

Modification proposal:	Balancing and Settlement Code (BSC) P324: Review of BSCCo's governance: introducing improved accountability to BSC Parties (P324)		
Decision:	The Authority ¹ directs that modification P324 Proposed be made ²		
Target audience:	National Grid Transmission Plc (NGET), Parties to the BSC, the BSC Panel and other interested parties		
Date of publication:	14 October 2016	Implementation date:	20 working days from date of this decision

Background

The Balancing and Settlement Code Company's (BSCCo) principal role is to provide and procure facilities, resources and services required for the proper, effective and efficient implementation of the BSC.³ In recent years, approved modification proposals P281⁴ and P303⁵ sought to update the provisions in respect of the BSCCo Board's composition and appointment process, however other elements of BSCCo governance have not been reviewed since the BSC's inception.

In 2013, the BSC Panel⁶ and BSCCo Board jointly commissioned an independent review of the BSCCo's governance (the 'Knight Report').⁷ The Knight Report set out a number of recommendations for reform to the BSCCo governance arrangements. These findings were subsequently discussed and developed by a joint workshop of the BSC Panel and BSCCo Board.⁸

Ofgem provided an initial response to the Knight Report in the form of an open letter⁹ in which we set out our views that:

- any changes must deliver greater accountability, improved governance and more effective decision-making; and
- the detailed arrangements should operate in the best interests of consumers and take account of the interests of smaller industry participants.

The modification proposal

This modification proposal ('P324 Proposed') was raised by National Grid on 24 July 2015. It proposes to change the current BSCCo governance arrangements with the aim of addressing certain issues identified in the Knight Report. In particular it seeks to:

¹ References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

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

³ BSC Section C 1.2.1. The BSCCo is Elexon Limited as defined in BSC Annex X-1 of the BSC.

⁴ <https://www.ofgem.gov.uk/publications-and-updates/balancing-and-settlement-code-bsc-p281-change-balancing-and-settlement-code-company-bscco-board-directors-chairman>

⁵ <https://www.ofgem.gov.uk/publications-and-updates/balancing-and-settlement-code-bsc-p303-amendments-provisions-bscco-directors>

⁶ The BSC Panel is established and constituted pursuant to and in accordance with Section B of the BSC and Standard Special Licence Condition C3 of the Electricity Transmission Licence available at: www.epr.ofgem.gov.uk

⁷ <http://www.elexon.co.uk/wp-content/uploads/2013/07/The-Governance-of-ELEXON-Final-Report.pdf>

⁸ "Elexon Governance Review": <https://www.elexon.co.uk/about/who-we-are/>

⁹ October 2013: <https://www.ofgem.gov.uk/ofgem-publications/83866/elexongovernancereview-ofgemopenletter.pdf>

- improve the Board's accountability to BSC parties by allowing them to vote to approve and remove directors;
- enable BSC parties to raise and vote on non-binding resolutions;
- allow for the appointment of up to two Executive Directors, and for the remuneration of all Non-Executive Directors (NEDs);
- allow the Board to approve the BSCCo Strategy, rather than requiring BSC Panel approval, and remove the Panel's involvement in director appointments;
- separate the roles of BSC Panel Chair and BSCCo Board Chair; and
- remove the Authority's role in approving the Chair's remuneration.

The P324 workgroup raised an alternative proposal ('P324 Alternative') which is identical to P324 Proposed except that it does not seek to remunerate all NEDs. Instead it would retain the current provisions whereby only NEDs who are considered to be 'independent' of the electricity industry are entitled to receive remuneration.

BSC Panel recommendation

At the BSC Panel meeting on 8 September 2016, the Panel unanimously considered that both P324 Proposed and P324 Alternative would better facilitate BSC objective 'd',¹⁰ and would have a neutral impact on the other applicable objectives. A majority of the Panel considered that P324 Proposed would better facilitate BSC objective 'd' compared to P324 Alternative. The Panel therefore recommended the approval of P324 Proposed.

