



Direct Dial: 020-7901 7491

24 December 2003

The National Grid Company, BSC Signatories and  
Other Interested Parties

Our Ref: MP No P129

Dear Colleague,

**Modification to the Balancing and Settlement Code (“BSC”) - Decision and Notice in relation to Modification Proposal P129: “Changes to Panel Determination Process and Panel Election Procedures”**

The Gas and Electricity Markets Authority (the “Authority”)<sup>1</sup> has carefully considered the issues raised in the Modification Report<sup>2</sup> in respect of Modification Proposal P129, “Changes to Panel Determination Process and Panel Election Procedures”.

The BSC Panel (the “Panel”) recommended to the Authority that Proposed Modification P129 should not be made and in the event that Proposed Modification P129 is made, that it should have an Implementation Date of 1 May 2004 if an Authority determination is received before 19 April 2004; or 1 May 2006 if an Authority determination is received after 19 April 2004.

Having carefully considered the Modification Report, the Panel’s recommendation and having regard to the Applicable BSC Objectives and the Authority’s wider statutory duties,<sup>3</sup> the Authority has decided not to direct the Modification to the BSC.

This letter explains the background and sets out the Authority’s reasons for its decision.

**Background**

Under the current arrangements BSC Panel Members are elected pursuant to Section B<sup>4</sup> of the BSC. The election of Panel members by Trading Parties takes place biennially and follows the election procedures established in Annex B-2. It is the Proposer’s assertion that the ‘quality’ of each Panel determination is dependent on the expertise of Panel members and whether decisions properly reflect the views of industry participants and other key stakeholders. Panel

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<sup>1</sup> Ofgem is the office of the Authority. The terms “Ofgem” and “the Authority” are used interchangeably in this letter.

<sup>2</sup> ELEXON document reference P129RR, Version No. Final/1.0, dated 18 September 2003

<sup>3</sup> Ofgem’s statutory duties are wider than the matters that the Panel must take into consideration and include amongst other things a duty to have regard to social and environmental guidance provided to Ofgem by the government.

<sup>4</sup> Section B paragraph 2

determinations, it is suggested, could be improved by ensuring elected Industry Members are drawn from a variety of backgrounds through the establishment of voting constituencies.

The Proposer further asserts that the time taken between the submission of a proposal and a decision by the Authority varies significantly and can be unacceptably long. In addition it was suggested that Panel recommendations do not always reflect the balance and breadth of views expressed by respondents to modification proposal consultations.

In order to rectify this situation, Powergen UK plc submitted Modification Proposal P129, "Changes to Panel Determination Process and Panel Election Procedures" on 7 May 2003.

### **The Modification Proposal**

Modification Proposal P129 seeks to modify the BSC so as to revise the election procedures for BSC Panel Members and introduce new powers to allow the BSC Panel to make determinations on Modification Proposals.

As regards the revision of the BSC Panel election procedures, Modification Proposal P129 seeks to replace the current system of biennial preference voting with a constituency-based annual election process employing a "first past the post" approach. The Proposer suggests that each trading party group would be permitted to cast two votes in its designated constituencies. Set criteria would be used to categorise each party.

Modification Proposal P129 proposes to introduce five constituency classes with each trading party group having two votes; one vote in each of two self-declared constituencies to which that trading party group belongs. In the case of pure Trading Parties,<sup>5</sup> two votes would be allocated in a single constituency. The Proposer believes that the revised process for electing industry Panel Members would, together with the proposal to make the Panel elections annual rather than biennial, make the Panel more representative of the industry.

With regard to the proposed new powers to allow the BSC Panel to make determinations on Modification Proposals, Modification Proposal P129 proposes that, where there is a "substantial majority"<sup>6</sup> of Panel Members in agreement, the Panel could make determinations in respect of Modification Proposals. Where there is no "substantial majority" the Modification Report would be sent to the Authority for determination. The Proposer believes that allowing the BSC Panel to make determinations will provide a 'filter' process to ensure prompt rejection of non-viable proposals and facilitate earlier implementation of changes that have substantial majority support. It is also suggested that parties may be dissuaded from submitting frivolous proposals, allowing the Authority to refocus its resources on the proposals that are sent to the Authority for a determination under the new process.

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<sup>5</sup> A Trading Party is a Party that has signed up to the BSC, other than NGC, which holds Energy Accounts i.e. accounts held by the BSC Party for the purposes of accounting in Settlement for quantities of electrical energy.

<sup>6</sup> The Proposer quantifies a "substantial majority" as 7 votes out of 9 from voting Panel Members (or 7 votes out of 10, if the Panel Chairman has appointed a sixth industry Panel Member, pursuant to Section B2.6.1).

