

Modification proposal:	Balancing and Settlement Code (BSC) [P263]: Code Governance Review: Send Back Process and Environmental Assessment (P263)		
Decision:	The Authority ¹ directs that this proposal be made ²		
Target audience:	National Grid Electricity Transmission Plc (NGET), Parties to the BSC and other interested parties		
Date of publication:	24 November 2010	Implementation Date:	31 December 2010

Background to the modification proposal

In November 2007, Ofgem initiated a review of the existing industry codes governance processes³ (known as the Code Governance Review (CGR)). During the CGR, we highlighted particular concerns we have that some final modification reports can be deficient. These deficiencies (such as insufficient or incorrectly drafted legal text, lack of clear and transparent reasoning and robust analysis) may lead the Authority to reject proposals and will affect the Authority's ability to make optimal decisions on those proposals. In our view, it would be more appropriate to address these deficiencies efficiently without the need to reject and re-submit proposals. We noted that one aspect of an effective governance regime should be rigorous and high quality analysis of the case for or against a proposed code change.

In June 2008, we published guidance on the treatment of greenhouse gas emissions under the industry code objectives⁴ (the 'GHG guidance'). Our GHG guidance set out how greenhouse gas emissions should be valued in the assessment of a code modification. It set out practical ways in which panels and workgroups should undertake this assessment.

In July 2009, the Government published revised guidance on the valuation of carbon emissions⁵ (the 'DECC guidance'). The DECC guidance reflected changes to the way that greenhouse gas emissions would be valued:

- emissions in sectors covered by the EU ETS would generally be valued using a 'traded price of carbon';
- emissions in sectors outside of the EU ETS would be valued using a 'non-traded price of carbon' instead of using the shadow price of carbon.

Initial values for both prices were set out in the DECC guidance.

In March 2010, we published the final proposals of the CGR⁶. In these proposals we restated our view that code panels and workgroups should assess the quantifiable impact on greenhouse gas emissions of any change proposals raised, where the impact is likely to be material. We reiterated that any assessment should occur by reference to our

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

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

³ The open letter initiating the CGR (Doc Ref. 284/07) appears on the Ofgem website: <http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/Open%20letter%20announcing%20governance%20review.pdf>.

⁴ This guidance appears on the Ofgem website at: <http://www.ofgem.gov.uk/Licensing/IndCodes/Governance/Documents1/Open%20letter%20response-%20final%20version%20of%20letter%2030%20June.pdf>.

⁵ DECC's guidance, 'Carbon Valuation in UK Policy Appraisal: A Revised Approach', is available at: http://www.decc.gov.uk/en/content/cms/what_we_do/lc_uk/valuation/valuation.aspx.

⁶ The final proposals appear at: http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/CGR_Finalproposals_310310.pdf.

published GHG guidance, which was itself updated to align with the DECC guidance⁷. We also confirmed our view on the need for send back powers.

The licence changes required to give effect to the CGR final proposals were implemented in network licences on 5 July 2010 and come into effect on 31 December 2010.

The modification proposal

The proposer (NGET) raised P263 in August 2010 to give effect to the above licence changes

This proposal has two elements:

1. Environmental Assessment – The proposal codifies the need for the panel/workgroups to evaluate the quantifiable impact on greenhouse gas emissions of proposals where the impact is likely to be material. This assessment is to happen in line with our prevailing GHG guidance.
2. Send Back – The proposal reflects the Authority’s ability to send back a final modification report to the panel. We can do this where we are unable to make a decision on the proposed modification(s) due to deficiencies in the existing report. The Authority would direct the panel to take additional steps to solve the deficiencies and return an updated report. These steps could include the giving or amending legal text, revision (including revision to the timetable) of the report, and/or the giving further analysis or information. The proposal also sets out what happens in response to our send back direction.

The proposer considers that:

1. Reflecting the new change management steps set out in its licence better facilitates applicable BSC objective (a) ‘the efficient discharge by the licensee of the obligations imposed upon it by this licence’.
2. The send back element of the proposal better facilitates BSC objective (d) ‘promoting efficiency in the implementation and administration of balancing and settlement arrangements’. This is because it may prevent wasted time and resources; therefore increasing efficiency in the implementation of the BSC. Currently, if the Authority cannot reach a decision due to deficiencies in the report, the proposal is rejected. If the proposer wished to pursue a rejected modification, they would have to raise a new proposal (addressing the past deficiencies) and start the whole process again. This can lead to wasted time and duplication of some steps/resources. Introducing an ability to address problems at our direction could avoid this situation.

BSC panel⁸ recommendation

On the 14 October 2010, the BSC panel voted by a majority in favour of approving P263. The majority of the panel agreed that P263 would better facilitate applicable BSC Objectives (a) and (d). A minority of the panel felt that applicable objective (c) would also be facilitated as it would improve the quality of the Authority’s decision making process thereby improving confidence for Parties in the BSC arrangements and encourage new participants.