Our decision

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 9 September 2016. We have considered and taken into account the responses to the industry consultations which are attached to the FMR.¹¹ We have concluded that:

- implementation of both P324 Proposed and P324 Alternative would better facilitate the achievement of the applicable objectives of the BSC;¹²
- P324 Proposed will better facilitate the achievement of the applicable BSC objectives compared to P324 Alternative; and
- directing that P324 Proposed be made is consistent with our principal objective and statutory duties.¹³

Reasons for our decision

We consider this modification proposal will better facilitate BSC objective 'd' and has a neutral impact on the other applicable objectives.

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

We consider that P324 Proposed will improve accountability and clarity in the BSCCo governance arrangements. This should in turn lead to more effective decision-making and therefore promote efficiency in the implementation and administration of the BSC arrangements. We consider that P324 Alternative would similarly improve the

¹⁰ Promoting efficiency in the implementation and administration of the balancing and settlement arrangements.

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: <https://epr.ofgem.gov.uk>

¹³ 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.

arrangements, but on balance we have decided that P324 Proposed better facilitates this objective for the reasons set out below.

Accountability to BSC parties

The ability of BSC parties to vote on binding resolutions to ratify director appointments, and to remove directors from the Board, is a fundamentally new process in the BSCCo governance arrangements and provides a clear mechanism for improving accountability to BSC parties.

The additional mechanism for parties to vote on non-binding resolutions provides a direct route for parties to raise BSC-related matters with the Board. While the outcome of such vote is not binding, given the ability of parties to remove directors it is expected that non-binding resolutions would carry appropriate weight with the Board. An example given by the P324 workgroup of a matter that parties might raise a vote on is in respect of the Business Strategy.

The P324 workgroup developed a voting model¹⁴ which incorporates a threshold for raising a resolution, the required quorum for the meeting, and a vote capping mechanism to ensure that no one class of Party/Parties dominate the vote. We are satisfied that the appropriate checks and balances have been considered and that this new process is an improvement on the current BSC arrangements. The ability of parties to remove directors where necessary supports the promotion of efficiency in the BSC arrangements.

NED remuneration

BSC modification P303 was raised in May 2014 and sought to enable all BSCCo NEDs to be remunerated, as determined by the Chair. Currently, only directors who are considered to be 'industry independent'¹⁵ are entitled to receive remuneration (as may be determined by the Chair). When making our decision on P303, we set out that we did not consider that a case for remunerating 'industry' directors¹⁶ had been made or that a defect in this area had been clearly identified. We set out that it was therefore not clear to us at that time that this proposed change would better facilitate the applicable BSC objectives.¹⁷ We commented that the Board and Panel's broader Elexon Governance Review had not yet concluded, and that this may have wider implications for the Board arrangements.

P324 Proposed goes some way to more closely examine the case for enabling 'industry' director remuneration. We are content that the analysis within the FMR¹⁸ indicates that a wider talent pool would be available if some level of remuneration was available for the role, at the Board's discretion.¹⁹ In the context of the broader reforms being introduced by P324, a direct line of accountability to BSC parties will be established, via voting on binding and non-binding resolutions, and this should ensure that if parties are dissatisfied with BSCCo Board remuneration levels, there is a mechanism for this to be addressed.

¹⁴ Voting by Trading Party Group according to funding share, with votes allocated to NGET and Distribution businesses.

¹⁵ Where, in the Nomination Committee's reasonable opinion (having regard, among other things, to any present or future business interests disclosed by those individuals), the director is suitably independent from the electricity industry, in accordance with BSC C4.1.3(c).

¹⁶ Directors with 'relevant industry experience', in accordance with BSC C4.1.3(b).

¹⁷ We approved the alternative modification which amended the BSCCo Board arrangements but not the availability of remuneration for directors.

¹⁸ See Appendix 2 of the FMR.

¹⁹ P324 amends the existing provisions such that director remuneration is determined by the Board rather than the Chair.

