

Balancing & Settlement Code Panel

Industry Code and Licensing Team
Office of Gas and Electricity Markets
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By email to industrycodes@ofgem.gov.uk

February 2023

Dear Ofgem,

ENERGY CODE REFORM: CALL FOR INPUT

We attach the BSC Panel's contribution to the above call for input.

The BSC Panel remains highly supportive of the aims of the Energy Code Reform (ECR) project, as the industry faces the challenges in the energy transition. However, it does have concerns at the lack of progress. With the current state of the retail market and the many significant industry changes needing to be implemented in the coming years, such as Market-wide half-hourly settlement and, we assume, the results of REMA, we also have serious doubts over Parties' ability usefully to engage in this programme. The outlook for increasing the pace seems unlikely.

More than seven years have passed since the ECR initiative started at the Competition and Markets Authority and there is now a risk that a disconnect has been introduced between the problems that ECR was trying to address and some of the previously identified solutions. It would be worth reconsidering the cost/benefit balance in several areas and the potential impact on the outcomes that the ECR programme is seeking to deliver.

There are certain aspects of the proposals that will necessarily go ahead, like the licensing of Code Managers (CMs) and Ofgem's ability to direct those CMs to deliver on certain requirements. This ability to command and control the work of CMs in itself should deliver many of the benefits that ECR was seeking to achieve. Other benefits are less obvious, for example the supposed advantage of Stakeholder Advisory Forums over the existing input provided by Code Panels: we believe that the value of the considerable "free" expertise offered by Panels is recognised, including by Ofgem, but we do not currently see in the call for input a coherent plan for their replacement. At this point in the programme the costs of Code consolidation itself should also be fully evaluated and considered in the light of the proposed benefits.

With the above points in mind, we urge Ofgem to take stock of the ECR initiative and revisit both the rationale and the approach, not with a view to abandoning it, but rather to review how it is best achieved. In doing so Ofgem should reassess the value in taking an incremental approach – to "re-align" Codes rather than make sweeping changes; to change the make-up of the Panels to address any concerns about Parties' influence on the Codes; to share best practice and to identify and correct specific issues in each Code. Ofgem might also look at whether there are useful learnings and benchmarks from other industry sectors which already been through the process of simplifying and modernising their 'Codes'.

We would be pleased to discuss our views in more detail.

The Panel is happy for its response, and this letter to be made public.

Yours sincerely



Sara Vaughan, FEI
BSC Panel Chair



Dr. Phil Hare
Deputy Chair

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RESPONSES TO DETAILED QUESTIONS

Please note throughout this response that views expressed as belonging to the "Panel" refers to the great majority of BSC Panel members.

CODE CONSOLIDATION

Q1: Do you agree with the design principles proposed to frame our assessment of code consolidation options? If 'no', please explain why.

We would comment as follows.

We do have some concerns about the rate at which Ofgem is developing its thinking on the Code Consolidation options. We had expected Ofgem at this stage to be consulting on detailed choices, given that almost a year and a half has passed since the previous consultation, and over seven years have passed since Code Consolidation was first discussed. Unless this pace is dramatically increased, there is considerable danger that much of the rationale behind the initiative will have been overtaken by changes in the market and the Codes' organisations.

At a high level the Panel agrees with the proposed design principles but we believe that the wording of the problem statement could be misleading, and raise false expectations in the proposed design principles. The Codes are multi-party agreements which exist to set out clear and detailed rules of engagement in markets that are becoming rapidly more complex with the introduction of new low carbon technologies and innovative business models. This is the primary reason for the Codes being complex. Their low-level rules have to set out, in a manner that is ultimately legally robust, the Parties' obligations to each other so that companies have confidence as to how the market arrangements will operate and can invest in them. It is far from clear how Code consolidation can reduce this complexity and we urge Ofgem to avoid the expectation that consolidating Codes per se will reduce their complexity to any material extent. Dumbing down the Codes may well lead to ambiguity in them – and potentially therefore to issues and disputes arising. Furthermore, there will be other contracts that are based on the rules within the Codes, which would also therefore need to adapt accordingly. This should be borne in mind when looking at the potential benefit arising from any proposed changes.

