

## Issue 40: Review of ELEXON Governance and Funding Arrangements for New Business Opportunities

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### Summary

#### The Issue

ELEXON Ltd (as the Balancing and Settlement Code Company) is unable to pursue new business development opportunities as it is precluded from doing so under Section C 1.2.2 of the BSC. The Issue 40 Group has considered options for an appropriate framework that addresses this issue.

#### Options

The Group has identified and investigated three straw-man models:

- **Model A** requires the creation of a new umbrella holding company (New HoldCo) to be the parent of an ELEXON Group. ELEXON Limited (BSCCo) would become a wholly owned subsidiary of this new holding company (rather than National Grid), but is otherwise unchanged in structure, funding, role or governance and remains cost pass through/non profit making. New business ventures would be competed for and delivered as ring-fenced (potentially regulated) subsidiaries of the new holding company. Subsidiaries may be either not for profit or profit making. Where profits are made, these may be distributed to any shareholders of that subsidiary (if not wholly owned by New HoldCo), reinvested in the subsidiary, or remitted to New HoldCo. Any losses made by a subsidiary would be borne solely by that subsidiary. Any profits made by (or remitted to) New HoldCo would be used for investment/cost defraying and would not be distributed to members.



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- **Model B** requires the creation of a new company (BSC ProcureCo) to procure and manage a BSC services company (BSC ServeCo) which would provide all the services that ELEXON Limited (BSCCo) does today, but under a contestable commercial services contract. The ownership, governance, funding and profit status of ELEXON Limited would be changed (becoming ELEXON Mk2 Limited). This organisation would be owned by those BSC Parties willing to invest in it and would be entitled to bid for the BSC ServeCo contract, as well as competing for other non-BSC activities. The BSC ServeCo contract would include a profit margin and appropriate incentives to reduce charges. The profit (or loss) made from the BSC ServeCo contract (and from other activities) would be invested by ELEXON Mk2 Limited or distributed to shareholders.
- **Model C** retains the existing governance and funding of BSCCo as a wholly owned subsidiary of National Grid. All future roles would be undertaken by ELEXON under this structure via incremental modification of the BSC.

## Process

The Group highlighted and prioritised a set of design objectives which it considered to be most important to industry, noting that the optimum model should have the most positive or least negative impact on these criteria (see Section 4 and Appendix VI). The Group reviewed each model against these design objectives. The top two objectives sought to avoid introducing unacceptable cost or risk for the BSC arrangements and BSC Parties by:

- Ensuring that the performance and standard of existing core BSC business services are maintained
- Ring-fencing and ensuring transparency of liabilities and costs for any new activities.

## Findings

The Group identified many concerns and inefficiencies associated with Model C that would preclude its use for anything other than very minor expansions of BSCCo's role.

The Group acknowledged that ELEXON's stated objective in proposing Model A is to create a vehicle that is most appropriate for delivering shared central market arrangements, such as will be required to implement the wide scale industry policies and



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reforms currently being proposed by Government. However, it did not agree with ELEXON's belief that a not-for-profit group, owned by a wide set of stakeholders would achieve this more effectively than a for-profit group owned and controlled by those who choose to invest. The Group further noted that Model B seeks to create a shareholder-owned and controlled for-profit entity that competes for commercial contracts, and looks to extend that commercial approach to the provision of the BSCCo services.

While there are some fundamental differences in the underlying philosophies behind Models A and B, both address the core problem by enabling ELEXON to undertake a wider set of business activities. Nevertheless, each presents some issues which would need to be mitigated in the detail of any implementation.

	Model A	Model B
Ownership and Control	<p><b>New HoldCo</b> is member-owned and independent of particular interested parties and must act in furtherance of overall purpose (to benefit wider industry and consumers)</p> <p><b>ELEXON Limited (BSCCo)</b> is a wholly owned but uncontrolled subsidiary of <b>New HoldCo</b> (with governance fully defined under BSC, as now)</p>	<p><b>BSC ProcureCo</b> owned by all BSC Parties (but governed under terms of BSC, largely as now)</p> <p><b>ELEXON Mk2 Limited</b> is owned and controlled by those industry parties that choose to become shareholder investors</p>
Initial Funding of New Ventures	Initial new activity spend capped at BSC budget, with commitment to repay BSC Parties.	Initial voluntary shareholder investment.
Use of Surpluses	<p><b>New HoldCo</b> is not-for-dividend, so <b>New HoldCo</b> profits reinvested to further overall purpose and/or defray costs. Any losses made by a subsidiary would be borne by that subsidiary.</p> <p>All BSCCo surpluses (i.e budget under-spend) returned to BSC Parties, as now.</p>	<p><b>ELEXON Mk2 Limited</b> profits or losses (including those arising from BSC service contract) distributed to shareholders.</p> <p><b>BSC ProcureCo</b> budget under-spend returned to BSC Parties, as now.</p>
BSC Services Contract	None. Existing BSCCo arrangement retained.	Commercial services contract, procured, funded and managed by <b>BSC ProcureCo</b> .
Main Concerns	Any BSC funds approved by the BSCCo Board for use in establishing a <b>New HoldCo subsidiary</b> may result in costs being imposed on BSC Parties and not returned if bids for commercial contracts are not awarded.	There is a risk that no (or too few) organisations will take shares in <b>ELEXON Mk2 Ltd</b> preventing the company from being set up and causing <b>BSC ProcureCo</b> to have to seek other providers for the <b>BSC ServeCo</b> .



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The Group recognised that **New HoldCo** and **BSCCo** are separate organisations that would be part of a company group. The Group felt that members of the **BSCCo Board** should be different / independent of the **New HoldCo Board** in order to ensure demonstrable separation between the two companies and to avoid any conflict of interest.

