

13 November 2008

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Ofgem
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Dear Mark

Thank you for your letter dated 7 November 2008. I understand that, to assist in your consideration of Modification Proposal P227, you are requesting information relating to the nature of ELEXON's contractual terms with Logica as the BSC Agent for the provision of communication services to the industry under the BSC Services Agreement ("BSCSA"). Unless otherwise stated, terms or expressions used in this letter have the same meaning attributed to them in the BSCSA.

At the outset I should make it clear that the BSCSA enables the information in this letter to be disclosed to a regulatory body however the said information is otherwise confidential and may not be further disclosed. ELEXON suggests that, if it would be helpful to you, it can enter into discussions with Logica with a view to agreeing the terms of a response which may be placed in the public domain.

I have provided a response to the two specific questions you asked below. This letter includes a number of appendices which I believe will assist in your understanding. Once you have read this response I would welcome the opportunity for my colleagues to discuss the information with you to provide any further clarification.

Communication services available to participants and the impact of ISIS

To place the response in context I felt it would be useful to set out what provisions are available and the contractual terms that ELEXON believes are relevant.

Currently a participant may use either use:

- 1) a dedicated communication network (known as the High Grade Service and for which a fee is payable); or
- 2) the public internet (which is known as the Low Grade Service and is accessible to all Parties and for which a Party is not charged a single 'fee'¹)

to connect to the central systems and submit notifications. Both are required to be provided by the BSC Agent under the Balancing and Settlement Code and therefore as part of their contract. Your letter seeks to understand the nature of the agreement surrounding the High Grade Service.

¹ The BSC Agent must establish and maintain a Low Grade Service for which costs are not charged directly back to participants on an individual basis but spread across Parties through the Funding Share System.

ELEXON has recently re-procured the services for the BSC Central systems through a competitive tender process. The contract awarded as a result of this competitive procurement is the BSCSA, which is with Logica. The main part of the BSCSA, and in particular the provisions relating to the High Grade and Low Grade Services, are effective from 1 April 2009. However, it should also be noted that new upgraded High Grade installations are currently being arranged and installed in accordance with the terms of the BSCSA. As P227 will not be submitted to Ofgem for decision until near April 2009, in answering the specific questions asked by Ofgem, we have only provided a response relating to the BSCSA as it takes effect from 1 April 2009.

Question 1: Information relating to... 'Any clauses within the BSCCo's contract with the central services agent that contain information relating to any charges incurred by the BSCCo or industry participants for early termination of the contract'

General contractual termination issues

In summary, ELEXON may terminate the BSCSA in whole or in part in the following circumstances:

- (i) for convenience at any time on: (1) 12 months notice; or (2) not less than 6 months notice whereby a termination payment would be incurred representing the charges Logica would have been paid had it received 12 month's notice.

Early termination for convenience of the BSCSA would in addition give rise to Transition Charges representing the costs for transition which the parties have agreed to spread over the term of the contract and Stranded Costs representing unbilled charges as at the date of termination and costs due to third parties as a result of termination.

- (ii) for cause in defined circumstances (including the occurrence of material Default).

Termination for cause would give rise to Transition Charges and in certain circumstances Stranded Costs.

- (iii) ELEXON has the right under the BSCSA to require Logica to terminate a sub- contract (e.g. the Cable & Wireless sub-contract relating to the installation of High Grade Service lines) where the acts or omissions of the sub-contractor give rise to ELEXON's general right of termination for cause but not for convenience.
- (iv) ELEXON has the right under the BSCSA upon written notice to terminate in whole or in part a BSC Operating Service (which prima facie would include the Communications Service of which the High Grade Service forms part (or part thereof)) where the Trading Arrangements are changed or ELEXON deems that such Services and/or System are not longer required in whole or in part.
- (v) ELEXON has the right under the BSCSA upon one month's notice to partially terminate any part of the services (which prima facie would include the Communications Service) on the occurrence of a material default by the Service Provider.

Termination of a High Grade Service

The new BSCSA provides flexibility to Parties to select the type of High Grade Service they wish to have, and they will then pay a fee in accordance with that level of service. Information on these charges is contained in Appendix 1. This flexibility was unavailable previously.