We suggest the design principles also need to take account of the following points:

- proper consideration of an appropriate span of control. Ofgem should incorporate principles of good organisational design and not seek to bring agreements together where this will lead to an over-broad and unwieldy result. In our view such an exercise would provide a more robust conclusion to the appropriate extent of consolidation.*
- efficiency of conducting daily business should be added to the design principles. We note that the entire document seems to omit the impact on the important day to day business conducted under all of the Codes (including Ofgem's roles) and including the sub-committees of the Codes.*
- the robustness of the Codes' governance from the perspective of their signatories. In order to invest in markets and strike contracts, the Parties need to have confidence in the checks and balances inherent in the Codes' organisations.*
- impact on progress towards and delivery of net zero is not mentioned explicitly; a Panel member suggested this should be included in the principles.*

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Q2: What are your views on the high-level options for code consolidation we have described ('no consolidation', 'vertical' & 'horizontal')? We welcome input on the possible benefits/disbenefits of each option.

Overall, the Panel supports the "Vertical" option, notwithstanding the points made below and in our answer to Q1.

Shared best practice, and avoidance of duplicated resources and activities, should also form part of this consideration. We would advocate a pragmatic step by step approach to consolidation where there are clear efficiency gains and a gradual clustering of Codes based on marginal benefits, rather than just looking at the end point. It is unfortunate that this document does not examine the routes to consolidation alongside taking a view on the final position.

As a general point, we believe that Ofgem should also include the factors against consolidation, or "over"-consolidation, so that it can reach balanced conclusions. The motivation to make the codes more agile, innovative and forward looking would argue against creating inflexible and unwieldy monolithic entities.

Merging the customer-facing Codes into the REC made sense mainly because of the way that the customer-facing retail market had developed into a dual-fuel approach and the similarities of customer protection in the gas and electricity sectors. However, such similarity does not apply for the codes that deal with the wholesale markets and the different types of networks. We do not favour the horizontal option.

The Panel maintains its view that some Code consolidation would be an improvement, where this brings benefits in accordance with the design principles (as revised in our answer to Q1) and so is less keen on the No Consolidation alternative. As explained in our answers to Q3 below, we suggest that the Ofgem explores the value in "reallocating" the scope of Codes, i.e. are there rules contained within one Code which actually better belong within another, to make them more coherent from different perspectives. Simply looking at shifting whole Codes is missing an opportunity to deliver improvements rapidly.

We have concerns that some of the Codes are highly technical and require very specialised expertise to manage them. Even if such Codes are notionally merged, the actuality is likely that they will continue to exist as sub-groups with little efficiency gain.

There is almost certainly considerable scope to improve each Code individually, and while we believe the No Consolidation option remains less desirable, Ofgem should not see the current situation as static – any comparison should include one in which each Code is improved in its own right. For example, many Codes have already embarked on digitisation to help parties navigate complexity, and many of the options Panels have to improve Codes in isolation are still open (e.g. in standardising modification processes to best practice).

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Q3: Do you agree with our initial preference to explore vertical code consolidation options and, if so, do you have any observations on the potential models set out in Cornwall Insight's April 2022 report? We welcome specific views on:

- **Whether the UNC and IGTUNC should be consolidated;**
- **If/how to consolidate the electricity codes;**
- **Whether the REC and SEC should remain separate; and/or**
- **Whether the consolidation of any codes should be prioritised, and if so, why.**

We are concerned that the Cornwall Report seems highly theoretical in its approach and that it missed considerations of suitable delivery pathways, implementation practicalities and the alternatives for "shaving" the Codes at the edges to create more alignment, particularly from signatories' points of view.

The Panel prefers the Vertical option, but has the following points:

- *To the extent that they use common systems we can see merits in merging the UNC and IGTUNC, but would recommend that arguments against doing this from the perspective of span of control and requisite expertise should also be examined – would this bring benefits to the signatories of the IGTUNC, or would this actually create greater complexity for them?*
- *The REC should not be consolidated with the SEC until it has operated for long enough to take a clear view on its track record. We would suggest that at least five years would be sensible to draw robust conclusions about its merits.*
- *Elxon and others have long argued for the value in first building commonality in the Codes in areas such as their modifications process and the Panel supports this. We urge Ofgem to incorporate this "low hanging fruit" incremental approach into its thinking instead of potentially exploring slow and unwieldy mergers of entire Codes.*
- *Rather than the theoretical considerations advocated in the Cornwall report Ofgem should explore alternative ways to work with the Codes so that alignment takes place more along the ways in which Code Parties organise themselves and their contents, i.e. examining which elements logically sit together (e.g. charging, connections, access). Market issues and network charging could be moved between different Codes, for example the BSC and CUSC.*
- *The Panel urges Ofgem to consider fully any potential conflicts of interest in merging of Codes. In this document, it appears that Ofgem believes these can be managed by licence conditions, but we believe this is more profound. Previously the Panel has only expressed concerns about conflicts where monopolies own a Code Manager, but the scope for such conflicts where the Code Managers are commercial entities could be far wider if Codes are merged.*