The Group's preference was that, under Model B, **ELEXON MK2 Ltd** would be awarded the initial **BSC ServeCo** contract. However, it was recognised that this may be subject to advice from Ofgem on the requirement for a competitive procurement.

Model B relies on establishing an effective, active and adequately resourced **BSC ProcureCo** to provide robust management of the BSC ServeCo contract.

The Group recognised that **BSC ProcureCo** and **BSC ServeCo** would be separate organisations and not part of a company group but felt that members of the **BSC ProcureCo Board** would need to be different / independent of the **BSC ServeCo Board** in order to avoid inherent conflicts of interest.

## Implementation

Based on the current DECC Smart Metering Implementation Programme Model B cannot be implemented in full in time to enable ELEXON to be considered for the role of the Data Communications Company (DCC) and potentially other opportunities arising from e.g. DECC's Electricity Market Reform proposals. The Group did consider that this could be addressed through some form of transitional arrangement but it did not explore such scenarios. While this is of critical importance to ELEXON, a majority of Group members indicated that allowing ELEXON to participate in such early opportunities is not their primary concern.

Models A and B cannot be implemented via a Modification to the BSC in isolation. Amendments to documentation outside the BSC will be required and the Group looks to Ofgem and DECC to provide a clear direction that delivers a way forward.

The Group recognises that Ofgem has commissioned its own report into ELEXON's diversification and governance. It encourages Ofgem to take account of the views presented in this report as part of its work.



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## Purpose of this Document

This document sets out the findings of the Issue 40 Group. The Group was established by the BSC Panel with an independent chairman (upon Issue 40 being raised by E.ON UK) to consider options for appropriate governance and funding regimes that protect the BSC and enable ELEXON Ltd. to pursue appropriate new business development opportunities. This document describes alternative models, provides an initial assessment of each and identifies the steps that would be required for their implementation.

This report is for information only. It does not compel or initiate further work to change the BSC, the Transmission Licence or other governing documents. It should be used to inform any subsequent action.



# Issue 40 Findings Report

## 1. Background

- 1.1. There are a number of restrictions currently imposed by the BSC on ELEXON. The company (including its subsidiaries) is prevented from undertaking any business or other activity outside its core BSC activities. In addition, ownership of ELEXON is restricted to National Grid, except where Ofgem (the Authority) otherwise directs. There are also significant restrictions on ELEXON raising finance by any means other than through the defined BSC funding arrangements. More information is provided in Appendices I and II.
- 1.2. When ELEXON consulted on its annual Business Strategy this year, there was broad acknowledgement amongst BSC Parties that ELEXON's current corporate structure, governance and funding arrangements are not an appropriate platform for the company to undertake any new activities in the future. Subject to establishing appropriate governance and funding arrangements, many BSC Parties were supportive of the skills and resources of ELEXON being applied to a wider set of activities so that industry may benefit from the company's experience and potentially avoid unnecessary replication and costs.
- 1.3. ELEXON expressed its desire to create a suitable vehicle for implementing wide scale industry reforms and operating shared central market arrangements whilst having a minimum impact on the BSC and BSC Parties. In particular, ELEXON has highlighted its ambition to:
  - rise to the challenges and embrace the opportunities that smart metering will offer, including actively pursuing material new roles, such as that of the Data Communications Company (DCC);
  - proactively position itself as the industry's preferred provider of central market arrangements; and
  - maximise the use of its available skills and resources by addressing opportunities beyond its traditional, constrained BSC role.
- 1.4. After full consideration of the responses received during the industry consultation, the BSC Panel approved ELEXON's Business Strategy (with conditions) at its meeting in March 2011. In doing so, the Panel agreed that a change to the scope of the activities that ELEXON is permitted to undertake (or 'vires') should be



### **Current Ownership of ELEXON Ltd.**

ELEXON Limited is a wholly owned, but unconsolidated subsidiary of National Grid. Ownership of ELEXON is under National Grid (except where Ofgem (the Authority) otherwise directs). National Grid has no obligation (financial or otherwise) to ELEXON or its subsidiaries except as set out in the BSC.

There are very limited 'step-in' provisions whereby National Grid can be directed by Ofgem to take responsibility for progressing a modification to the BSC in certain circumstances. For clarity, these provisions have effect by virtue of the Transmission Licence and BSC, and do not rely in any way on National Grid being the owner of ELEXON



### **BSCCo Business Plan 2011/12:**

The BSCCo Business Plan can be viewed at:

[http://www.elexon.co.uk/ELEXON%20Documents/BSCCo\\_Business\\_Plan\\_2011-12.pdf](http://www.elexon.co.uk/ELEXON%20Documents/BSCCo_Business_Plan_2011-12.pdf)

Industry responses to the consultation can be seen at:

<http://www.elexon.co.uk/pages/corporateandfinancialinformation.aspx>

The Panel minutes are at:

[http://www.elexon.co.uk/ELEXON%20Event%20Documents/Panel\\_Minutes\\_181\\_v1.0\\_OPEN%20SESSION.pdf](http://www.elexon.co.uk/ELEXON%20Event%20Documents/Panel_Minutes_181_v1.0_OPEN%20SESSION.pdf)

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pursued and encouraged ELEXON to set out a timetable for progressing this, and to continue to engage fully with the industry on its proposals.

## 2. The Issue

- 2.1. Issue 40 was raised in March 2011 and is attached to this report. It notes that the Balancing and Settlement Code Company (ELEXON Ltd.) is unable to pursue new business development opportunities as it is precluded from doing so under Section C 1.2.2 of the BSC. The Issue 40 Group has considered options for an appropriate framework that addresses this issue.
- 2.2. The Group has taken account of the straw-man developed by ELEXON as presented to the BSC Panel and discussed at stakeholder events in late 2010 and early 2011. It has also looked at alternative models. The initial proposals considered by the Group are set out in Appendix III.
- 2.3. The Group noted that a separate, independent, report has been commissioned by Ofgem on this matter. This report is distinct from Issue 40 and has been produced simultaneously. It was published on 29 July 2011 towards the end of the Issue 40 assessment. Consistent with the Issue 40 Group's Terms of Reference, the Group has not been involved in the development of this report.



