Balancing & Settlement Code Panel

3rd April 2024

Dear Ofgem

CONSULTATION ON THE IMPLEMENTATION OF ENERGY CODE REFORM

As Deputy Chair of the BSC Panel I have pleasure in submitting the Panel's response to this important consultation. I am leading this to avoid any potential conflict, or perception of a conflict, with Sara Vaughan's role of Elexon Chair.

Recognising the huge challenges ahead in changing the governance of the Codes, the Panel believes it can offer a lot of constructive advice – several Panel members were personally involved getting NETA going, and many others have been part of complex industry restructurings. Our comments are made to help the programme deliver its objectives.

It is unfortunate that the Licence Condition and Secondary Legislation consultation was launched after this one; while we are pleased that some of the deepest concerns expressed here are now being met, we feel that we should be responding to each consultation as it stands.

Overall, while the proposals being consulted on here are largely supported by the Panel, we are deeply concerned that as an *implementation* plan, it is missing too many important details. The 'how' is just as important at the 'what'. In particular, the lack of timescales mean that it is impossible to gauge whether it is practical, or to be able to suggest what is needed to make it happen in the overall time set out by primary legislation. Some obvious external influences on this programme, not least the 2024 General Election, and REMA cannot be avoided.

You will be aware that NGESO is represented on the Panel through its Panel Member; please note that this response does not contain or imply any views from NGESO/FSO because it will be making its own separate response.

Unless explicitly mentioned, the responses represent the views of the great majority of the remainder of the Panel, excluding the NGESO Panel Member. For obvious reasons, the Ofgem Panel member has also recused themselves.

We welcomed the Ofgem teams at the Panel's February meeting and felt the discussion on these proposals was very productive. In that spirit we would be very happy to discuss any of the points made in this response or answer further questions if appropriate.

We are content for our response to be made public.

Yours sincerely

Dr. Phil Hare

BSC Panel Deputy Chair

Section 2

1. Do you agree that we should recommend to the Secretary of State that the 11 industry codes listed (including the SQSS) should be designated as "qualifying documents" for the purposes of using our transitional powers in the Energy Act 2023 to deliver energy code reform?

We agree that the 11 industry codes listed (including the SQSS) should be designated as "qualifying documents" in line with our responses to previous consultations.

2. Do you agree that we should recommend to the Secretary of State that the 5 central systems listed (including the Central Switching Service) should be designated as "qualifying central systems" for the purposes of using our transitional powers in the Energy Act 2023 to deliver energy code reform?

We agree that the 5 central systems listed should be designated as "qualifying central systems" in line with our responses to previous consultations. We note that this is consistent with the end-to-end business model that has operated well over many years in the BSC.

Section 3

3. Do you agree with the monetised costs and benefits set out in the accompanying draft impact assessment (i.e. the quantitative analysis)? Please specify if you think there is any further evidence that we should consider.

It is difficult to make a clear judgement because of the lack of sufficient detail provided. However, based on what we have seen, various concerns have been raised by Panel Members. At a general level: 1. For consistency (and pertinent to Q15), the impact assessment should include the BSC and REC; 2. The NPVs have a surprisingly large range, suggesting a particularly wide range of inputs and risks underpin the evaluation – so these should be detailed. 3. The CBA needs to explain how the uncertainties arising from REMA are taken into account. 4. There is no clear exposition of the risks to the implementation programme. Arguably, given the point where we have reached, this would be far more informative than a CBA. The risk register should be published and consulted.

On a more specific level:

1. The costs appear to be missing the industry's costs, legal costs, and any consultancy costs needed for implementation. These are highly likely to be substantial.
2. Grossing up by 50% to take account of the CMs' new roles and responsibilities seems arbitrary and high, which would then overstate the benefits.
3. The basis for estimating Parties' costs of Code interface looks very arbitrary, and the 2.5% of SGA looks very high. Parties should be asked for their figures.
4. Footnote 23's comment about not including the costs seem to be allowing the evaluation to make arbitrary decisions based on how far the process has progressed. Surely the assessment should be based on the overall costs.
5. It would be very helpful to have some context to take an opinion on the number of Ofgem FTEs working on Code Governance. How many are there today, compared to the estimated 50. And what is the profile of the 50 over time?
6. On the consequential Mod reduction, this sounds reasonable, but it will take a long time to get there. Different Codes will be affected in different ways – and the work will still need to be done even if it's under one Mod number. Paragraph 2.17 states "significant" savings, which doesn't sound right.
7. The savings figure should be stated explicitly.