As a final point, it may be that lessons can be learned from comparable industry sectors that have faced similar issues. For example, in the internet sector, the initial focus was on setting common standards, enabling solutions to be kept local and innovative. Over time the most effective models prevailed without the need for excessive central oversight. The DNOs' data privacy process had many parallels and seems to have worked well. We have some concerns that this consultation (and previous ones) have offered little evidence on benchmarks and learnings from other sectors and, even at this relatively late stage, suggest that this could be of value if done.

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Q4: Do you agree with our preferred implementation approach (Option 2)?

- **If so, do you have any additional observations on what we should consider when further developing this approach, including which code provisions should be considered within the scope of governance arrangements?**
- **If not, please provide details.**

We support Option 2, but make the following comments:

- *combined Codes should have identical modification processes and Ofgem should look for best practice in determining these to drive out potential inefficiencies.*
- *delivery will need to strike the right balance between "getting it right" and "doing it fast". We are concerned that after seven years, these proposals do not look credible unless the pace is dramatically increased.*
- *the detail on governance arrangements is far too light to pass sensible comment. At a high level either Ofgem or the Parties need to make sure that the Code Managers are being effective; the general direction appears to be towards Ofgem (albeit that it will be Parties who are funding the Code Managers and so will have a strong vested interest in their effectiveness), but this needs to be explained. There should also be consideration of the make-up, remit and operation of the Stakeholder Forums as they will form an essential element of the industry governance structure.*

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CODE MANAGER LICENSING

Q5: Are any of the contents we have identified for the licence conditions unnecessary, or, would be more effectively covered outside of the licence (e.g. in the codes)?

While the Energy Bill now requires licensing to be in place, Ofgem still has considerable latitude to judge the appropriateness and nature of the licence conditions. In the context of the BSC and BSC Co Limited (Elexon), we note that many of the proposed licence conditions are already either in the BSC or covered by company law or Elexon Directors' responsibility for good governance; Ofgem should not replicate any of these in the Licences.

In relation to the application of incentives and penalties in licence conditions, these raise a number of issues. On the one hand, we would support Ofgem's own view as expressed in the recent consultation on the future of the DCC, in relation to a not for profit (NFP) model. This was that there should not need to be any explicit financial incentives on the organisation to drive quality of service and it was noted that incentive structures of complex operations can be difficult to design and imperfections can have unintended consequences. Further, that in a NFP model, it is expected that the [DCC] Board would be able to respond to the needs of [DCC] users through the accountability route, thus removing reliance on an incentive structure. This would also address the challenge of incentivising an asset light organisation like [DCC].

In addition, on incentives it is not right that Code Managers are paid extra for doing their job properly – and any gains made would just revert to parties (who were the original funders). Conversely, if penalties are levied, they will eventually work through the system into higher customer costs. This would also require the creation of regulation and compliance teams, at additional cost, to ensure that penalties were avoided. Finally, as a point of principle, we cannot support arrangements in which Parties, who will have to pay the penalties, do not control the management of the arrangements and the causes of the penalties.

In previous Panel submissions we voiced our concern that the process of a "Strategic Plan" issued by Ofgem with Code Managers then reporting on progress could easily turn into an expensive and unproductive cottage industry of Compliance reporting. Ofgem will have to issue a meaningful plan which has also suitable flexibility to be workable in turbulent external market conditions, yet be relevant to any compliance process. By way of illustration, Ofgem's current work plan is highly unsuitable for this process, as really being a broad indication of themes, rather than a plan against which progress and performance can properly be judged. We already have some evidence of the higher workloads that will be potentially carried by Ofgem and the industry from the size of the existing NGESO quarterly reports, that now run to over 100 pages.

Ofgem appears to be leaning towards a process of obliging the Code Managers to produce their own plans first rather than providing the "top down" industry leadership to coordinate the development of the Codes that was originally envisaged. It is hard to see how this can be an efficient, or effective process.