### Section C1.2.2 of the BSC:

"Subject to the further provisions of this Section C, BSCCo shall have the powers, functions and responsibilities set out in or assigned to it pursuant to the Code, and shall not undertake any business or activity other than as provided for in the Code."



### Independent Report for Ofgem

The report commissioned by Ofgem on the diversification and governance of ELEXON Ltd can be viewed at:

<http://www.ofgem.gov.uk/Licensing/IndCodes/Governance/Documents1/Elexon%20report%20final.pdf>

## 3. Options Considered

- 3.1. The group identified three models for consideration which are set out below.
- 3.2. In describing these models it is helpful to establish some terminology to ensure consistency when referring to the entities which make up each model. These are:

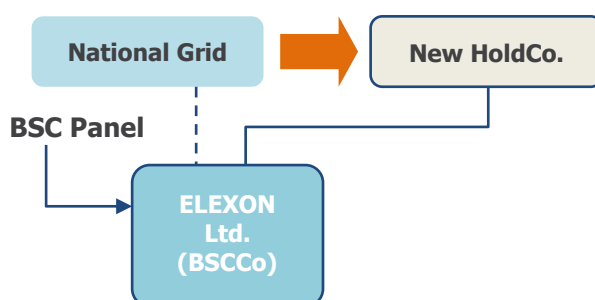
"ELEXON Limited (BSCCo)"	ELEXON in its current form and role.
"New HoldCo"	The proposed parent company of a new ELEXON Group.
"ELEXON Group"	The proposed group of affiliates under New HoldCo, including ELEXON Limited (BSCCo).

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"Regulated Affiliate"	An affiliate of New HoldCo which is a licensed entity or an industry code administrator, e.g. ELEXON Limited (BSCCo).
"ELEXON Mk2 Limited"	A reformed version of ELEXON Limited (BSCCo), with different ownership, governance, funding, profit status and vires from present. ELEXON Mk2 Ltd could act as the BSC ServeCo and could also undertake other roles.
"BSC ProcureCo"	New company proposed under Model B to procure BSC services company.
"BSC ServeCo"	Under Model B, a role defined in the BSC as the company providing BSC services under contract to BSC ProcureCo. This will be ELEXON Mk2 Ltd.

## Model A

3.3. Model A requires the creation of a new umbrella holding company to be the parent of an ELEXON Group. ELEXON Limited (BSCCo) would become a wholly owned subsidiary of New HoldCo (rather than National Grid), but is otherwise unchanged in structure, funding, non profit/cost pass through status, role or governance. It would continue to deliver the BSC services according to the BSC strategy set by the BSC Panel and a budget set by the BSCCo Board.



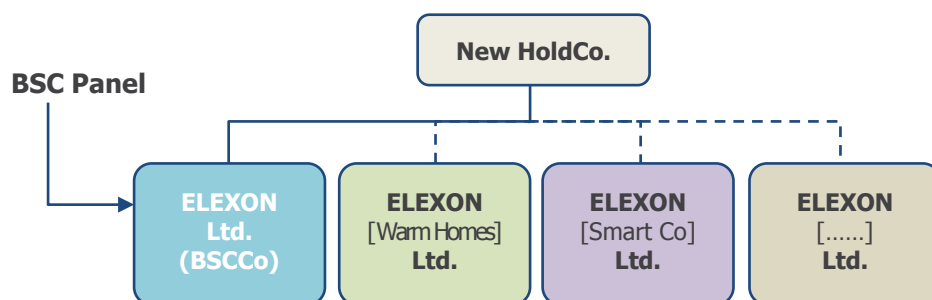
3.4. New HoldCo would undertake all future non-BSC roles, either directly or through separate special purpose vehicles formed as appropriate for each opportunity. The ELEXON Group subsidiaries could be a combination of:

- regulated not for profit entities e.g. ELEXON Ltd (BSCCo) and Warm Homes Ltd;



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- for profit entities earning regulated returns e.g. (if selected) the DCC; and
- for profit entities (including joint ventures).



- 3.5. New HoldCo is a company limited by guarantee (CLG) whose members would include, but not be limited to, electricity and gas licensees (including new licensees), Industry Code signatories and consumer representatives. Membership would be voluntary.
- 3.6. While some of these subsidiaries may return a profit, the holding company itself will be 'not for dividend', i.e. it will not distribute profits to its members.
- 3.7. Instead, it will be established as a company limited by guarantee and have a defined purpose. For example:

*"Promoting and delivering innovation, cost efficiency, and rationalisation through the provision of regulated and unregulated services to the utility sector for the benefit of industry, consumers, regulatory bodies and other legal authorities."*

- 3.8. It will therefore re-invest any surpluses solely to further that aim which may include defraying its overheads and therefore reducing its costs.
- 3.9. This model is based upon ELEXON's straw-man.
- 3.10. The model specifies a number of restrictions and BSC governance enhancements which seek to provide protection to BSC Parties.



## Company Limited By Guarantee (CLG).

A CLG is commonly used as a vehicle for non-profit making functions, where the sharing of profit with the members is not contemplated.

A CLG is different from a company limited by shares (CLS), in that it is owned by members, rather than shareholders. Importantly, the members do not hold shares, but instead guarantee they will contribute to the assets of the company in the event that it is wound up (the amount of which may be a nominal sum). The liability of the members is, therefore, limited.

