

PANEL GOVERNANCE REVIEW – INITIAL THOUGHT-PIECE: ACCOUNTABILITY AND INDEPENDENCE

1. Aim

- 1.1 In order to address those matters arising in Stage 1, the review is considering the existing view of BSC Panel accountability and independence. It is not seeking to amend or re-define, but to consider and clarify the current situation so as to provide context for any recommendations arising in other areas.
- 1.2 This paper sets out the initial conclusions of the Panel's Governance Review Group for discussion. Further background and additional considerations giving rise to these initial conclusions are set out below in Appendix 1.

2. Initial Conclusions for Discussion

Panel Member Accountability

- 2.1 Panel accountability is complex. The requirement to establish a BSC Panel is set out in the Transmission Licence, as overseen by the Regulator. The BSC Panel must ensure that the BSC delivers against the Applicable BSC Objectives as set by the Regulator via the Transmission Licence.
- 2.2 Panel Members are either appointed directly by various bodies or via an election process. The Panel Chairman's appointment is undertaken by the BSC Panel and is approved by the Regulator. However, the BSC requires that Panel Members (including the Chairman) must always act without 'undue' regard to the particular interests of those appointing them¹ and also for the benefit of all parties to the BSC (regardless of type or funding share)².
- 2.3 Once appointed, Panel Members can only be removed during their term of office in certain, limited, circumstances³ and, in any case, not by the Regulator.
- 2.4 In working level discussions, Ofgem has noted the Panel (including the Panel Chairman) is accountable to the industry as it is on the industry's behalf that the Panel undertakes its various functions. There is no formal or direct line of accountability from the Panel to the Regulator in the same way that there is for licensed parties.
- 2.5 It therefore seems incorrect to suggest that Panel Members are accountable to only the regulator, the transmission company or any particular BSC Party. The provisions of the BSC regarding independence seem to support this.
- 2.6 Nevertheless it should be recognised that there are specific, defined functions the Panel undertakes that are a direct result of Ofgem's licence rules (e.g. the requirement to produce Modification reports and assess change against the Applicable BSC Objectives). Further, the BSC is a product of the Transmission Licence and so falls under Ofgem's regulatory remit. Given that the Panel's role and functions form part of that BSC, it follows that Ofgem has a general oversight of this (and would be the decision-maker on any change to the Panel arrangements).
- 2.7 On balance, it can be said that the Panel constitution shares many features of a trustee model: Panel Members are appointed for their specialist skills or knowledge and because they are representative of⁴ those with a stake or interest in the balancing and settlement arrangements. Like trustees, Panel Members are not delegates of the parties or bodies that appointed them: they must act independently, presumably in favour of the *greater common good* as viewed through the lens of the Applicable BSC Objectives.

¹ BSC Section B2.8.1

² BSC Section B1.2

³ BSC Section B2.7.4

⁴ (rather than *representatives* of)

ACCOUNTABILITY AND INDEPENDENCE

2.8 It can therefore be concluded that the Panel and Panel Members, as trustees, are accountable to BSC Parties and the wider industry for:

- i) **independently ensuring that the BSC is given effect as a multi-party contract and operates fairly and effectively for the benefit of all; and also**
- ii) **independently ensuring that any proposed changes to the contract are robustly assessed in a timely fashion and that parties to the contract comply with its provisions.**

Purpose of the Panel

2.9 BSC Panel Members must always ensure that the balancing arrangements continue to facilitate delivery of the Applicable BSC Objectives², both now and in the future, even if this means going against the short-term interests of parties that appointed them (or any other party).

2.10 Further, and consistent with the responsibilities that corporate and trustee governance models afford to wider stakeholders, it could be said that BSC Panel Members must also take account of / and or comment upon the impacts of the BSC and the determinations of the BSC Panel on:

- consumers (including large industrial and commercial energy consumers and domestic energy consumers);
- the environment;
- the achievement of UK government policy; and
- other stakeholders as the case may be (including for example, European government, trade associations and other energy industry groups and committees).

2.11 With this in mind, and given that the BSC operates as a contract between market participants (and the system operator), it seems appropriate to conclude that:

The BSC Panel is responsible for independently ensuring that the terms of a multi-party contract (the BSC) are given effect and operate fairly and effectively for the benefit of all parties (or prospective parties) to the contract but always in favour of the greater common good in a way which is consistent with achieving the Applicable BSC Objectives in a transparent, economic, efficient and non-discriminatory fashion.

Defining 'the greater common good'

2.12 The considerations above suggest that Panel Members, as trustees of the BSC, should seek to ensure that the terms of the BSC continue to serve the greater common good. If this is accepted as part of the Panel's responsibility under a trustee-model, the Panel must be clear what this means. This is not a simple question and the answer will evolve over time.