In considering how the Strategic Plan process will work, it is worth noting that historically Ofgem's workplan has failed to address key market issues like the lack of market liquidity over many years. The root cause of this is not the structure of the Codes, or the Code Managers, or the Panels, but is Ofgem's inactivity. We would ask that Ofgem provides more evidence to assure the market that its Strategic Plan will be workable and effective.

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Q6: Are there any additional areas that should be subject to licence rules?

Following the views outlined in Q5, we advocate a "light touch" approach in the licences.

Areas such as digitisation are already happening in many Codes, and we suggest that Ofgem re-evaluate the underlying need for many of the licence conditions it is suggesting as their origins are now well in the past, or are covered elsewhere, as already indicated above.

We believe that Ofgem also needs to evaluate the unintended consequences that licensing Code Managers can create. For example, the way it would function across Codes, with licence conditions in one Code potentially affecting changes in others.

Q7: Do you agree with our indicative prioritisation for policy development, and do you identify any specific dependencies that you think we should factor into our policy considerations?

In general, the priorities should reflect Ofgem's broad work programme, and we would urge Ofgem to focus its efforts on taking the Energy Codes Review forward. At the current pace there is a significant possibility that the original rationale for the Codes Review will have moved so much that the original problem has morphed into something very different or substantially disappeared.

As in our answer to Q6, we note that many of the topics are already in Codes, or corporate law or fall under good governance. We suggest that the first stage of this process should be to identify all the areas that would be duplicated and then remove them.

Notwithstanding this point, we broadly agree with many of the priority areas suggested. However, we have the following comments:

- the Corporate and Financial controls should not be an issue if you have appointed an independent professional Board, because this is just good governance.*
- certainly as regards the BSC, the Budget setting process is already in the Code, so this becomes a question of enforcement: whether this is down to Parties or Ofgem.*
- Conflicts of Interest are definitely important, but Ofgem should consider how they can be designed away by reallocating parts of Codes.*

We request that in considering responses to this question Ofgem also evaluates the motivations of the respondents (e.g. their business models, ownership structures etc).

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Q8: Are there any issues that we should take into account when considering moving the current 'code owner' licence provisions to the new code manager licence (such as unintended consequences)?

We agree that a condition of this sort should appear as a legislative basis for the Code Manager.

STAKEHOLDER ADVISORY FORUMS

Q9: What do you think the stakeholder advisory forums' key roles and/or functions should be, and what areas (other than code change) should the forum(s) potentially have a role in?

There is far too little detail in the document to provide meaningful comment. Given that almost a year and a half has passed since the previous consultation we are somewhat disappointed to find this. Stakeholder Advisor Forums were proposed as a solution to the Parties' perceived unhelpful involvement in Code Governance many years ago. We expected far more advanced proposals at this point.

Nevertheless, we have several general comments that build on many of the points that the Panel made in the previous consultation:

- *The benefits to the industry of the Panels and the work they do (including a lot of day to day operations) need to be fully evaluated. Most of this wide-ranging and deep industry expertise is given without cost, and it is likely that this would be significantly lost in the move to Stakeholder Advisory Forums as currently envisaged. Ofgem needs to consider how this deep level of expertise will be retained. Would they need to be paid?*
- *"Advisory" suggests a lack of executive responsibility, but there is a fundamental need for the governance role occupied by the Panels. The industry values the checks and balances they provide to give Parties assurances that any changes to the Codes are appropriate. New entrants and innovators need to know that the industry is not dominated by, for example, large parties or well-funded lobbyists. It will not be satisfactory for this simply to become a free-for-all of who shouts loudest or is best funded, or to transfer this governance responsibility to the CMs which may have their own interests, or simply lack capability and capacity to carry it out. Ofgem needs to explicitly examine the governance structures involved in the move to SAFs.*
- *All the Codes need to have checks and balances in them. Many do this through constitutional requirements of the Panels in the Codes to have members from different sectors of the industry as well as independent members and, in the case of the BSC, Citizens Advice. To avoid the danger of the SAFs just being populated by parties directly affected by an issue, or not bothering to turn up when they are not affected, we recommend that the SAFs have enduring formal constitutions and prescribed membership requirements and that Terms of Reference are drafted for each of them.*
- *Ofgem needs to provide suitable assurances that it too will have the operational capability and capacity to engage more in the operational affairs where the Panels currently provide something of a "buffer" between it and the Code Manager. In the BSC, areas such as Performance Assurance, Credit Committee, Dispute Resolution and "Section H" financial defaults are largely dealt with by the Panel, occasionally being referred to Ofgem for final approval. While Ofgem might envisage simply placing these responsibilities on the Code Manager, we would expect that Ofgem's final adjudication will be called on far more often. As these are operational matters where time is of the essence, Ofgem will find its current response times unworkable.*

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Q10: What options/issues should be considered in terms of constituting the stakeholder advisory forum(s), in terms of membership and securing appropriate representation?