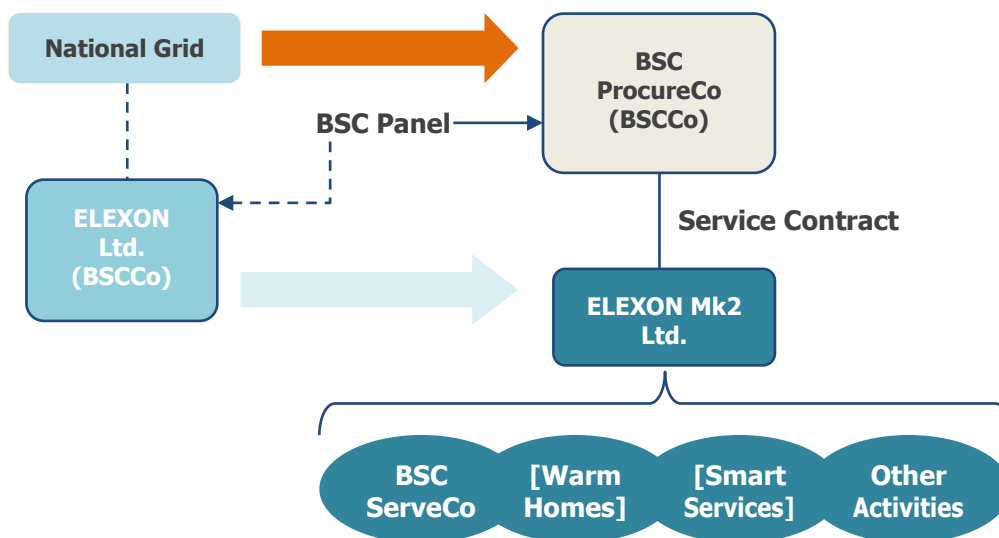
As with a CLS, a company limited by guarantee is managed by a board, appointed by the members. The board owes fiduciary duties to the members, including to promote the success of the company for the benefit of its members and to avoid conflicts of interest.

The company is regulated by its articles of association, which can be drafted, generally, to accommodate the members' requirements

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## Model B

- 3.11. In developing Model B, the Group referenced the provisions established under the MRA which gave rise to MRASCo and Gemserv. A summary of these provisions is provided in Appendix IV.
- 3.12. Under this model, a new company (BSC ProcureCo) would be created under the BSC to procure and manage a BSC services company (BSC ServeCo) which would provide all the services that ELEXON Limited (BSCCo) does today, but pursuant to a contestable commercial services contract, as opposed to under obligations in the BSC as is currently the case for ELEXON.
- 3.13. All BSC Parties would hold an equal share in BSC ProcureCo and each new Party that acceded to the BSC would be allocated a share in BSC ProcureCo.
- 3.14. The vires, ownership, governance, funding and profit status of ELEXON Limited (BSCCo) would be changed (becoming ELEXON Mk2 Limited). Shares would be offered in ELEXON Mk2 Limited and could be acquired by existing BSC Parties or other organisations at the time of the sale, according to how much each buyer is willing to invest. Restrictions on the types of organisation and/or the size of the stake an individual organisation could have in ELEXON Mk2 Limited could be applied if considered appropriate.

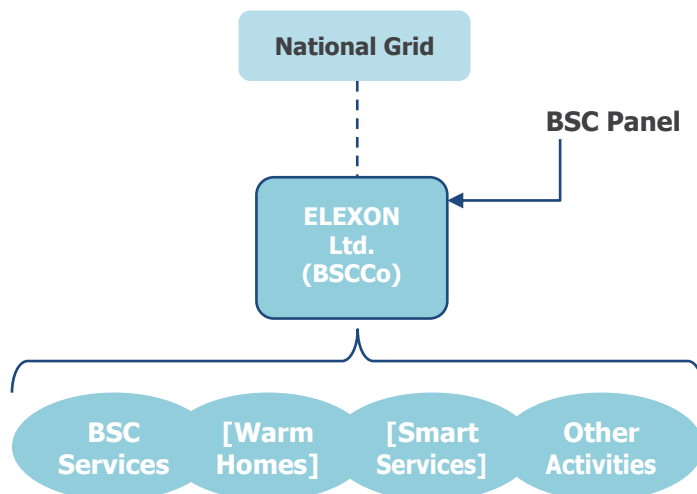


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- 3.15. ELEXON Mk2 Limited would be a company limited by shares (CLS), and would therefore return any profits in the form of dividends to its shareholders (owners).
- 3.16. ELEXON Mk2 Limited would be entitled to bid for the BSC ServeCo contract, as well as competing for other non-BSC activities. If successful in that bid, the BSC services and all other non-BSC roles would be undertaken by the same corporate entity (ELEXON Mk2 Limited).
- 3.17. The Group noted that while a service contract would need to be established upon implementation of Model B it might be anticipated that for an initial period ELEXON Mk 2 Limited would provide the BSC ServeCo services.
- 3.18. The Group's preference was that only once ELEXON Mk 2 Limited is firmly established as a commercial entity would tendering for the BSC ServeCo contract be considered. However, it was recognised that this may be subject to advice from Ofgem on the requirement for a competitive procurement.

## Model C

- 3.19. Under this model, ELEXON would remain with its current structure and governance as set out in the BSC – i.e. ownership would remain with National Grid and the directorship, management structure and funding (via cost recovery solely from all BSC Parties) would also remain as is. All future roles would be undertaken by ELEXON under this structure. No subsidiary or other separate company (i.e. a "NewCo") would be used.