2.13 Importantly, as a creature of the Transmission Licence, the BSC is also creature of the Electricity Act 1989. The Act confirms that the principle objective of the Secretary of State and the Regulator is to protect the interests of existing and future consumers in relation to electricity generation, transmission, distribution and supply.

2.14 The Act also confirms that this objective shall be delivered in a way which has regard to the need to secure that all reasonable demands for electricity are met and that licence holders are able to finance the activities

ACCOUNTABILITY AND INDEPENDENCE

which they are obliged to undertake in relation to the Act. It further requires that, having regard to the effect on the environment, the Secretary of State and the Regulator must promote efficiency and economy in the transmission, distribution and supply of electricity and secure a diverse and viable long-term energy supply.

- 2.15 These obligations appear consistent with the well-documented trilemma facing the energy industry: ensuring security of energy supplies and catering to rising demand without prices becoming unaffordable and while reducing greenhouse gas emissions. It would therefore seem appropriate to conclude that the Panel should be concerned with these matters when considering the greater common good.

The need for transparency

- 2.16 Given the limitations regarding accountability, it should be expected that the Regulator and BSC Parties would seek assurance regarding the performance of the BSC Panel and its Members. The Panel should be as transparent as possible in how it conducts its business so as to ensure that those interested parties who are able to (re-)appoint Panel Members from time to time, can do so in an informed way, based on the work of the Panel and the performance of Panel Members as engaged and impartial trustees of the balancing arrangements. With this in mind, it could be that the Annual BSC Meeting provides an opportunity for the Regulator and BSC Parties to consider and discuss the performance of the BSC Panel.

Adam Richardson

BSC Advisor and BSC Panel Secretary

13 April 2015

ACCOUNTABILITY AND INDEPENDENCE

APPENDIX 1

1. Background

The Balancing and Settlement Code

- 1.1 The BSC was introduced in 2000 as part of the new electricity trading arrangements, which superseded the pool trading arrangements established on privatisation of the electricity industry in 1990. It was established under (and remains a requirement of) the licence granted to NGET as system operator.
- 1.2 The BSC operates as a contract between the market participants *inter se* and the system operator and provides for the Balancing and Settlement Code Company (BSCCo) to facilitate the effective implementation of the BSC. The BSCCo acts as the contracting party with service providers; employs individuals involved in the management of the BSC and provides secretariat and resources to support the BSC governance arrangements. National Grid is the sole shareholder in the BSCCo.
- 1.3 The governance principles were set out in the consultation for the new arrangements.
 - **Objectivity** - the decision-making processes within the BSC should be objective and not unduly biased by the interests of any particular party or group.
 - **Transparency** - decisions should be taken transparently.
 - **Inclusivity** - there should be no exclusion of relevant information or viewpoints.
 - **Effectiveness** - decision-making processes should balance the need for timely decision making and thorough consideration of issues.
 - **Efficiency** - the procurement, management and enforcement of contracts with service providers, the monitoring and enforcement of rules, financial control and dispute resolution need to be undertaken impartially and efficiently, with scope and responsibilities laid out clearly.

Origins of the Panel

- 1.4 In the 1999 consultation Ofgem said that the Panel 'will be the key body tasked with ensuring that the BSC is effectively and efficiently managed, and that appropriate revisions to the trading arrangements are secured in a robust and timely fashion.' The consultation went on to describe the function of the Panel 'to establish, supervise and administer the operation of BSC functions, systems and processes.'
- 1.5 One of the important objectives of the new arrangements was to ensure that the governance of the BSC should not be factional in nature. Ofgem aimed for an approach which emphasised objective decision-making with reference to pre-defined objectives rather than negotiation among competing commercial interests.
- 1.6 Ofgem therefore proposed that Panel members should not formally represent any pre-defined constituency but would provide expertise and experience in carrying out the duties assigned to them in accordance with the principles set out in the BSC. The aim was to establish rules and structures to ensure as far as possible that Panel members acted impartially in accordance with the objectives of the BSC and not merely in accordance with the interests, wishes or directions of a particular company or group. The aim was to avoid factionalism as far as possible and encourage a constructive, efficient and objective approach to decision-making, although it was recognised that there was a risk that Panel members drawn from within the industry might always be partisan to some extent.
- 1.7 Two possible options for the composition and appointment of the BSC Panel were consulted upon. Under option 1, the Panel would comprise members elected by the industry, while option 2 entailed members being appointed by the Panel chair and being independent of the industry. Following consultation a hybrid approach was adopted with the Panel consisting of a chair appointed by Ofgem, five elected industry

ACCOUNTABILITY AND INDEPENDENCE

members, two independents and two consumer members, plus a member appointed by National Grid. The chair can appoint a further industry member to reflect industry interests which would not otherwise be represented.