As stated in our response to Q9, there is far too little detail in the document to provide meaningful comment. Given that almost a year and a half has passed since the previous consultation we are somewhat disappointed to find this. Stakeholder Advisor Forums were proposed as a solution to the Parties' perceived unhelpful involvement in Code Governance many years ago. We expected far more advanced proposals at this point.

We restate some of the points made in our response to Q9.

All Codes should have checks and balances in them. Many do this through constitutional requirements of the Panels to have members from different sectors of the industry as well as independent members and in the case of the BSC Citizens Advice. To avoid the danger of the SAFs just being populated by parties directly affected by an issue, or not bothering to turn up when they are not affected, we recommend that the SAFs have enduring formal constitutions and that Terms of Reference are drafted.

Processes beyond the SAFs need to be properly examined: Ofgem will need to clearly outline its plans to engage with them and the Code Managers. For example, it needs to provide suitable assurances that it will have the operational capability and capacity to engage more in the operational affairs where the Panels currently provide something of a "buffer". In the BSC, areas such as Performance Assurance, Credit Committee, Dispute Resolution and "Section H" financial defaults are largely dealt with by the Panel, sometimes being referred to Ofgem for final approval. While Ofgem might envisage simply placing these responsibilities on the Code Manager, we would expect that Ofgem's final adjudication will be called on far more often. As these are operational matters where time is of the essence, Ofgem will not be able to simply resort to slower consultative processes.

It is our understanding that the Code Managers will have an obligation to consult with SAFs and, presumably, to take their advice into account. If this is to be the case, then there should be a reciprocal obligation on parties to engage with Code Managers, either directly or through, for example, a representative appointed for that class of party.

Q11: Are there any lessons learnt (either good or bad) from the current code arrangements that should be considered?

Given the current position of the Code Reform project, and the extensive passing of time since it began, we think this is a very good time for Ofgem to re-evaluate and define the problems with Panels it believes it is looking to resolve – for example, Panels do not create the complexity that is highlighted as an issue, they have to manage it; Panels do not administer processes slowly; they work within the processes in place. It is really clear and, we think, acknowledged by Ofgem that Panels bring huge benefit in terms of industry expertise and, effectively, free consultancy and scrutiny.

If Ofgem can direct the subject areas that Panels have to consider and work on, are Panels still the "wrong bodies" to be in the position of considering them? Basically, we would ask Ofgem: what it is that Panels do that Ofgem would not want the new forums to do – and what do they not do that the new forums will do? It may well be that such an exercise would help to devise a better solution, potentially within an adjusted framework, rather than "throwing the (current) baby out with the bath water and then trying to conceive a new baby".

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Ofgem should look to parallel industries to see how they have dealt with similar situations to look for best practice. We believe that this could provide assistance in terms of potential ways forward.

Over the years the BSC has provided considerable input to all the previous consultations on Code Governance. While these remain on record, we summarise the most relevant in response to this question:

- Governance of the BSC has worked well because of its broad representation (industry, Consumers) and relatively high level of independent members to avoid bias.*
- The value of industry expertise and huge amount of time put in by the Panel must be recognised. Ofgem should consider carefully whether any perceived slowness in the process as a whole really originates from the Panel – as well as whether there are difference between Panels which give an insight into better or worse approaches to modifications.*
- Ofgem is intimately bound up in the changes it is proposing but there has been little reflection on its own effectiveness as part of the modification process or the changes it can do itself. For example, could Ofgem adapt its processes positively to address issues such as speed of Code Modifications.*
- Notwithstanding our views on how to get engagement, Ofgem may consider whether a licence condition on Codes to cooperate may be worth consideration.*
- We have made the point that the Codes are often complex for a reason – that they have to deal with complex issues. It is far more important that they are robust to stand the test of time than being rushed through.*
- In the BSC we have tried hard to address the needs of innovators – with the Panel often considering “those not in the room”. The BSC Sandbox has had only three applications in two years – a similar low level to Ofgem’s and other Codes. We urge Ofgem to make more effort to validate its thinking on ways to attract more innovation into the industry.*