

By e-mail to: CodeGovRemedies@ofgem.gov.uk

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1 February 2017

Dear Laura,

Industry Code Governance: Initial consultation on implementing the Competition and Markets Authority's recommendations – Panel Response

The BSC Panel welcomes the opportunity to comment on the proposed reforms to industry code governance being considered as part of work to implement the recommendations of the Competition and Markets Authority (CMA).

The Panel has responsibility for oversight of the Balancing and Settlement Code (BSC) and is comprised of voting members from industry (elected by BSC Parties every two years), an independent chair, non-industry members and consumer groups and non-voting members from the Transmission Licensee, Distribution businesses and Ofgem. All members are required to act independently of their businesses and interests. One of the Panel's functions is to oversee changes to the BSC which we do through a Modification process which requires us to consider changes against a number of Applicable Objectives which Ofgem has set out in the Transmission Licence. Indeed the existing BSC arrangements stem from clear direction in the Transmission Licence cascaded into the BSC which provides for transparency, good governance and appropriate powers for Ofgem to participate and direct.

We believe that the BSC model provides for an excellent balance between the roles and responsibilities of Ofgem, the Panel, BSC Parties, ELEXON, consumer groups and the ELEXON Board. There is transparency of BSC activities and costs and a clear plan of the priorities, changes and activities under the BSC. ELEXON delivers a comprehensive code management/ delivery body service which could be reflected in other arrangements. The constitution of the BSC Panel is a template for Panel constitution given the breadth of its independent membership across the stakeholder community and the inclusion of two places for consumer representatives.

We have provided some broad observations on the proposals below and responses to relevant consultation questions in Appendix 1.

Panel observations on the oversight of the BSC and support to Ofgem

Ofgem should be mindful that the BSC is a contract between the parties in the wholesale power market. It is therefore vital to the success of the industry as a whole, accommodating market entry and overseeing market exit, while ensuring the customers' requirements for secure, economic electricity supplies are met. Since 2001 the Panel has overseen numerous improvements to the BSC arrangements through the change process and has worked closely with Ofgem both directly and through ELEXON, in supporting changes driven by regulatory and policy changes. We have supported and encouraged ELEXON in progressing cross code initiatives including the development of the CACoP, cross code forums and cross code working groups. For a number of years we have maintained a forward work plan which identifies known and projected future changes and our/ELEXON proposals for reviews of the BSC and its services. We are pleased to see that such plans are now becoming

standard across other codes. We have supported ELEXON's role in developing a single cross code plan (recently published) which may be a precursor to the materials which would assist Ofgem in planning strategic change.

Strategic direction would be useful to the industry

The Panel believes there is merit in setting a strategic direction for industry and supporting more co-ordination will benefit industry and consumers.

Licensing and competition for licences is not needed and could be counterproductive

Ofgem needs to provide specific evidence of the benefits of licensing (and competition for licensing) for BSC services. The Panel can identify no benefits itself. We do not believe a broader competitive licensing regime would benefit other code services either. There is no evidence that competitive licensing would help smaller parties or consumers, and Ofgem also needs to evaluate all potential costs of moving to its proposed regime.

Competing for Licences also has potential unforeseen consequences and any comparison to the benefits to the Offshore Transmission Owners (OFTOs) regime is highly misleading (especially in the absence of any cost benefit analysis for code licensing).

By making code bodies accountable to Ofgem via a licence, Ofgem is fundamentally changing their role and responsibilities. Under the BSC, ELEXON is currently seen as a trusted, independent, reliable market expert, highly regarded by industry, the regulator and government for its services, views and support. This independence will be lost if ELEXON is seen to simply be an agent of the regulator.

Ofgem is going beyond the CMA's intended remedy to simply have greater code coordination and the Panel has great concerns with the package of proposals. There is a good argument that a far better alternative is building on current arrangements with far deeper engagement by Ofgem representatives in the current Code activities.