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## Comparative Descriptions of Models

3.20. The Group compared 20 key attributes of each model including:

- The overall design
- Permitted activities of BSC services company (equivalent to ELEXON Ltd. today)
- Permitted new non-BSC activities (“vires”)
- Funding of BSC services
- Funding of new (non-BSC) ventures
- Treatment of losses and financial liabilities of BSCCo
- Treatment of losses and financial liabilities from new ventures
- Treatment of BSC surpluses
- Treatment of surpluses from new ventures
- Corporate structure
- Ownership/Membership of BSC services company
- Ownership/Membership of new entity/entities undertaking non-BSC ventures
- Owners/Members control/influence
- Restrictions on Change of Ownership
- Other special protections/restrictions
- Corporate governance
- Regulatory framework
- Commercial basis of BSC services
- Intra Group Services
- Implementation steps and timing

3.21. This comparison is set out in Appendix V.



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## 4. Design Objectives

4.1. In order to compare the candidate models the Issue 40 group identified a set of Design Objectives. These are:

- 1. Appropriateness - Create a fit for purpose corporate structure and governance for existing activities and new activities that:**
  - a. Safeguards BSCCo's unique position of independence such that no BSC Party can have a controlling interest in BSCCo.
  - b. Enables ELEXON to pursue new activities in an autonomous and agile fashion.
  - c. Allows for fair reflection of all existing and future stakeholder interests.
  - d. Enables appropriate funding to meet capital requirements for new ventures.
  - e. Enables those parties that wish to be part of any new ventures to participate, without compelling those that do not.
  
- 2. Protection for the BSC Arrangements - Avoid introducing unacceptable cost or risk for the BSC arrangements and BSC Parties by:**
  - a. Ring-fencing and ensuring transparency of liabilities and costs for any new activities.
  - b. Avoiding inappropriate cross-subsidy or unfair competitive advantage arising from non-BSC activities.
  - c. Ensuring that the performance and standard of existing core BSC business services are maintained.
  
- 3. Achievability - Changes are capable of being implemented in a way that:**
  - a. Enables ELEXON to apply its expertise in new areas in the near/mid-term including enabling ELEXON to participate in the competitive process for award of the DCC licence.
  - b. Is legally robust with clearly articulated rights, obligations and liabilities.
  - c. Enables an appropriate balance between implementation costs and the realisation of any efficiency savings for BSC Parties.
  
- 4. Ensures an appropriate regulatory framework for any regulated activities that ELEXON may undertake.**



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- 4.2. The group assessed the significance of each design objective. Each was rated as very important, important, desirable but not essential or undesirable. A breakdown of Group views can be seen in Appendix VI.

## Significant Design Objectives

- 4.3. It was the unanimous view of the Group that any model should be legally robust and clear (**design objective 3b**) and should be compatible with appropriate regulatory frameworks (**design objective 4**)
- 4.4. The following objectives were identified as being of primary concern:
- **2a – Ring-Fencing BSC:** The majority of Group members agreed that ring fencing was very important and thought it was required to protect BSC arrangements. It was noted that ring fencing would have to be appropriately defined and applied in order not to unduly limit the opportunity to take advantage of synergies that would benefit the BSC.
  - **2b – No Inappropriate Cross-subsidy:** The majority of Group members agreed this was very important and a requirement for any fair and robust model.
  - **2c – Maintaining BSCCo. Performance:** The Group was unanimous that this was of paramount importance.
- 4.5. A minority of Group members felt that the following objectives were also very important with the majority of the remainder feeling they were important:
- **1a – Independence of BSCCo:** The general view of Group members was that BSC arrangements should be protected from undue influence from individual parties, or any group of parties, given the nature of the services that the BSCCo is obliged to provide.
  - **1d – Funding New Ventures:** The Group noted in particular that it was important to safeguard BSC Parties from any enforced funding for new ventures. It was observed that a good business model will attract investors.
  - **1e – Does not Compel Involvement:** Some Group members felt that BSC Parties should not be compelled to fund any initial venture or future



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ventures outside the BSC. One Group member noted that compulsion is less of an issue if the funding arrangements are appropriate. It was also noted that providing choice to assess any risk/reward associated with a new venture means the company has to develop a convincing business case.

- **3c – Costs and Savings:** Group members felt that there should be an appropriate balance of costs and benefits.

## Second Order Design Objectives

4.6. The Group also noted that some of the design objectives, while important, were less significant. The following objectives were identified as important areas to take account of when considering each model:

- **1b – Autonomy for New Activities:** A minority of Group members felt that autonomy to undertake new activities was of little concern so long as expansion into new activities did not impact delivery of the core BSC service. It was recognised that there are benefits in enabling ELEXON to pursue new business efficiently without needing to overcome undue barriers that could impose additional costs or delays should suitable opportunities arise.
- **1c – Reflect Stakeholder Interests Fairly:** The Group made a number of observations in respect of stakeholder interests. In particular it was felt important to protect the BSC arrangements for future stakeholders and the Group noted that no BSC Party should be disadvantaged. An appropriate model should reflect the needs of those funding the business. A Group member suggested that smaller Suppliers would like to have an influence but those with a greater market share may want to invest in any future ventures.

## Third Order Design Objectives

4.7. Finally, the majority of the Group observed that some of the design objectives could be viewed as desirable but not essential:



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- **3a – Near/Mid-Term Implementation:** The Group acknowledged that this was important for ELEXON in the short term and that it had impressed the urgency of resolving these governance and vires issues to allow it to participate in forthcoming opportunities and thereby share its expertise for the wider benefit of Government, industry and consumers. It was noted that this was the primary driver behind ELEXON raising its reform proposals in the first place but the majority of Group members felt that the right governance and funding arrangements were critical to expanding the role of ELEXON. The Group noted that ELXON does not share the view that it may be necessary to rule ELEXON out of these opportunities in favour of taking a longer term view of appropriate reforms and it recognised that an interim or ad hoc arrangement might service this objective if necessary. Transitional arrangements could be put in place until the final model is delivered but it is important to know the direction of travel. The nature of such transitional arrangements was not explored by the Group.





