

Modification proposal:	<b>Balancing and Settlement Code (BSC) P362: Introducing BSC arrangements to facilitate an electricity market sandbox</b>		
Decision:	The Authority <sup>1</sup> directs that this modification be made <sup>2</sup>		
Target audience:	National Grid Transmission Plc (NGET), Parties to the BSC, the BSC Panel and other interested parties		
Date of publication:	20 August 2018	Implementation date:	5 days after publication date

## Background

The energy industry is experiencing rapid developments in technology, products and services. There is a need for more flexible arrangements to enable new business models, services and technology to be trialled and tested. To support innovation, Ofgem created a regulatory sandbox for small-scale innovative propositions to be trialled. However, the scope of this sandbox is limited by Ofgem's remit, and does not extend to industry codes.

The breadth of innovative propositions we are currently witnessing has revealed a need to adopt a joined up approach across the regulatory framework. In January 2018, we invited all industry code chairs to discuss innovation and a wider adoption of the sandbox approach. We further engaged with all code administrators' panels.

Under the current BSC framework, provisions do not exist to enable pre-competitive or proof of concept testing for innovative products or business models in the live BSC Settlement environment. The current BSC arrangements can pose a barrier to innovative business ideas.

An existing BSC modification process exists to enable proposed changes to the code to be developed and decided upon. This process is not designed for trialling innovative proposals. A new process would be needed to enable relevant parties, where appropriate, to be exempted from specific BSC obligations to trial innovative products or ideas for a fixed time period at a small scale.

## The modification proposal

Elxon recommended to the Panel, at its meeting on 9 November 2017, to raise modification P362 to introduce a sandbox and derogation process into the BSC. The Panel agreed to raise P362 in accordance with BSC Section F2.1.1(d).

The P362 Proposed Modification allows industry participants, that have pre-competitive innovative products or services but are facing barriers to entry, to seek derogation from relevant BSC obligations, in order to test and develop a product or service for a fixed time period. The key elements of this proposal are:

- Applications for a derogation will be made to Ofgem, which will act as the single point of access to coordinate applications across the industry. Ofgem will pass successful applications to Elxon. This process is designed to ensure that Elxon's resources are only applied toward relevant proposals.

<sup>1</sup> 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.

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

- Elexon will assess applications against eligibility criteria, which consider potential risks and impacts of granting a derogation.
- Anyone (other than Elexon) can apply to the electricity market sandbox, including non-BSC parties. However, if successful, such parties will have to accede to the BSC for the derogation(s) to take effect.
- The process aims to be faster and more flexible than the existing code modification process.
- Derogations provided in the electricity market sandbox are time and size limited, with a focus on testing, learning and implementing outcomes if successful.

The P362 Proposed Modification does not allow for Elexon or National Grid Electricity Transmission Plc (NGET) to apply for and be granted a BSC derogation in the electricity market sandbox.

The P362 workgroup developed an Alternative Modification to the P362 Proposed Modification. The P362 Alternative Modification is identical to the P362 Proposed Modification except that it also allows NGET to apply for, and be granted, a derogation in the electricity market sandbox.

### **BSC Panel<sup>3</sup> recommendation**

At the BSC Panel meeting on 12 July 2018, the BSC Panel recommended that the P362 Proposed Modification be rejected and that the P362 Alternative Modification be approved, as it would better facilitate applicable BSC Objectives<sup>4</sup> (c) and (d) as compared to the Proposed Modification and the baseline.

### **Our decision**

We have considered the issues raised by the modification proposal and the P362 Final Modification Report (FMR) dated 18 July 2018. We have also considered and taken into account the responses to the industry consultations, which are attached to the P362 FMR.<sup>5</sup> We have concluded that:

- implementation of P362 Alternative Modification will better facilitate the achievement of the applicable objectives of the BSC;
- directing that P362 Alternative Modification be made, is consistent with our principal objective and statutory duties.<sup>6</sup>

### **Reasons for our decision**

We consider that both the P362 Proposed Modification and Alternative Modification will better facilitate BSC Objectives (c) and (d) and have a neutral impact on the other objectives. We consider that the Alternative Modification best facilitates BSC Objective (c).