An individual Party may ask ELEXON to arrange for the termination of its High Grade Service line. ELEXON's liability under the BSCSA associated with termination of individual Party connections depends on the total number of terminations during each Contract Year. This arrangement (which is explained further below) was negotiated so as to reduce the potential costs for individual Parties.

A Party will not be charged any termination fee unless it terminates within the first 12 months after installation. Where termination occurs within 12 months of installation, this requires 90 written days notice and the line rental charges for the whole of that year may become payable.

The cost to ELEXON (which are recovered from Parties on a cost pass through basis) depends on the number of terminations in any 12 month period. No termination fees are payable provided that 30 days written notice is provided and no more than 10% of the total High Grade Services are terminated within the same Contract Year. If more than 10% are terminated in a Contract Year then any terminations in excess of the 10% will be required to give 90 days written notice, and ELEXON will be liable for 100% of the charges up until the end of the 90 day period and then 40% of the line rental until the end of the 5 year term. The full range of potential charges associated with termination are set out in Appendix 2.

Question 2: Any information relating to... 'Any charges or restrictions that would be applied on BSCCo or industry participants if they were to contract for this service with another provider'

The BSCSA currently does not oblige Logica to co-operate or interact with a third party provider of a Participant Communications Service. Such a service would need to interface with the systems provided by Logica under the BSCSA.

Turning to the Code, Section V of the Code requires the Balancing Mechanism Reporting Agent (BMRA) to make the High Grade service available to those Parties that request it. Those that do will then be liable for the set of charges set out in Section D of the Code (see Appendix 1). The Low Grade service will also be made available, at no charge, to any Party that requests it.

Therefore at Code level, while there may be practical or other difficulties, there would not appear to be a specific restriction which would prevent a Party using a different provider to provide the relevant communications lines. Below Code level, there is the Communications Requirements Document, which is a Code Subsidiary Document, which sets out the technical requirements of the High Grade Service as provided by BSCCo. The Communications Requirements Document also would not appear to be a specific restriction which would prevent a Party using a different provider to provide the relevant communications lines.

Further considerations

I believe it is useful to provide you with additional information on the operational impacts and risks if further competition were to be realised. We have therefore included some initial thoughts in Appendix 3.

My colleague David Jones is available if you wish further clarification on this letter (David.jones@elexon.co.uk, 020 7380 4213). As stated we would welcome the opportunity to discuss this response with you in person, I will ask David to contact you to arrange this.

Yours sincerely

Stuart Senior
Chief Executive

List of Enclosures

Appendix 1 – Costs options for use of High Grade Service from 1 April 2009
Appendix 2 – Further detail of termination fees
Appendix 3 – Further thoughts on risks and impacts of further competition

Appendix 1 – Costs Options for use of High Grade Service from 1 April 2009

Participants may choose from the packages of services and associated costs for the High Grade Service lines set out in the following table:

Technical Specification	Line Options								
	HG1a	HG1b	HG2a	HG2b	HG3a	HG3b	HG4	DR1	DR2
Primary Line Rental:									
256Kb Lease Line	✓	✓	✗	✗	✗	✗	✗	✗	✓
512Kb Lease Line	✗	✗	✓	✓	✗	✗	✗	✗	✗
1Mb Lease Line	✗	✗	✗	✗	✓	✓	✗	✗	✗
2Mb ADSL	✗	✗	✗	✗	✗	✗	✓	✓	✗
Backup Line Rental:									
ISDN Backup	✗	✓	✗	✓	✗	✓	✓	✗	✗
2Mb ADSL Backup	✓	✗	✓	✗	✓	✗	✗	✗	✗
Support:									
5 Hour Fix on Primary Line	✓	✓	✓	✓	✓	✓	✗	✗	✓
24 Hour Fix on Primary Line	✗	✗	✗	✗	✗	✗	✓	✓	✗
1-1 Contention Ratio ²	✓	✓	✓	✓	✓	✓	✗	✗	✓
20-1 Contention Ratio	✗	✗	✗	✗	✗	✗	✓	✓	✗
One-off Costs									
Installation	£3,255	£3,115	£4,526	£4,386	£5,805	£5,665	£2,235	£1,033	£2,550
Ongoing Annual Costs									
Annual Rental	£5,920	£5,687	£7,692	£7,460	£8,942	£8,710	£3,700	£2,640	£4,577
Annual Support (2009/10)	£1,025	£1,025	£1,025	£1,025	£1,025	£1,025	£1,025	£1,025	£1,025
Total Rental + Support (2009/10)	£6,945	£6,712	£8,717	£8,485	£9,967	£9,735	£4,725	£3,665	£5,602

² Contention Ratio – means the ratio of the potential maximum demand to the actual bandwidth. The higher the contention ratio, the greater the number of users that may be trying to use the actual bandwidth at any one time and, therefore, the lower the effective bandwidth offered, especially at peak times.