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## 5. Assessment Against Design Objectives

- 5.1. The Issue 40 Group made observations and identified a range of benefits and concerns in respect of each Design Objective. The Group identified a number of minor matters or potential benefits and concerns in relation to each model. These are set out in the detailed assessment tables in Appendix VII.
- 5.2. For all models the Group recognised the significant role that the BSCCo (or BSC ProcureCo) Board plays in the management of BSC Services and the BSCCo budget. It acknowledged the importance of the BSCCo (or BSC ProcureCo) Board being able to drive BSCCo (or BSC ProcureCo) according to the needs of its stakeholders (BSC Parties). Further, the Group felt that the composition of the BSCCo (or BSC ProcureCo) Board should be changed to ensure that BSC Parties have greater control over the BSCCo Board and associated funding while still drawing on appropriate expertise from outside the industry in decision making.
- 5.3. The Group also believed that, for Models A and B, members of the BSCCo (or BSC ProcureCo) Board should be different/independent of the New HoldCo (or BSC ServeCo) Board to avoid any conflict of interest.
- 5.4. The key findings in relation to each model are summarised below.

### Model A

#### 5.5. Observations

- Model A preserves the existing oversight of BSC activities by BSC Parties via the established BSC Panel and BSCCo Board governance. The Group noted that BSC Parties elect industry Panel members every two years and can also inform the decision-making of the BSC Panel and Board through its consultation on the BSC Strategy and other matters on an ongoing basis. Two of the elected Panel members are subsequently appointed to the BSCCo Board by the BSC Panel.
- Company directors have a primary responsibility to act in the interests of the company. The BSCCo Board must therefore act independently of the New HoldCo Board and the Boards of other New HoldCo subsidiaries.
- All new (non-BSC) activities are undertaken through limited liability subsidiaries, or Special Purpose Vehicles (SPVs), to ensure that all ELEXON



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Group companies will be operationally and financially independent of ELEXON Limited (BSCCo). The checks and balances required to ensure appropriate ring-fencing of costs and liabilities for Model A would need to be captured in the BSC and in the Articles of Association of New HoldCo, the BSCCo as one of its subsidiaries and any other New HoldCo subsidiaries as required.

## 5.6. Protection for the BSC Arrangements (Design Objectives 2a, 2b and 2c)

- New HoldCo's constitution (including its Articles of Association and associated provisions in the BSC) will prevent it from facilitating the grant of security or otherwise the creation of any encumbrance over BSCCo.
- Any use of BSC assets and resources for non-BSC activities would be charged at arms-length rates at the discretion of and upon terms to be agreed by the BSCCo Board. Provision would need to be made for this in the BSC Business Plan and Budget (which are consulted upon) and set out in the financial accounts presented in the BSC Annual Report. Appropriate protections would be provided in any such contracts established by BSCCo for the provision of such BSC assets and resources to other companies (including ELEXON Group SPVs).
- Any BSC funds approved by the BSCCo Board for use in establishing a SPV may result in costs being imposed on BSC Parties which may not be returned if any bids for commercial contracts are not awarded. It is envisaged that any such bad debt would be handled as it currently is under the existing BSC. That is: BSCCo may have to accommodate this bad debt by calling for funds from BSC Parties to cover the loss, since the BSC cannot be under-funded. Accordingly, in any circumstances where BSCCo charges out resource to other organisations (including one from BSCCo to another ELEXON Group subsidiary) and these charges are not met, there is a risk that BSC Parties have funded services to companies which may not be able to meet their liabilities, potentially requiring BSC Parties to cover the loss. However, it was noted that there would be no compulsion on BSCCo to fund New HoldCo or its subsidiaries and it would be for the BSCCo Board to take full account of any risk in doing so.



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- ELEXON reported on legal advice it had received under legal privilege (and therefore not available to the Group for review). This advice confirmed that the provision of funding by BSCCo to an affiliate for the purposes of funding a bid for the DCC is not anti-competitive. Indeed, it may be viewed as pro-competitive as it will enable an additional bidder, the ELEXON Group, to participate in the competition for the licence to undertake the DCC role. The Group acknowledged this and determined not to commission its own advice at this time, recognising that a legal view would be more valuable in respect of specific drafting when any proposed model was being developed for implementation.
- The model contains features that will continue to ensure that core BSC services are maintained through the responsibilities of the company boards and the protections established in any service contracts.
- BSC Parties retain their existing oversight of BSC activities via the BSC Panel and the BSCCo Board. The BSCCo Board must be satisfied that any activities do not compromise ability to discharge its BSC obligations.
- There is no risk of financial failure of the BSC service company (BSCCo) since the existing BSC funding arrangement (where BSC Parties fund BSCCo on a funding share basis) remains in place. Under Model A, Ofgem retains its existing powers to direct a change in ownership of BSCCo and in the event that New HoldCo became insolvent it would fall to Ofgem to exercise this power.

## 5.7. Independence of BSC Services (Design Objective 1a)

- Safeguarding BSCCo's position of independence is a core principle underpinning Model A. ELEXON Ltd (as the BSCCo) would operate as an independent subsidiary of New HoldCo (rather than National Grid) and continue to be overseen by the BSCCo Board, delivering a BSC strategy set by the BSC Panel as it is now.

## 5.8. Funding and BSC Costs (Design Objectives 1d, 1e and 3c)

- BSC Parties may have to fund some of the costs associated with establishing New HoldCo if other forms of funding cannot be found.



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However, outside this initial set-up, Model A provides a framework which does not require BSC Parties to fund new ventures.