The Group's views on the exact issues concerning the proposed process for electing BSC Panel Members and on allowing the BSC Panel to make determinations on Modification Proposals are elaborated upon in greater detail in the Modification Report for Modification Proposal P129.

The justification for the Modification Proposal was that it would better facilitate the achievement of Applicable BSC Objective<sup>7</sup> C3 (3) (d).

The Panel considered the Initial Written Assessment at its meeting of 12 June 2003 and agreed to submit Modification Proposal P129 to the Assessment Procedure. The Panel agreed to submit Modification Proposal P129 to a 3 month Assessment Procedure, to be undertaken by the Governance Standing Modification Group ("the Group"). The Group met on three occasions on 18 June, 9 July and 5 August 2003. Within that time period the Panel requested that an interim report be presented at its meeting on 14 August 2003. At this meeting the Panel agreed with the Group's recommendation in the interim report that assessment of Modification Proposal P129 should be terminated.

ELEXON published a draft Modification Report on 11 September 2003, which invited respondents' views by Friday 29 August 2003.

### **Respondents' views**

ELEXON received 12 (twelve) responses to the consultation on Modification Proposal P129. 1 (one) response (representing 14 (fourteen) Parties) expressed support for the Proposed Modification, 10 (ten) responses (representing 18 (eighteen) Parties) opposed the Proposed Modification and the remaining respondent (representing 1 (one) Party) provided a "no comment" response.

The party which did not agree with the recommendation of the Panel considered that Modification Proposal P129 would facilitate 'lighter-touch' regulation and greater involvement of all key stakeholders in the modification decision making process. The respondent undertook its own investigation into how many of the past Panel recommendations were made on a 'substantial majority' basis. This investigation concluded that as of 21 August 2003 of the 102 determinations made by Ofgem since Go-live, 60 of 102 had been subject to a 'substantial majority' Panel recommendation and that from P101 onwards 16 of 17 recommendations fitted within this definition.

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<sup>7</sup> The Applicable BSC Objectives, as contained in Standard Condition C3 (3) of NGC's Transmission Licence, are:

- a) the efficient discharge by the licensee of the obligations imposed upon it by this licence;
- b) the efficient, economic and co-ordinated operation by the licensee of the licensee's transmission system;
- 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;
- d) promoting efficiency in the implementation and administration of the balancing and settlement arrangements
- e) the undertaking of work by BSCCo (as defined in the BSC) which is:
  - (i) necessary for the timely and effective implementation of the proposed British Electricity Trading and Transmission Arrangements (BETTA); and
  - (ii) relevant to the proposed GB wide balancing and settlement code;and does not prevent BSCCo performing its other functions under the BSC in accordance with its objectives.

It was suggested that over 90% of modification decisions could be made by a Panel. This, they considered would speed up the decision making process and enhance efficiency in the administration of the balancing and settlement arrangements.

The respondent further suggested that unlike other important industry codes the presence of employees from some of the larger organisations elected to the BSC Panel is disproportionately low when compared to other Panels. The respondent attributed this to the current 'two votes per trading party group concept' used for BSC Panel elections. It considered that the constituency model advocated under P129 would offer all industry stakeholders whether large or small the opportunity to have their views reflected by a newly constituted Panel.

The respondent also considered that if P129 were not implemented it might ultimately be better to simply limit the Panel's powers to the management of the modification process, but that if the Modification Proposal was not followed another option may be to allow an appeal of an Ofgem decision only where such a decision was contrary to a 'substantial majority' recommendation of the Panel.

All other respondents agreed with the Panel's recommendation that Proposed Modification should not be made. One respondent commented that in its opinion the effective removal of independent regulatory decision making for many modification proposals would be a retrograde step that would be detrimental to promoting effective competition in the generation, sale, purchase and supply of electricity. It further commented that the implementation of P129 would hinder industry reform in the England and Wales market and is counter to the principles of having an independent regulator as envisaged in the European electricity directive.

The same respondent suggested that there is no optimal number of constituency classes as modification proposals ought to be assessed on the relevant arguments, rather than by votes from constituent blocks. It considered that it is not possible to reconcile constituent structures with a requirement for impartiality and that it is far easier to ensure impartiality in Panel considerations when an independent regulator is responsible for decisions.

It further considered that it was difficult to see how the Panel could make decisions without considering Ofgem's wider objectives, but that it would not be appropriate to attempt to adjust the BSC objectives to align with Ofgem's wider objectives, as BSC parties do not have the expertise or the relevant public policy experience to consider the broader Government framework.