Appendix 2 – Further detail of termination fees

1. The provision of the High Grade Service is subject to 30 days written notice. No termination charge will be applied for up to 10% of total High Grade Services in the same Contract Year (the Contract Year being the period starting at Go Live and ending on 31 March 2010 and each subsequent anniversary).
2. Where more than 10% of sites are to be terminated in any Contract Year, those in excess of 10% incur termination charges and require 90 days notice. The termination charges being the Line Rental charge for the 90 day notice period plus 40% of the remainder of all Line Rental charges to the end of the five year term. These termination charges become payable in the month following termination.
3. Where termination occurs within 1 year of installation, this requires 90 written days notice and the line rental charges become payable for the whole of that year become payable.
4. If termination occurs within 20 Working Days of the date of the installation Order the only charges that we are liable for are third party costs that have been incurred.
5. Where the entire BPO/Host agreement is terminated, termination notices are not required in respect of each individual high grade service. Where this termination is for ELEXON's convenience, Exit Management Provisions apply and ELEXON is liable for any stranded costs.
6. Communication lines in place for more than a year at the end of the agreement, incur no termination charges. For High Grade lines ordered in the final year of the term of the contract and terminated at the end of the Agreement, one years worth of charges are payable.
7. Where a service is relocated no termination fees are payable unless that relocation occurs within 1 year of installation in which case the line rental charges become payable for the whole of that year become payable.

Appendix 3 – Further thoughts on implications of further competition

1. Impacts

To allow participants to procure their own communications the industry would need to consider the impact on the following (this list is not exhaustive):

- 1.1 Security - The current network is private and secured from all other non industry related traffic. Any alternative would have to meet similar security requirements established by the Code if the integrity of any High Grade service is to be maintained;
- 1.2 Ownership - A single service provider offers the advantage of having one point of contact with whom any network issues or disputes may be raised. Where alternative service providers are used, participants would have to make their own arrangements, including the agreement of suitable service levels. At present, these are negotiated by ELEXON on behalf of the industry;
- 1.3 Interfaces - The central systems would have to make provision for communicating with multiple network providers using a range of potential protocols. This is likely to be expensive and difficult for ELEXON and the BSC Agent to administer;
- 1.4 Configuration management and change - without central configuration there would be an increased risk to settlement, which would need to be mitigated by a more extensive testing regime funded by all participants; and
- 1.5 Commercial Risk – by increasing the level of competition within the service there is the risk associated with multiple suppliers. This constitutes all the above risks but the cost of managing that risk will be passed to ELEXON and therefore on to industry.

Increasing the number of networks and interactions carries a risk of degrading the overall high-grade service to a level which is not much better than the current Low Grade internet service.

2. Theoretical commercial options for further competition

There are a couple of commercial options that could be put in place if Ofgem or a Party desired to increase competition. These are our initial thoughts and would need detailed investigation before any considerations on implementation can be made.

- 2.1 Participants procure their own communications lines: This approach could be mandatory or optional; if optional, ELEXON would continue to maintain the central service for those participants that wished to use it. As noted above, the increase in risk caused by alternative networks would need to be mitigated by more extensive monitoring and testing, the additional costs of which would be passed on to industry. These increases may outweigh the competitive and financial benefits for individual participants.
- 2.2 ELEXON management of competition: An alternative mechanism of introducing more competition could be for a Modification to create an environment where there are more available network service providers, with ELEXON and the BSC Agent carrying out mini-tenders within this framework. This approach could offer an amount of 'choice' to participants while ensuring that the options are suitable for Settlement purposes. However, from a contract administration perspective this would have a

significant resource impact for ELEXON and BSC Agent, with these costs again being passed on to industry. Such a solution requires significant work.