- BSC Parties could act as a potential source of funding for an initial new business venture (e.g. bidding to become the DCC) via BSC funding shares. These funds could be re-paid to BSC Parties in due course based on appropriate (e.g. commercial) agreed terms and if ELEXON Group was successful in its bid. The Group noted that the use of these funds would be at the discretion of the BSCCo Board in the delivery of the BSC Strategy set by the BSC Panel and recognised the importance of the governance underpinning such decision-making where BSC Parties could be impacted.
- BSCCo would continue to operate on a not-for profit, cost pass-through, basis. Any surpluses (i.e. under-spend against the approved BSC budget) would be returned to BSC Parties (as now). Accordingly, there would be no profits available to New HoldCo from BSC services to re-invest in new, non-BSC activities, however, individual entities (SPVs) within the ELEXON Group are not prohibited from attracting alternative sources and types of finance dependent on the nature of each venture. As each new opportunity arises over time, and where SPVs are established to deliver new activities, potential investors can make an informed decision to participate or not. Such SPVs can attract the full diversity of available funding sources (equity, debt, joint ventures, etc.), using the recognised ELEXON brand and experience.
- It is anticipated that BSC costs could reduce over time as new activities were taken on by the ELEXON Group and could be defrayed as outlined in ELEXON's current business plan. A commentary on implementation costs is provided in section 5.11 of this report.

## 5.9. Autonomy of ELEXON Ltd and Reflection of Stakeholder Interests (Design Objective 1b and 1c)

- Model A permits the ELEXON Group to pursue activities in an autonomous and agile fashion. These activities would be restricted to those permitted by its constitution (e.g. the promotion of innovation and efficiency through the provision of regulated and unregulated services to the utilities sector



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for the benefit of industry, consumers, regulatory bodies and other legal authorities).

- Model A provides flexibility to ensure that all existing and future stakeholder interests are reflected in the activities undertaken by the ELEXON Group of companies. As a Company Limited by Guarantee, members have influence over New HoldCo via their responsibility to elect New HoldCo Board members. One member one vote means equal say for all members (irrelevant of size) at New HoldCo level. Membership would be open to all future stakeholder communities that the ELEXON Group might serve through new ventures. New entrants are not excluded.
- Any investors (shareholders) in a New Hold Co subsidiary (SPV) who wish to ensure an appropriate influence over any new ventures could do so via that SPV's Board.

## 5.10. Compatibility with Regulatory Frameworks (Design Objective 4)

- Model A provides for flexibility in the application of appropriate regulatory frameworks. It allows for separate entities to be established for regulated activities with separate boards and governance for these entities. This separation provides transparency for the Regulator and users of regulated services. Overall, Model A supports a clear legal and regulatory framework by separating distinct regulatory activities into relevant subsidiary companies.

## 5.11. Commentary on Implementation (Design Objectives 3a, 3b, 3c)

**Making the Required Changes (Legal Implications):** Implementation of Model A will require the Authority to direct National Grid to transfer its ownership of ELEXON to the New HoldCo (the Authority already has this power). A Modification to the BSC will be required to effect the restructure and include the proposed protections for BSC Parties relating to New Hold Co. It is felt unlikely that there would be any enduring changes to the Transmission Licence and it is anticipated that any that were required would be minimal. There would be a process to attract members to New HoldCo, however establishment of New HoldCo could be realised as soon as a single first member is found. Existing BSCCo



### **Transferring Ownership of ELEXON Ltd.**

The Authority may direct National Grid to transfer its shareholding in ELEXON to another entity. Thus, a Modification to the BSC is not required to effect any transfer in the ownership of ELEXON.

However, a subsequent Modification would be required to replace "Transmission Company" with the name of the new shareholder of BSCCo.



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assets would remain with ELEXON Limited (BSCCo) and, going forward, the use of any BSCCo assets by other ELEXON Group companies would be under commercial terms with appropriate protections.

**Costs to BSC Parties:** The one-off cost to BSC Parties for changing the BSC is likely to be broadly similar across all three models but the cost of establishing New HoldCo is anticipated to be lower than the combination of establishing a BSC ProcureCo and putting in place a contract between the two entities under Model B. It is recognised that there is a need to solve the initial transitional funding issue. A solution to this has been suggested through the BSC Business Plan. However, it would not be possible to provide funds to allow ELEXON to bid for new business opportunities until the BSC is changed to allow this.

**Timescales:** ELEXON believes that Model A could be implemented in a relatively short timescale (e.g. 3-6 months). This is based on the transfer of the single National Grid share in ELEXON Ltd to New HoldCo and the progression of a Modification as outlined above, under regulatory leadership and direction. The Group recognised that Model A would be quicker to implement than Model B but noted that there may be elements of detail in the implementation which extend this timeline.

## Model B

### 5.12. Observations

- Model B preserves the level of oversight of BSC activities by BSC Parties via the established BSC Panel and a BSC ProcureCo Board governance. The Group noted that the BSC ProcureCo Board would be broadly equivalent to the BSCCo Board in that it would oversee the activities of the procurement vehicle, and not the activities of the organisation delivering the BSC services directly, as now. This creates an important distinction between the company that is BSC ProcureCo and any service company appointed as BSC ServeCo.
- The Group acknowledged the significant role that BSC ProcureCo must take in robustly and actively managing the services provided by a BSC



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ServeCo under a commercial contract on behalf of the BSC Panel and BSC Parties.

- Company directors have a primary responsibility to act in the interests of the company. The Group noted that BSC ProcureCo and BSC ServeCo are separate organisations and not part of a corporate group. Accordingly, the BSC ProcureCo Board must act independently of the BSC ServeCo Board.
- Under Model B BSC ServeCo could undertake new (non-BSC) activities which may or may not be undertaken through limited liability Special Purpose Vehicles (SPVs) on a case by case basis. The checks and balances on BSC ProcureCo required to ensure appropriate ring-fencing of costs and liabilities must be captured in its Articles of Association and within the BSC. Further protections should be detailed in the contract between BSC ProcureCo and BSC ServeCo.