4. Do you agree with the hard-to-monetise costs and benefits set out in the draft impact assessment (i.e. the qualitative analysis)? Please specify if you think there is any further evidence that we should consider.

We recognise that the qualitative impacts are difficult to assess, but also that they can help to form an overall view and complement the numerical evaluation.

Nevertheless, we have some concerns:

1. In the third of the design principles, "minimising disruption" should be removed as this concerns the implementation process rather than a design principle, and the evaluation re-done.
2. It needs much more detailed description of the counterfactual against which the assessment is being made (including alternatives that would involve selected low-cost ways of realising the benefits)
3. There should be explicit evaluation of potential impacts on REMA in this assessment.
4. While we like the ambition of turning the qualitative assessment into numbers, it would be very helpful to have a commentary as to whether the changes to the totals are material, or not.

5. Do you agree with our preferred option to consolidate the CUSC and DCUSA to form a unified electricity commercial code?

The Panel has supported Code consolidation in general, so would be supportive of this proposal, but with the caveat that the Codes are complex legal agreements, and that therefore consolidation will not cut out their complexity.

We have deep concerns about the lack of detail of any process to consolidate the two Codes. It needs to be defined properly to take an opinion on what is achievable and give far more concrete opinion on what "merging" these Codes will mean at a practical level.

For example: given that Ofgem wanted Code Reform to make it easier for parties to engage with Codes – notably new entrants or smaller companies – *how* the new Codes are applied will be critical. If we consider a small Genco that signs up to the DCUSA to access the DNO and then has a Bilateral Embedded Generator Agreement to be in the Balancing Mechanism. How will it be clear to it what applies to it in the combined CUSC/DCUSA Code?

6. Do you agree with our preferred option to consolidate the Grid Code, STC, SQSS and Distribution Code to form a unified electricity technical code?

The Panel has supported Code consolidation in general, but with the caveat that the Codes are complex legal agreements, and that therefore consolidation will not cut out their complexity.

We have two general concerns about this four-way merger:

1. Apart from the consolidation of boilerplate sections it is likely that this will turn into one enormous document instead of four very large ones. We do not believe that this will help Parties navigate their way through the Codes and may well create a barrier for small new entrants.
2. There are several aspects of the Grid Code that have a strong commercial implication – e.g. ramp rates. We would like to see these moved into the Commercial Codes (e.g. moving the dynamic parameters to the BSC). Other opportunities to "shuffle at the edges" should be considered and consulted upon. This could help smaller or new entrants by creating "a path of logic" as to where they will find certain matters of relevance to them.

7. Do you agree with our preferred option to consolidate the UNC and IGTUNC to form a new unified gas network code?

The Panel agrees with this, in line with responses to previous consultations. However there has to be a benefit that goes beyond having fewer numbers of Codes and not just making them bigger.

In considering the merger of these two Codes, Panel members noted the need to avoid greater burden on the IGTs who may be less well-resourced than UNC members.

Overall, the Panel felt that it needed to have a much more detailed view of the process of the merger to provide an opinion.

8. Do you agree with our proposals to rationalise the identified code provisions as part of any consolidation exercise?

Generally, we see this as a sensible thing to do, but Ofgem needs to set out the processes that it envisages to achieve this for the Panel to take a view on their feasibility.

Several Panel members were personally involved in the creation of both the BSC and UNC. These required the market to set aside 3-4 days in a week over several months to sit in a room with Ofgem and DESNZ (equivalents at the time) and lawyers and go through the drafting. As it is hard to see how this will be much different (arguably harder, given entrenched positions), Ofgem and Government must make the commitment to lead it and outline the processes in advance – otherwise we have great concerns that they will extend for many years.

Section 4

9. Do you agree with our proposal to publish the first SDS for all codes next year (before code managers are in place)?

We completely agree with publication of the first SDS for all codes next year.