We note that one consultation respondent considered that there should be a more defined process for setting 'industry' director salaries, and they felt that this should be considered in a timely way in order to give BSC parties confidence that any remuneration is reasonable. We agree that due consideration is required in respect of the process and principles for determining director remuneration. While there are no immediate costs associated with the implementation of this change, it could result in a higher wage bill for the BSCCo estimated in the FMR as being up to £90,000. We anticipate that the decision to remunerate directors will be taken on a case-by-case basis and the benefits of doing so should be evident against the costs involved.

Board role and composition

We generally support moves to delineate certain decision-making roles between the BSC Panel and BSCCo Board, with the aim of achieving more timely and effective decision-making. However, we also recognise concerns raised by one consultation respondent that the new provisions do not provide parties, or the Panel, the opportunity to vote on the BSCCo Strategy.²⁰ Despite removal of the Panel role in approving the BSCCo strategy, scrutiny of the proposed strategy by both the Panel and parties should remain an important part of the process, and a consultation process in this respect is provided for. We also note that P324 removes the requirement for consultation with the BSC Panel in respect of director remuneration, and the Panel's oversight of the Nomination Committee Terms of Reference. However, the new checks and balances being introduced by P324, by way of the party voting mechanism on binding and non-binding resolutions, should be effective in ensuring that the Board continue to act in the best interests of BSC parties.

P324 introduces the ability to appoint up to two Executive Directors, provided that one is the CEO, and it is reported in the FMR that such appointments would serve to increase Executive accountability to BSC parties. One respondent did not agree that Executive Directors should be appointed to the Board, commenting that they should attend meetings but not vote. We note that P324 does not require Executive Directors to be appointed and this would be at the discretion of the Board. Given the ability of BSC parties to remove directors from the Board, the benefits of any Executive Director appointment should be clear and transparent.

Chair role and remuneration

P324 will create a separation of the roles of BSC Panel and BSCCo Board Chair, although it does not mandate that the roles be undertaken by different people. We agree that separately defining these roles is appropriate under the new governance rules which, among other things, aim to more clearly define the roles of the Panel and Board. We recently approved the reappointment of the BSC Panel/BSCCo Board Chairman and do not consider that any immediate change to this arrangement is required, however, this can be considered for future Chair appointment processes.

Given the changes being introduced by P324, and recognising earlier amendments to the Panel Chair appointment process introduced by Ofgem's Code Governance Review²¹ and P281, we no longer consider it necessary that the Authority retains a role in setting the Chairperson's remuneration, and removal of this step under P324 is appropriate.

²⁰ Under the existing arrangements the strategy must be approved by the BSC Panel, and this approval role is being removed.

²¹ <https://www.ofgem.gov.uk/publications-and-updates/code-governance-review-final-proposals-4310>

CMA Code Governance Remedies

In June 2014 we issued our decision to refer the retail energy market to the Competition and Markets Authority (CMA) for investigation.²² The CMA published its final report in June 2016.²³ The CMA found that a number of features of the energy markets related to industry code governance give rise to an adverse effect on competition (AEC), through limiting innovation and causing the energy markets to fail to keep pace with regulatory developments and other policy objectives. The CMA has recommended a number of remedies to address this AEC, including a recommendation to BEIS²⁴ to make the provision of code administration and delivery services activities licensed by Ofgem.

There is further work required to implement this remedy; we will support BEIS on delivering the required legislation, and consult with industry to develop the detail of the new licensing regime and related code governance remedies. We recognise that implementing these remedies could result in further changes to the BSCCo's governance arrangements. However, we consider that the changes under P324 are consistent with the direction of travel of the CMA's remedies in this area and are a beneficial step towards delivering the more fundamental reforms to the wider code governance arrangements.

Decision notice

In accordance with Standard Condition C3 of NGET's Transmission Licence, the Authority hereby directs that modification proposal BSC P324 Proposed: '*Review of BSCCo's governance: introducing improved accountability to BSC Parties*' be made.

Lesley Nugent

Head of Industry Codes and Licensing

Signed on behalf of the Authority and authorised for that purpose

²² https://www.ofgem.gov.uk/sites/default/files/docs/2014/06/state_of_the_market_-_decision_document_in_ofgem_template.pdf

²³ <https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf>

²⁴ Department for Business, Energy and Industrial Strategy