There is already good competition in existing BSC services to keep costs down

The Panel notes that competition occurs under the BSC through the BSC Agent services that are tendered by and managed by ELEXON. These BSC Agents (or subcontractors) currently equate to over 45% of ELEXON's total cost base¹. We recognise that there may be some scope to extend competition in outsourced activities to other codes.

The Consultative Board may not fit with existing governance bodies

Ofgem's suggestions on the way the consultative board will interact with existing governance arrangements and on its roles and responsibilities lack sufficient detail to provide good comment. We believe there is significant danger of introducing more costs and bureaucracy into the system. Any change should not introduce additional bureaucracy or act as an impediment to change and the scope and powers of the consultative board need to be better understood before we can comment further.

The end to end governance of the new regime needs clear accountability and the right checks and balances. Code licence holders should not be penalised due to the inaction or failure to comply of code signatories/users.

Ofgem should ensure that current code governance improvements work effectively

Ofgem recently introduced its third phase of Code Governance Reforms (CGR3) and we do not believe these have had sufficient time to bed in. Both the SCR process and the CGR3 changes are good vehicles for industry modifications that cut across several Codes (the SCR is an excellent process to

¹ See ELEXON Business Plan, issued annually to industry for comment.

get detailed stakeholder views). It would be far better to make these processes work than introduce further change again.

Ofgem should proactively engage in existing governance arrangements

Ofgem as the regulator and decision maker on material industry change has an important role in contributing to industry debate and change progression. Ofgem needs to ensure it can support the changes going through industry with informed personnel who can contribute and provide appropriate steer when necessary. Ofgem representatives do attend the Panel, issue groups and modification workgroups but the extent of their guidance and comment has significantly decreased over the last 5 years. We encourage Ofgem to ensure that its representatives are able to provide an Ofgem view at the earliest stage and engage in Code changes and Panels as much as possible.

Scale of change and industry effort in supporting existing initiatives

There is a substantial body of industry change already underway (including half hourly settlement, faster/reliable switching, smart rollout, project NEXUS, implementing European codes). The impact on the resources and efficient delivery of the current work should be understood as licensing is likely to be a major distraction for those bodies who are responsible for supporting and delivering change between now and 2019. Smaller Parties may struggle to engage in even more governance change especially when the objectives and benefits of such change have not been clearly articulated by Ofgem.

Continued engagement with Ofgem

If you would like to discuss any areas of our response, please contact me by email, Michael.gibbons@elexon.co.uk.

Yours sincerely,

Michael Gibbons
Chair, BSC Panel

Dr Phil Hare
Deputy Chair, BSC Panel
List of enclosures

Appendix 1 – Responses to specific consultation questions

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CHAPTER: Two: Scope of the new arrangements

Question 1: Do you agree that the codes and functions we have identified (i.e. the codes within the scope of the CACoP and their associated central system delivery functions) should be within scope of the new regime?

The Panel believes that any new regime should apply to codes equally. However the Panel does not believe that the case has been made to introduce licensing as part of a new regime, however we do see benefit in the setting of a strategic direction for industry on cross-codes issues.

Is there a clear cost benefit for the proposal to introduce a competitive licensing regime? Whilst we recognise that the CMA proposed that licensing should be introduced, it was vague on the concept of any competitive regime. Ofgem should consider whether the effort and costs of introducing further governance and competing for code services under a licence regime will deliver benefits for consumers (and how). Whilst we understand that Ofgem may believe that a licence regime will give it greater control the Panel does not believe that licensing is necessary in order to deliver the objective in Ofgem's consultation.