Finally the respondent suggested that the development of a workable appeals mechanism is problematic and that an open approach would provide more confidence in the policy outcomes at the cost of certainty and speed for the specific policy under consideration, and possibly other live modifications.

The respondents' views are summarised in the Modification Report for Modification Proposal P129, which also includes the complete text of all respondents' replies.

## **Panel's recommendation**

The Panel met on 11 September 2003 and considered the Modification Proposal P129, the draft Modification Report, the views of the Modification Group and the consultation responses received.

The Panel recommended that the Authority should reject the Proposed Modification but that, if approved, the Proposed Modification should be implemented on 1 May 2004 if an Authority Determination is received before 19 April 2004, or 1 May 2006 if an Authority Determination is received after 19 April 2004

## **Ofgem's view**

Having carefully considered the Modification Report and the Panel's recommendation, Ofgem considers, having regard to the Applicable BSC Objectives and its statutory duties, that Proposed Modification P129 would not better facilitate achievement of the Applicable BSC Objectives.

Ofgem's role as a decision making body in the Modifications process is derived from Standard Condition C3 5 (a) of the Electricity Transmission Licence. This allows the Authority, upon receipt of a report, to decide whether a Proposed Modification or an Alternative Modification would better facilitate achievement of the Applicable BSC objectives when compared with the existing provisions.

The BSC objectives found in C3 3 (a-d) of the Standard Conditions limit the matters which the BSC Panel may consider when making its recommendation in relation to a Modification Proposal. For example, Applicable BSC Objective (c) only allows the panel to consider the promotion of "...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".

In considering a proposed modification, Ofgem must have regard not only to the applicable objectives, but also to its wider statutory duties, which the Panel cannot consider. Under s.3A (1) of the Electricity Act 1989<sup>8</sup> (the Act), Ofgem must have regard to, amongst other things, the promotion of "...effective competition between persons engaged in, or in commercial activities connected with, the generation, transmission, distribution or supply of electricity".

Ofgem considers that to divest its ability to consider matters, such as distribution, which are outside the vires of the Panel, would significantly detract from the comprehensive nature of the current decision making process and that this mitigates against the introduction of P129.

Furthermore, until the formal introduction of the Great British Trading Arrangements the Panel will not be competent to consider matters affecting Scotland. s.6 of the Electricity Act 1989<sup>9</sup> defines the consumers whose interests are to be protected by the Authority under s.3A (1) as "...both existing and future consumers". This statutory authority provides Ofgem with a mandate

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<sup>8</sup> As amended in August 2003.

<sup>9</sup> Ibid.

to take into account the interests of consumers in Scotland who/which will be covered by the BETTA regime. If this modification was accepted it is possible that between the acceptance of the modification and the formal introduction of the GB wide arrangements a situation would arise whereby a substantial majority of the Panel arrived at a decision which would be of material detriment to the development of the British energy market as a result of these constraining vires. Ofgem does not consider a divestment of its powers which could give rise to this situation would be appropriate.

As regards the second perceived defect, it is Ofgem's view that the current Panel is fairly constituted. Ofgem observes the importance of expertise as a resource for any body involved in making recommendations on the trading arrangements. Ofgem considers that the current regime as opposed to a constituency-based system is more conducive to the establishment of a Panel with the appropriate expertise to discharge its duties under the Code. The current Panel has eleven members, composed of an independent Chairman, two independent members, two consumer members, five industry members, a distribution appointee and an appointee from the Transmission company. If there is a perceived gap in any area of expertise, then an option exists to appoint a sixth industry member.

Under the Proposal each trading party group would be permitted to cast two votes in its designated constituencies. This would replace the current system of biennial elections which uses a preference voting system with a constituency-based annual election process that employs a "first past the post" approach. The effect of this would be that a Party's constituencies would be conferred dependent upon its annual metered electrical offtake or delivery. It is Ofgem's view that this would not necessarily lead to the establishment of a better balanced Panel or a wider breadth of expertise. Ofgem further considers that constituency-based voting arrangements are less in keeping with the impartiality obligations than the current voting arrangements.

### **The Authority's decision**

The Authority has therefore decided not to direct that the Proposed Modification P129, as set out in the Modification Report, should be made and implemented.

Having regard to the above, the Authority, in accordance with Section F1.1.4 of the BSC, hereby notifies NGC that it does not intend to direct NGC to modify the BSC as set out in the Modification Report.

If you have any questions, please contact me on the above number.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'N. Simpson', written over a horizontal line.

**Nick Simpson**

**Director of Industry Code Development**

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