This is because of the value for all concerned in seeing it as early in the process as possible to get a rounded picture of what the SDS means in practice. Mindful that Code Mod prioritisation is likely to be specifically addressed in the SDS, we are currently thinking it can be pragmatically delivered under existing BSC governance. At least seeing the SDS early this would enable us to be confident.

However, we do have some concerns that the early Codes shouldn't be disadvantaged. So, for example, Ofgem shouldn't be looking to enforce Delivery Plans when only a couple of Codes have to produce them.

10. Do you have views on the proposed SDS process?

We understand that the SDS does not require publication of an SPS first.

However, while we are still waiting for the outcome of the SPS consultation (which closed in August 2023, so over six months ago) we reiterate our concerns that the draft SPS was limited in its steer at an operation level.

The SDS will need to be as specific and detailed as possible – and ideally outcome based – to help "operational level" implementation.

It would be helpful to have a clear statement as to whether the SDS will remain with Ofgem or move to NESO.

11. Do you agree with our proposal that a principles-based standard condition for gas and electricity licensees would support the development and delivery of code modifications related to the SDS?

We agree with this approach, because it will be impossible to define every eventuality – a principles-based approach gives far more flexibility and allows the Code Managers to achieve the required aims in the most practical and pragmatic means available to them. It is also important for Code Managers and Ofgem to achieve the co-operation of gas and electricity licensees and this will help with that aim.

We believe that it is also likely to make the SAFs more effective, giving them a suitable level of flexibility, which following specific prescribed wording would not.

We do have some concern that Ofgem's obligations need to be mirrored. The slow progress of Code Reform is no reflection on the Codes, but it is hard to ignore that we are now almost eight years on since the CMA published its recommendations in 2016 and six years since the Codes Review's Terms of Reference were published. The danger is that the market environment moves so much that the original intent becomes far less relevant – as may well be happening now as momentum on REMA builds.

Section 5

12. Do you agree with our preferred option for how a Stakeholder Advisory Forum should be constituted?

We are pleased that Ofgem has listened to the concerns about the engagement of the industry and hope that this is going to be covered in Licence Conditions and Code Provisions (4.26 and 4.27).

It is heartening that we are going in the direction of the BSC model as it has always worked well, and the Panel gets huge value from expertise of varied participants including independents, academics and Citizens Advice.

However, we want to see much more detail on the proposed role of the SAFs. They should have aligned objectives and balanced membership (see later for context of SAFs' authority).

The Panel sees merits in the SAF having an independent chair, who needs to be chosen by the SAF itself. However, the SAF Chair role shouldn't be excluded from that of the Code Manager Chair; the reason that the BSC Panel has gone down this route for the last several years is because the Panel has felt that this arrangement is very efficient and effective, and that any conflicts can be dealt with where they arise. Panel members have recognised the value in having a Chair with industry experience and believe this would also apply to the SAF Chair role.

In the previous consultation we noted the important role of Panel sub-committees – e.g. the PAB and the Credit Committee in the BSC – but the way in which these roles would be taken forward is not considered.

We will also need a firmer proposition on the degree to which the CM has to adhere to the SAF's views (to inform the rationale behind the SAFs' constitution) and what options are open to it in the case of disagreement or other concerns that the SAF has in relation to the CM's actions (or inactions) in the operations of the Codes. Otherwise, the Parties will require Ofgem to intervene and adjudicate regularly in an *operational timescale.* This also raises the importance of having appropriate appeal channels – so how would appeals work when Ofgem is already involved? Panel members have suggested that there is merit in reviewing the current appeals processes (which are an important facet of our industry governance) rather than simply translating them into the new structures.

It is worth recognising that, in the proposed arrangements, the CM will be providing secretariat and many other resources to the SAF (including modifications workgroups, for example) to enable its operation. While it is probably inappropriate to have the SAF directly involved in the budgeting process, it will be important to ensure that it is adequately supported.

Finally, we have some general concerns (which already exist in the current set up) about filling the SAFs with suitable expertise – in recent years many companies have cut their resources, many experienced industry people have simply stopped working, and requiring smaller players and new entrants to provide people could be counterproductive.

13. What are your views on i) a requirement to assess the greenhouse gas impact of code modifications with updated guidance, or, ii) introducing a 'net zero' code objective?