The Panel offer the following views and observations:

- There is a tremendous body of work industry and code bodies are committed to which are geared to delivering benefits for consumers (for example - project NEXUS, the major infrastructure challenge of the smart meter rollout, half hourly settlement projects and faster, reliable switching). There is a risk that industry, Ofgem and especially code body resources could be strained if focus turns to establishing and competing for licences for code services.
- In addition to the GB driven change there is a substantial amount of effort required to implement the changes within the GB framework of the European network codes. Code bodies are already committed to working together to ensure cross code development of changes and planning.
 - It would seem prudent to see if the existing bodies and Panels could deliver on this far reaching cross code change programme using the mechanisms Ofgem has just recently introduced under CGR3
 - An alternative view is that part of the complexity of the implementation of the European network codes is due to the fragmentation of codes in GB and therefore instead of licensing, maybe code consolidation would be more appropriate?
- We do not believe there has there been sufficient time for the CGR3 changes to embed themselves and demonstrate if they work.
- What are the consequences of moving to a competitive licensing regime? If code bodies are to compete to provide their existing service, who will conduct the tender process? Do Code administrators or Ofgem have the necessary skills to respond to and/or implement competitive tenders? Who will fund these additional resources? How will Ofgem measure whether the changes are delivering value for money or working to the benefit of the customers? What will the costs of any competitive process be? How many staff will be needed in Ofgem and Code Administrators to administer the new regime on a daily basis?

- With specific reference to the BSC, the Panel believes that where competition can drive cost saving this is already in place, through the obligation on ELEXON/BSCCo to conduct tenders for BSC Agent services (the systems and major service contracts). The Panel works with ELEXON and its Board to ensure value for Parties (and ultimately customers). These BSC Agents (or subcontractors) equate to over 45% of ELEXON's total cost base of ELEXON's variable costs².
- The Panel is satisfied with existing BSC arrangements enabling it to challenge ELEXON on its performance. The introduction of licensing has been suggested as a means to incentivise code body performance via additional reward or margin at risk. For the BSC where ELEXON is not for profit, both situations would result in an increase in costs for no discernible benefit.
- Ofgem has never formally commented on the Panel plan or the BSCCo Business Plan. We assume Ofgem would have done so if it felt that effort, investment and prioritisation was not being directed to the appropriate strategic activities?
- Ofgem has powers under the BSC to instruct the Panel to re-prioritise changes, however it has never done so. Presumably Ofgem would have if it felt that change was not being progressed and prioritised as appropriate?
- Ofgem as the regulator and decision maker on material industry change has an important role in contributing to industry debate and change progression. Ofgem needs to ensure it can support the changes going through industry with the right personnel who can contribute and provide appropriate steer when necessary. The Panel notes that Ofgem personnel attend the Panel, issue groups and modification workgroups but the extent of guidance and comment has significantly decreased over the last 5 years. The Panel encourages Ofgem to ensure that its representatives are always able to provide a prompt Ofgem opinion and engage in Code changes and Panels as much as possible.

Question 2: Are there any other codes or systems that should be within scope and if so please give your reasons?

If any new regime is introduced, it should apply to all code services. We note that Ofgem has indicated that the data transfer service (DTS) could sit outside of any regime. We are concerned that this overlooks the importance of the link between the DTS and how obligations are discharged under the MRA and BSC and information transferred between Parties (data that is vital to the change of supplier process that directly impacts consumer experience). Changes to the BSC/MRA can impact the DTS, similarly the DTS should not be outside a regime when any change to the DTS could have a direct impact on the BSC/MRA.

Question 3: Are there any other factors you think we should consider when making this decision?

Please see the Panel response to question 1.

CHAPTER: Three: Licensing and competition

Question 1: What are your views on our proposed approach of including the code manager and delivery body function in a single licence?

Whilst the Panel does not believe licensing is necessary it observes that there is merit in having an end to end service under the BSC. ELEXON as the BSCCo has delivered the

² See ELEXON Business Plan, issued annually to industry for comment.

code manager services and competitively procures and manages the delivery of the systems for BSC Parties and users. Having both elements within a single entity has allowed for the delivery of end to end change and a single point of contact for users. This is backed up by transparency of how costs and services are managed, through annual consultation on forward plans aligned to the Panel's plans.