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<sup>3</sup> 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](http://www.epr.ofgem.gov.uk)

<sup>4</sup> As set out in Standard Condition C3(3) of NGET's Transmission Licence: <https://epr.ofgem.gov.uk>

<sup>5</sup> BSC modification proposals, modification reports and representations can be viewed on the Elexon website at [www.elexon.co.uk](http://www.elexon.co.uk)

<sup>6</sup> 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.

***(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***

The proposer and the majority of the workgroup considered that both the P362 Proposed Modification and Alternative Modification facilitate BSC Objective (c) on the basis that the electricity market sandbox would allow for the trialling of innovative ideas from more companies and should therefore increase competition.

The minority of workgroup members were neutral against BSC Objective (c) for both the Proposed Modification and the Alternative Modification. With regard to the Alternative Modification they were of the view that any benefits were outweighed by potentially negative impacts on competition introduced by allowing NGET to trial products or services, which may not benefit all participants. However, we understand they considered that appropriate checks and balances have been put in place to mitigate this risk.

A minority of workgroup members believed the Alternative Modification was detrimental against this objective and raised concerns about monopoly entities, such as NGET, applying for derogations that may give certain companies an unfair advantage.

We welcome the introduction of the electricity market sandbox. We agree with the proposer and the majority of the workgroup, that a sandbox further enables the extent to which innovative propositions can be trialled in the energy industry. Allowing both BSC and non-BSC parties the ability to apply to the electricity market sandbox may promote competition by broadening the scope of applicants and ideas. The sandbox therefore, further facilitates BSC Objective (c). We believe that any concern regarding certain companies getting an unfair advantage are mitigated by the processes detailed in the Modification. By design, trials must be small-scale, time limited, and will report (non-commercially sensitive) results to Elexon, which would be published and shared with industry.

We consider that the Alternative Modification facilitates BSC Objective (c) better than the Proposed Modification as it allows for greater participation. Therefore, it has an increased chance of enabling innovative products and services to be trialled, which could better promote competition. We think that concerns over applications being made by NGET are mitigated by the process detailed in the Modification. The Alternative Modification has a number of stages for review, before, during and after an application is made to the electricity market sandbox, with Ofgem being the point of entry for applications. Any derogation would require a Panel recommendation and the Authority's agreement.

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

The proposer and the majority of the workgroup agree that both the P362 Proposed Modification and Alternative Modification would better facilitate BSC Objective (d) as they could enable small-scale trials with no material impact on the rest of the industry, allowing Elexon and industry resources to be focused elsewhere. They considered that if enduring code changes are the output of successful trials, then more information about the solution and any impacts will be known in advance, facilitating a more efficient modification process.

The minority of the workgroup and respondents were neutral against this objective as they believed that any efficiency gained was balanced out by the cost of administering the electricity market sandbox.

We agree with the proposer and the majority of the workgroup that allowing for time restricted small-scale trials may be an efficient way of learning from and testing

alternative arrangements. Learnings gleaned from trials should also enable a more efficient modification process, should a trial lead to an enduring code modification.

The electricity market sandbox will require resource from Elexon to administer. Ofgem will act as a gatekeeper for applications, which is expected to reduce administrative burden for Elexon. Additionally, the Modification allows the Panel to set an application fee if required (currently set to zero) to recover costs if the volume of work becomes significant. We think this is a reasonable approach.

### **Decision notice**

In accordance with Standard Condition C3 of NGET's Transmission Licence, the Authority hereby directs that Alternative Modification proposal BSC P362: 'Introducing BSC arrangements to facilitate an electricity market sandbox' be made.

**Philippa Pickford**

**Interim Director, Future Retail Markets**

Signed on behalf of the Authority and authorised for that purpose