We are more comfortable with having a 'net zero' code objective, but it will need a clear definition of the process required to assess it and clear guidelines on its relative importance to other Code objectives. Otherwise, it is unlikely to have a meaningful impact on decisions especially when several objectives are being considered.

14. Do you agree with our proposal to extend and harmonise the ability of code panels to prioritise the assessment of code modification proposals?

We broadly agree with the principle of prioritisation – some Panel members noted that the recent changes in the CUSC seem to be working sensibly. Nevertheless, the Panel believes that the BSC already has effective processes for nominating and progressing Urgent Mods, and it is not really clear why harmonised arrangements would be any better.

While we agree that limitless resources are not an option, it does concern us that the For-Profit Codes may de-prioritise some Mods because of the different pressures that being "for profit" imposes on them. Some Panel Members expressed concerns that prioritisation may be used by CMs to relegate small players and new entrants permanently to the back of the queue – effectively curbing market innovators and disruptors when they are very much needed. Suitable checks and balances need to be put in place (ideally within each Code, and without recourse to Ofgem) for prioritisation to work.

Enduring arrangements for prioritising will need suitable checks and balances on the Code Manager to be put in place. Unless Ofgem proposes to be directly involved at this operational level, it is inevitable that the SAF will have wider governance involvement than just advising on Modifications. We don't want a situation where a CM uses prioritisation as a means to thwart SAF support for a Mod, for example. We look forward to more detail on the remit of the SAF in future consultations.

Section 6

15. Do you agree with our proposal to adopt a phased approach to transitioning codes to the new governance model?

We make our comments only in relation to documents issued in this consultation but are mindful that some of the issues with which we express most concern are dealt with in the Licence Condition and Secondary Legislation consultation subsequently issued.

While we agree in principle with a "phased approach" to transitioning the Codes, because it will avoid overloading Ofgem, DESNZ, the Code Bodies and the Parties, more consideration should be given to issues that affect all Codes and therefore represent critical paths to the overall programme:

1. Choice of business models (for-profit, not-for-profit) should be explicitly dealt with upfront – it fundamentally affects the governance arrangements and licence conditions. This is not mentioned anywhere in the document.
2. As it is likely that all Code Bodies want to be involved in the early movers' Licence drafting, notwithstanding the above point, is it realistic to develop a licence condition for the first Codes and then adapt it for the later ones to eventually have a licence condition that applies to all CMs?

Ofgem should review the programme for other "critical paths".

In addition, the selection of the phased approach needs to recognise the time/effort to develop Code Manager licences – Ofgem needs to set up timescales for the phases. We are concerned that at this point we have far too little detail on how the approach will work, the input from the market, the legal resourcing, etc.

At this point in the overall CGR programme, we recommend that Ofgem reviews the potential for addressing easy wins to realise its ambitions. In a business situation many organisations would naturally adopt a "low hanging fruit" approach, for example asking the Code Administrators to align their objectives.

It will be worth considering how the current electoral/appointment processes will cut over to appointments in the SAFs. As in response to an earlier question we will need a firm proposition of how the SAF members will be chosen.

We have some concerns that a phased transition (which may take several years) may cause additional complications for cross-code modifications in a phased process. Recognising that simplifying cross-code mods was a major objective of the reform, explicit mitigations should be established early on in the programme.

Finally, Codes in the first wave should not be disadvantaged in any way and put in jeopardy.

16. Do you identify any strategic or operational considerations that might inform the transition sequence?

The Panel believes that there are many considerations that have not been picked up.

There needs to be a clear evaluation of the relative benefits of the sequence. While we can see the merits of putting the standalone codes first, the proposals appear to be putting the steps with the biggest benefits to the back of the programme. Surely there is a case for getting benefits as early as possible?

We are deeply concerned that, without a clear timeline for each phase of the implementation, the plans are deeply flawed. With a clear time-limit in the Energy Act, this is a major omission; it means that many important issues such as programme risks, resource requirements (in Parties and at Ofgem and DESNZ), and many critical paths etc are simply going to be missed. For example, the plan needs to recognise the potential for delays arising from a 2024 General Election.

Even in the absence of timelines, given the tenor of the consultation, we suspect that Ofgem is seriously underestimating the time and effort (and cost) to make the changes (noting the "bunker" type regimes that had to be used in developing the Network Code with locked rooms/long nights). Ofgem staff will be required to be far more involved in a live process making real-time decisions.