The Panel believes the new governance proposals will lose many of the valuable current checks and balances. Code licence holders cannot be penalised due to the inaction or failure to comply of code signatories.

The Panel notes that many BSC parties have expressed a desire to see additional code functions merged into the BSC, for example where the rules around the balancing sit partly under the BSC and partly in the CUSC. These overlaps may be exacerbated by the way EU codes are introduced. Ofgem may therefore want to give additional thought to alternative ways to coordinate change and move the market forward, and we would support this.

Question 2: What are your views on strengthening the licence of NGET to include new code management requirements rather than holding a tender to identify an appropriate code manager?

The Panel believes that users of the NGET code services are best placed to comment. However the Panel believes that any new regime should be applied to all code services and does not agree that codes operated by National Grid need to be treated differently.

The Panel notes there are often interactions between the BSC, the CUSC and Grid Code. For many years the Panel has sent a representative to the Grid Code and ELEXON engages with the CUSC to understand potential cross code matters. In certain circumstances BSC changes rely heavily on National Grid's plans and system changes (e.g. Releases or EBS). Any changes must therefore continue to support or strengthen the links between the codes and how change is progressed and managed.

Question 3: What are your views on the merits and drawbacks of the four identified models for competitively licensing code management where applicable?

The Panel does not believe competitive licensing will be necessary to deliver improvements to cross code co-ordination and that existing mechanisms should be fully supported and made to work.

The Panel notes the scarcity of third parties with suitable skills to conduct any tender process for the proposed licensed services. The Panel itself does not have the appropriate structure (or skills) to run competitive tenders: it was never designed to do so. The BSC provides for BSCCo to be able to tender services but it as the incumbent provider it would be ineligible to conduct the tender process.

The Panel believes that Ofgem would need substantial (and probably expensive) new resources and skills to conduct any tender process for code services. However it must also justify the aim of tendering for licences: Is this to reduce costs? To oversee investment? or some other ambition? The principles and design of any licence and tender approach will determine how bidders respond and what type of service will be delivered. If there are additional activities required or cost controls from current code services can these not be introduced through existing licensing obligations and code rules?

The Panel is very concerned that the focus of any tender was simply about cost reduction. The BSC, along with other codes, is a highly technical contract which governs how BSC parties trade wholesale power. ELEXON staff are often extremely specialised in

their knowledge and ability to respond to BSC parties' needs. As BSC Agent services are already tendered out by ELEXON, any cost reductions will only be achieved at the expense of replacing more experienced staff with cheaper, less experienced personnel, which in the Panel's view, and that of industry generally, would be a retrograde step.

While a new provider could potentially run the BSC, and TUPE the staff, that sort of interruption and distraction to day to day operations represents a risk to the market that the Panel believes BSC parties will not wish to take, potentially for very small gain.

We do not expect any participant would enter into the process of obtaining a generic (permissive) licence to be able to bid for a fixed selection of services every few years. This appears to be an inefficient approach given the generic licence is unlikely to demonstrate capability to deliver any specific service which would have to be formally tendered for at a later point. This would point to the sole provider licenses being more appropriate and less costly to all parties than a permissive approach. In addition, willingness to participate will depend on how the licences are constructed, the perceived reward, what the enforcement looks like and the triggers for these.

CHAPTER: Four: Strategic direction

Question 1: Do you agree with the purpose of the strategic direction?

The Panel agrees that it is beneficial to set a strategic direction which would provide a steer for how Ofgem wants industry, Panels and code bodies to focus their efforts and investment. Setting such a direction will be a challenge which will require all stakeholders to support and understand how a strategic direction balances the ambitions of policy against current change programmes, emerging technology and services and a backdrop of European driven changes, all whilst government is navigating Brexit discussions.

Question 2: Do you have any views on how the strategic direction should be developed and implemented?