The Panel today

1.8 The Panel's constitution and powers are set out in detail in the BSC. In summary the Panel's objective is to give full and prompt effect to the BSC consistent with achieving the Applicable BSC Objectives in a transparent, economic, efficient and non-discriminatory way. Standard Licence Condition C3 of the Electricity Transmission Licence establishes six Applicable BSC Objectives. These can be summarised as:

- a) Efficient Discharge of Transmission Licence Obligations;**
- b) Efficient Operation of Transmission System;**
- c) Promoting Effective Competition;**
- d) Efficient Implementation of the Balancing and Settlement Arrangements;**
- e) Compliance with European Regulations; and**
- f) Facilitating Delivery of Electricity Market Reform**

1.9 The Panel comprises:

- the Chair, now nominated by the Panel after consultation with the BSCCo board and approved by Ofgem;
- not more than five industry members elected by trading parties;
- not more than two members appointed by Citizens Advice;
- a member appointed by National Grid;
- not more than two independent members appointed by the chair; and
- an additional member appointed by the chair if he or she decides that the interests of a class of generators or suppliers who are exempt from the requirement to hold a license are not reflected in the composition of the Panel.

1.10 A representative of distribution system operators, a representative from the Gas and Electricity Markets Authority ('the Authority') and the chief executive of BSCCo are allowed to attend and speak, but not to vote, at any meeting of the Panel.

1.11 The Panel Chair holds office for three years, and Panel Members for up to two years. Panel Members retire together on 30th September in each even year. All are eligible for re-appointment or re-election an unlimited number of times.

1.12 Panel Members can only be removed during their term of office in certain, limited, circumstances defined in the BSC. These include where the Panel Member is convicted of an indictable offence, is (or may be) suffering from mental disorder, becomes bankrupt or is prohibited by law from being a director of a company. The Panel may also resolve that a Panel Member should cease to hold office on grounds of serious misconduct. Such a resolution shall be subject to veto by the Authority.

1.13 Panel Members are bound to act impartially with a view to achieving the Panel's objectives. Panel members are not representative and must act without 'undue' regard to the particular interests of those appointing them. Panel Members are bound to disclose such interests and as a condition of appointment they must confirm in writing that they accept their obligations. Where the member is an employee he or she must provide a letter from the employer agreeing that these requirements prevail over their duties as an

ACCOUNTABILITY AND INDEPENDENCE

employee. Panel Members are expected to attend meetings personally but with the consent of the chair they may appoint an alternate of their choice.

- 1.14 The Panel has important powers relating to the suspension of the rights of parties and modifications of the BSC. The Panel is responsible for approving the business strategy of the BSCCo. The Panel meets monthly, with a quorum of a majority of members, and may delegate to committees with members of suitable experience and qualifications including employees of any BSC party or BSCCo. The Panel may not, however, delegate its functions relating to BSC modifications.

2. Additional Considerations

- 2.1 A series of committees have investigated corporate governance issues over the 1990s and 2000s. Following the first of these⁵, a Canadian committee suggested that accountability must take into account parties other than shareholders:

“Corporate Governance” means the process and structure used to direct and manage the business and affairs of the corporation with the objective of enhancing shareholder value, which includes ensuring the financial viability of the business. The process and structure define the division of power and establish mechanisms for achieving accountability among shareholders, the board of directors and management. The direction and management of the business should take into account the impact on other stakeholders such as employees, customers, suppliers and communities’

Toronto Stock Exchange (1994)

- 2.2 The matter of Panel accountability is complicated. While the Panel is established under the Transmission Licence, National Grid’s role is deliberately constrained and the appointment of the Panel Chairman is subject to Authority approval. Further, all Panel members, once appointed or elected, are required to act independently and impartially.
- 2.3 In its review of Code Governance in 2010, Ofgem confirmed its view that ‘industry codes are the contractual arrangements that underpin the electricity and gas wholesale and retail markets and which define aspects of the terms under which industry participants can access the electricity and gas networks’.
- 2.4 Accountability to the wider industry
- 2.4.1 Given that the BSC operates as a contract between the market participants (and the system operator), some have said that the BSC Panel is responsible for independently ensuring that this multi-party contract is given effect and operates fairly and effectively for the benefit of all parties (or prospective parties) to the contract.
- 2.5 In overseeing the BSC, Panel Members share many similarities with trustees who, in legal terms, hold authority, or a position of trust or responsibility for the benefit of another. In this case, Panel members could be said to be acting on behalf of parties to the contract (and other stakeholders as well).
- 2.6 Directors of UK companies are accountable to the owners of the company for its continuing prosperity and the owners have the ultimate sanction of dismissing some or all directors and replacing them with new appointees (in practice this is often achieved by confirming appointments of the board at the company’s annual general meeting).
- 2.7 However, directors are not mandated delegates of shareholders. If they were, this would imply that they should forego their own individual judgement in order to follow the wishes and demands of shareholders. The Institute of Directors (IoD) is clear that a director who was merely the mouthpiece of the shareholders

⁵ The Cadbury report (1992)

ACCOUNTABILITY AND INDEPENDENCE

would, by fettering their discretion in this way, be failing in their duty to act in the best interests of the company.