The likely great effort to interact with all Parties needs to be recognised and allowed for (e.g. changing commercial contracts). And has Ofgem considered how to get input from those parties "not in the room"? – i.e. potential new entrants and business model disruptors.

Given the time to develop this consultation, we would have expected far more detail on how the programme would be organised and resourced. For example, is Ofgem going to use an external project manager as we did for NETA?

In Panel members' experience (e.g. corporate post-merger integrations), many successful transition projects were successful because the final players knew who they were early on – they then supported the transition rather than obstructed it (sometimes very effectively). Ofgem should consider appointing the final CMs at the front of the implementation programme.

While we agree with the Ofgem's rationale that the BSC and REC are most likely to underpin REMA, we don't think this represents an overriding need to transition them first (see answers to Q15).

17. What are your views on our proposed transition sequencing?

Notwithstanding our views on the Impact Assessment, the proposed sequence appears to be pushing the estimated benefits to the back.

As stated in our response to Q15, we have some sympathy for doing the standalone Codes first to "pilot" the Licence, SAF constitution etc. However, all the Codes will have a legitimate interest in developing Standard Licence Conditions, and in taking this into consideration may negate any apparent simplicity of doing REC and BSC first.

This complication will be further compounded by omission of a decision on the business model being followed by each CM. Although we have long argued for a not-for-profit model for all Codes, even if it is proposed to have for-profit CMs as well, their Licences and governance principles are likely to be quite different. We suggest that having a clear view on the business model should be an early step (noting that this may well align with our view on early appointment of the CMs as mentioned before).

Effective implementations usually work best when those involved are driving them forward rather than resisting them – in that regard, we would suggest that it would be better to appoint the CMs at the front of the process. Some Panel members continue to have concerns over NESO's role as a CM – worrying about actual or perceived conflicts of interest, although others argue that these ought to go away once NGESO transitions to NESO. A Panel member suggested that the efforts to engage in Code Governance Reform may distract NESO in making the transition from NGESO.

18. Do you have any other comments on how Ofgem should approach the implementation and transition process?

It would be good to see Ofgem commit to reducing the length of Codes while merging them. For example, with single definitions, etc. across each Code. Ofgem could also set out how it intends over time to make sure some of the processes across Codes are aligned, for example the accession process and credit requirements, etc.

As stated before, the implementation plan needs timescales alongside it. Only with timescales for each phase will it be possible to consider the full range of risks, critical paths, resourcing requirements and the full range of internal and external factors that affect the programme. The validity of the timings needs to be explained in the context of progress to date as a common-sense check on their realism.

We have concerns about how Ofgem ensures that its institutional learning is maintained during this programme, and how it draws on the experience of previous transition programmes (either internally or from the industry). It would appear that Ofgem plans to take on many new staff to deliver the CGR programme, but it is important to avoid "reinventing the wheel", and to make sure that there is some sense of practicality and pragmatism in the face of persuasive organisations arguing their own case. Many Panel members have expressed support for the "bunker" approach taken in NETA.

Any other thoughts/comments (e.g. omissions)

Ofgem needs to provide far more detail on the "how" this implementation will work if it is to be credible. For example:

1. An internal and external resourcing plan and outline budget (including legal support) to meet the time objectives

2.Including a comparison against the historical pace of the Code Governance Reform so that it can pass the "sense test" as to its plausibility.

3. A comprehensive assessment of programme risks and mitigations

4. A view on how the programme management structure will look like

The biggest omission is probably the choice of for-profit vs not-for-profit business model for Code Managers – this fundamentally affects so many aspects of the reform.

In this context, we have concerns that the wider governance role of the SAFs needs a lot more consideration – for example the position of sub-committees (e.g. in the BSC, the PAB and Credit Committee) and how they will be dealt with, the implications of limiting the SAF to just advice on Mods, and the degree to which CMs have to take heed of the SAF. Without the SAF acting as a check and balance on the CM, Ofgem will inevitably have to step in more frequently in operational timescales, and everyone will need the assurance that it can and will.

We reiterate our concern that there needs to be a general principle of no detriment from going earlier.