The Panel would expect there to be deep consultation with all relevant bodies, including consumer groups, government, industry, code Panels, code bodies and other interested stakeholders. However we note that, to be useful, the direction will have to provide more than high level statements.

Currently codes are driven by different objectives and Ofgem has its own criteria for assessing change. It may be that this drives some inconsistency in assessment/outcomes.

Consideration could be given to greater alignment of the Applicable objectives across the codes and/or alignment with Ofgem's own duties. This could include, for example, the introduction of a consumer benefit specific Applicable objective to codes (which Ofgem has previously resisted).

Question 3: How much detail do you consider should be included in the strategic direction?

The strategic direction must allow stakeholders to adequately plan long term resources and system developments. In doing so it needs to balance the ambitions of policy against current change programmes, emerging technology and services and a backdrop of European driven changes (all whilst government is navigating Brexit discussions). Only then will a realistic overarching plan and with appropriate delivery timescales be created. Consideration could also be given to greater alignment of the Applicable objectives across the codes and/or alignment with Ofgem's own duties. This could include, for example, the introduction of a consumer benefit specific Applicable objective to codes (which

Ofgem has previously resisted). Currently codes are driven by different objectives and Ofgem has its own criteria for assessing change. It may be that this drives some inconsistency in assessment/outcomes.

Question 4: Which specific projects do you consider should be included in the initial strategic direction?

The Panel's existing live plan would be a key input to inform a strategic direction (and we understand other Panels are now developing their own plans and ELEXON is working with other code administrators on the initial cross code forward plan). As noted in our covering letter there is a substantial body of work currently underway that is drawing heavily on industry, code Panel, code body and other stakeholders' resources and funds. Items that should be included in a strategic direction (and their interactions, effort and priority understood) are Half Hourly settlement, faster/reliable switching, project NEXUS implementation, smart metering rollout, implementation of the European network codes and any intended additional policies arising from BEIS's current consultations and the latest European package.

CHAPTER: Five: Consultative board

Question 1: What do you see as the core role and functions of the consultative board?

The Panel makes the following observations in considering the role of the consultative board:

- Any new entity should not create additional burdens, costs or further fragment industry processes. This is particularly for smaller participants who currently struggle to engage across the existing framework
- Any entity needs to have suitable powers and responsibilities to avoid it becoming a talking shop
- Its constitution and membership must ensure a suitably detailed and cross code understanding (does any entity outside Ofgem have a suitable view of all the changes across industry and what type of people have a suitably broad understanding of the how the GB arrangements work as a whole)
- Expectations on code Panels with regards to the governance, providing information to a consultative board or where decision making and powers lie between the entities will need to be fully identified

CHAPTER: Six: Moving to new arrangements

Question 1: What are the main impacts of the proposed new arrangements on existing projects?

The Panel notes that there is a substantial body of work underway (including half hourly settlement, faster/reliable switching, smart rollout, project NEXUS, implementing European codes). The impact on the resources and efficient delivery of the current work could be highly detrimental as we believe the current level of change and industry programmes are already stretching participants.

Question 2: Would Ofgem's enhanced powers over strategically important modification proposals mean that our Significant Code Review (SCR) powers will be obsolete, and will the new powers form an effective substitute? Please explain your reasoning.

Ofgem must avoid becoming the proposer, judge and jury on code changes. This is partly because it is unlikely to fully understand at a necessarily detailed level the impact

of changes on all participants in the market. Current Code body involvement ensures that this attention to detail is carried out.

Ofgem must therefore be careful to include full consultation in whichever process it uses to take forward changes. The Panel believes that the SCR process and the CGR3 changes are good vehicles for industry modifications that cut across several Codes (the SCR is an excellent process to get detailed stakeholder views).

Question 3: What are your views on staggering the implementation of competitive applications for licences?

The Panel does not believe that competitive licensing is appropriate to deliver greater co-ordination of change. Any cost benefit analysis would need to consider the impact on Ofgem and stakeholder resources to how licensing might be introduced and managed.