not agree that the proposal would better facilitate this objective. The proposal, if implemented, would introduce a different voting process for an SCR directed modification (including for suspended and subsumed proposals as per the alternative proposal). We consider that this would introduce additional complexity into the governance arrangements, and we see no justification to consider making it more difficult for the Panel to achieve a majority recommendation for licence directed modification proposals and for treating these proposals differently to other modification proposals with regard to voting thresholds. We consider the arguments put forward in support of this objective to be at best tenuous and that the proposal would not better promote efficiency of the BSC governance arrangements.

Other issues arising from modification P264

More broadly, we note that the modification would if approved alter the application of a statutory appeals process that has been subject to Parliamentary scrutiny through the industry codes modification process with the trigger being changed from simple majority to two thirds majority for licence directed proposals. In rejecting the proposal on its merits, we have noted the QC advice disclosed with the FMR, but we have not needed to reach a final view on the legality or appropriateness of this aspect of the proposal for the purposes of our decision.

For the reasons set out above, we have decided not to direct the implementation of either P264 'Two-thirds majority Panel recommendation on licence originated Modifications' or the P264 Alternative.

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Signed on behalf of the Authority and authorised for that purpose

¹⁷ Section B 2.8.1 of the BSC.