- 2.8 The independence requirements placed on Panel Members reflect this approach and re-enforce the concept that Panel Members' duty of care falls more widely than the organisation(s) that appointed them.
- 2.9 It could be argued that the current provisions for the appointment of Panel Members bear some of the hallmarks of a trustee model of representation. Trustee models are frequently contrasted with delegate models of representation. Constituents elect their representatives as 'trustees' (or 'entrust' them) for their constituency. These 'trustees' have sufficient autonomy to deliberate and act in favour of the greater common good, even if it means going against the short-term interests of their own constituencies. By contrast in the delegate model, the representative is expected to act strictly in accordance with a mandate from the represented. Essentially, a trustee considers an issue and, after hearing all sides of the debate, exercises their own judgment in making decisions about what should be done. Nevertheless, trustees can still find they face regular conflicts of interest, particularly where they are appointed by outside bodies.
- 2.10 The National Council for Voluntary Organisations (NCVO) notes that three traditional models of trustee governance exist:
- Where trustees are recruited for their status, influence, contacts or public standing;
 - Where trustees are recruited for their specialist skills or knowledge; or
 - Where trustees are recruited because they are representative of those with a stake or interest in the organisation's work.
- 2.11 The NCVO concludes that an effective committee of trustees should draw on elements of all three of the models. An effective committee should be able to draw on a range of skills, knowledge, qualities, attributes and backgrounds to be effective.
- 2.12 Given these considerations, and the appointment of a significant proportion of Panel Members via industry election, it is not unreasonable to conclude that the BSC Panel is accountable to BSC Parties and the wider industry and that these parties would seek assurance regarding the performance of the Panel and its Members.
- 2.12.1 Accountability to the Regulator
- 2.12.2 The BSC is a product of the Transmission Licence, and so falls under Ofgem's regulatory remit. Given that the Panel's role and functions form part of that BSC, it follows that the Regulator has a general oversight of this. Indeed, the Authority is responsible for approving the appointment of the Panel Chairman and oversight is granted to the Regulator through a range of other provisions which require Authority consent. For example, while the Panel is responsible for ensuring that BSC Parties comply with the BSC, expulsion of defaulting parties can, in certain circumstances, require the prior approval of the Authority.
- 2.12.3 Similarly, while the Panel is responsible for ensuring that proposed changes to the BSC are robustly assessed in a timely fashion, the Modification process requires that (in the main) consent for any change is granted by the Authority based on evidence and rationale provided by the BSC Panel. Consequently, the Regulator would be the decision-maker on any change to the Panel arrangements.
- 2.12.4 However, there is no formal or direct line of accountability from the Panel to the Regulator in the same way that there is for licensed parties. In working level discussions, Ofgem has noted that the Panel (including the Panel Chairman) is accountable to the industry as it is on the industry's behalf that the Panel undertakes its various functions.

ACCOUNTABILITY AND INDEPENDENCE

2.12.5 Such separation is amplified by the provisions of section 173 of the Energy Act 2004⁶ and Statutory Instrument 2005 No 1646 The Electricity and Gas Appeals (Designation and Exclusion) Order 2005. This legislation makes it clear that parties have rights of appeal in relation to certain energy code modification decisions made by the Regulator where the Regulator goes against the majority recommendation of the BSC Panel (as set out in the Panel's Modification Report). In 2005, the Competition Commission noted⁷ that this constituted a significant development in accountability in the regulation of gas and electricity markets. The Competition and Markets Authority (as the successor to the Competition Commission) is responsible for hearing such appeals.

2.12.6 Nevertheless it should be recognised that there are specific, defined functions which the Panel undertakes that are a direct result of Ofgem's licence rules (e.g. the requirement to produce Modification reports and assess change against the Applicable BSC Objectives) and that it might be reasonable to expect that the Authority would seek assurance regarding the performance of the Panel and its Members.

2.13 Overall Accountability

2.13.1 Consequently, it would seem that, although the BSC Panel must consider the views of the Authority (given Ofgem's regulatory oversight of the BSC), it is accountable for its performance to existing BSC Parties.

2.13.2 However, in conducting its business the Panel must also consider the impact of its work with respect to:

- prospective BSC Parties and Trading Parties; and
- other stakeholders (including for example, European and UK government, trade associations and other energy industry groups and committees, large industrial and commercial energy consumers and domestic energy consumers).

⁶ [Energy Code Modification Appeals under section 173 Energy Act 2004](#)

⁷ [Guide to Appeals in Energy Code Modification Cases](#)