⁷ The latest version of our GHG guidance (July 2010) to reflect updated values for the traded and non-traded prices of carbon appears at:
http://www.ofgem.gov.uk/Licensing/IndCodes/Governance/Documents1/GHG_guidance_July2010update_final_080710.pdf.

⁸ The BSC panel is established and constituted pursuant to and in accordance with Section B of the BSC.

One panel member noted that in coming to their decision they saw zero benefits against objective (a). A minority of panel members considered that the proposal would adversely impact objective (c) by weakening the incentives for Ofgem to both fully participate in the development of modifications and make timely decisions. This would add regulatory uncertainty and could reduce the number of new entrants.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 20 October 2010. The Authority has considered and taken into account the responses to Elexon's⁹ consultation which are attached to the FMR¹⁰. The Authority has concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the BSC¹¹; and
2. directing that the modification to be made is consistent with the Authority's principal objective and statutory duties¹².

Reasons for the Authority's decision

The majority of respondents to the P263 consultation consider the proposal should be approved. However, a number of concerns were raised about send back powers.

One concern was the effect of 'send back' on proposer ownership. The respondent wanted confirmation that the ownership of the modification would be retained by the proposer. It was felt that the introduction of a process that could vary the modification proposal without the consent of the proposer would conflict with P247¹³ which introduced the concept of proposer ownership of modification proposals into the BSC. Our view is that the send back powers do not allow for changes to the modification proposal itself by either the proposer or us. It should be noted that the legal text for P263 has been updated to clarify that the modification proposer does not have a right to withdraw or vary their modification if it has been sent-back.

One respondent was concerned about the detail of the requirement to consider environmental impacts of a modification proposal. They were concerned that the requirement might include assessment of such things as the effects of a modification proposal on fauna and flora, which the panel would not likely be qualified to give. As set out above the industry process is required to consider modification proposals in line with our GHG Guidance which does not include consideration of fauna and flora.

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 P263 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.

⁹ The role and powers, functions and responsibilities of ELEXON are set out in Section C of the BSC.

¹⁰ BSC modification proposals, modification reports and representations can be viewed on the ELEXON website at www.elexon.com

¹¹ As set out in Standard Condition C3(3) of NGET's Transmission Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=4151

¹² 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.

¹³ P247 related documents -

http://www.elexon.co.uk/changeimplementation/findachange/modproposal_details.aspx?propID=275

We also note that recent changes to the Authority's statutory duties clarified that our principal objective to protect the interests of existing and future gas and electricity consumers includes their interests in the reduction of greenhouse gases. The proposal would therefore not only align the BSC code modification procedures with NGET's licence obligations but also help align the industry's assessment with this particular element of the Authority's own decision making process. By obliging code panels and workgroups to assess the impact on greenhouse gas emissions of code change proposals, where that impact is likely to be material. We consider this would have a broader beneficial impact on the efficiency of the BSC governance process.

(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 our decision making process. This would be achieved through our decisions potentially being based on better quality analysis and assessment of the modification.

We disagree with the view that the modification would weaken the incentives for Ofgem to fully participate in the development of modifications and make timely decisions adding to regulatory uncertainty. We highlighted in our CGR final proposals the importance of timely resolution of deficiencies when these arise in final modification reports. We will seek, as resources allow, to engage with the modification process and to highlight any concerns in the development of modification proposals. Resolving deficiencies through use of send back would be preferable and more efficient than an Authority rejection of a proposal. This is because the proposer would then have to restart the whole process to address the deficiencies and pursue the proposal. We would anticipate that instances where deficiencies arise after the final report has been sent to the Authority ought to be rare.

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

A majority of panel members and respondents felt that the P263 would better facilitate applicable objective (d) by increasing the efficiency of the modification process. If we are unable to make a decision on a proposal, we can send the modification back, saying what we need to make the decision. This could take less time/resources than the current process where we reject the modification as the merits are not proven, or the legal text is wrong. This would result in a new proposal and a repeat of the whole process being needed.

Some respondents felt that the send back powers increased regulatory uncertainty. This is because parties would be uncertain whether a modification would be approved and when. We disagree. This proposal will have a beneficial impact on the efficiency of the BSC governance process by removing a risk that modification proposals are rejected because of identified deficiencies which are not related to the merits of proposals. By addressing these deficiencies through send back, in a timely manner and without wastage of previous valid work on proposals, the governance process would operate more effectively and produce better and more robust decisions.

Decision notice

In accordance with Standard Condition C3 of NGET's Transmission Licence, the Authority, hereby directs that modification proposal P263: Code Governance Review: Send Back Process and Environmental Assessment be made.

**Mark Cox
Associate Partner, industry Codes and Licensing**

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