## 5.13. Protection for the BSC Arrangements (Design Objectives 2a, 2b and 2c)

- The Group felt that ring-fencing BSC Parties from any costs and risks associated with ELEXON Mk2 Ltd undertaking new (non-BSC) ventures would not be an issue under a robust contract between BSC Procure Co and BSC ServeCo with appropriate protections and transparent service levels and key performance indicators for the service company. BSC Parties would have no financial liability for losses incurred by BSCServeCo or its subsidiaries.
- It was observed that, under Model B, BSC ServeCo would disclose only its charges (as opposed to its costs) under the contract. It was further observed that where BSC ServeCo is undertaking multiple roles without Special Purpose Vehicles, the transparency for BSC Parties of costs is reduced across the total portfolio of services (although where some of those BSC Parties are also shareholders in BSC ServeCo, BSC ServeCo will be accountable to those companies in their capacity as shareholders). Given their interests are expected to be protected through the service contract, BSC Parties may well be indifferent as to how BSC ServeCo chooses pursues its new business and as such transparency is less relevant.



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- Maintaining core BSC services will be the responsibility of the BSC ProcureCo Board who will manage and enforce the protections established in the commercial services contract with BSC ServeCo. BSC Parties retain their existing oversight of BSC activities via the BSC Panel and the BSC ProcureCo Board and the BSC ProcureCo Board must be satisfied that steps are taken to ensure BSC ServeCo discharges its BSC obligations according to the terms of its contract.
- The Group noted that there is a slightly increased risk of disruption to BSC activities arising from the financial failure of BSC ServeCo. This is not seen as a significant concern since it is envisaged that an administrator of BSC ServeCo would not terminate the profitable BSC ServeCo contract but instead seek to ensure a managed transition to a new service provider. The Group reasonably expected that Ofgem would step in to direct BSC ProcureCo to appoint a BSC ServeCo if the existing BSC ServeCo became insolvent and no replacement could be found.

## 5.14. Independence of BSC Services (Design Objective 1a)

- The Group agreed that Model B should be established in a way that restricts any BSC Party from having a controlling interest in BSC ProcureCo and in the procuring of BSC services. All BSC Parties would hold an equal share in BSC ProcureCo and each new Party that acceded to the BSC would be allocated a share in BSC ProcureCo. This might be accomplished by defining an equivalent of Trading Party Groups that encompasses all BSC Parties rather than only Trading Parties.
- The Group acknowledged that the shareholders of BSC ServeCo would be different to those of BSC ProcureCo and as such, interests may not be aligned and conflicts of interest could arise. Independence would therefore need to be supported through robust contractual arrangements with BSC ServeCo being actively managed by an appropriately resourced BSC ProcureCo.



### **Trading Party Groups.**

Annex B2, Section 3.1.5 defines a Trading Party Group as a Trading Party and every Affiliate (i.e. holding company or subsidiary) of that Trading Party.

## 5.15. Funding and BSC Costs (Design Objectives 1d, 1e and 3c)





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- BSC Parties will be compelled to fund the costs associated with establishing BSC ProcureCo. Outside this initial set-up Model B provides a framework which does not compel BSC Parties to fund new ventures.
- Model B provides for a high degree of flexibility in funding and addresses a key concern around the funding of an initial venture since only willing investors would fund the new business opportunities. Accordingly, ELEXON Mk2 Limited can fund an initial venture through shareholder investment and can attract the full diversity of available funding sources (equity, debt, joint ventures, etc.), using the recognised ELEXON brand and experience.
- Because BSC Parties are not compelled to invest in ELEXON Mk2 Ltd. at its start-up it is felt that those that do will be fully engaged in the new company. However, future investors can only become shareholders in and invest in ELEXON Mk2 Ltd or any subsidiary at the discretion of the existing shareholders.
- The Group anticipated that, although costs may initially rise to reflect the introduction of a profit element within the BSC ServeCo contract, the costs of running BSC ServeCo may reduce over time due to commercial drivers and incentive arrangements within the BSC ServeCo contract and that these savings could be shared between BSC ServeCo and BSC ProcureCo (and therefore BSC Parties) subject to the contract. A commentary on implementation costs is provided in section 5.18 of this report.

## 5.16. Autonomy of ELEXON Ltd and Reflection of Stakeholder Interests (Design Objective 1b and 1c)

- Model B permits ELEXON Mk2 Ltd to pursue activities in an autonomous and agile fashion. These activities would be aligned to those that are acceptable to its shareholders.
- The influence of stakeholders (BSC Parties) over BSC ServeCo is via their influence through the Board and/or BSC Panel of BSC ProcureCo and ultimately depends on robust and active management of the contract with BSC ServeCo.



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- Investors (shareholders) in ELEXON Mk2 Ltd who wish to ensure an appropriate commercial return for any new ventures have oversight (via the ELEXON Mk2 Ltd Board) of new activities undertaken by ELEXON Mk2 Ltd. The ownership of ELEXON Mk2 Ltd. can only evolve to reflect a changing customer base at the discretion of the existing shareholders. This could exclude stakeholders of new services provided by ELEXON Mk2 Ltd from ownership and influence. Therefore the influence of stakeholders over new activities undertaken by ELEXON Mk2 Limited would depend upon any additional governance around these activities (e.g. where they are regulated or codified such as the BSC).

## 5.17. Compatibility with Regulatory Frameworks (Design Objective 4)

- Model B provides for flexibility in the application of appropriate regulatory frameworks. It allows for separate entities to be established for all regulated activities with separate boards and governance for these entities. The separation provides transparency for the Regulator and users of regulated services.

## 5.18. Commentary on Implementation (Design Objectives 3a, 3b, 3c)

**Making the Required Changes (Legal Implications):** A direction from the Authority would be needed to effect the change of ownership in ELEXON under Model B. In addition it would require a Modification of the BSC to create and define the ownership, role, governance and funding arrangements for the new BSC ProcureCo. Additionally it would be necessary to create an appropriate commercial services contract for the delivery of BSC services and to negotiate a contract with an organisation to fulfil the role of BSC ServeCo. There may also be a need to undertake a procurement process for the BSC ServeCo contract (although Group members felt that ELEXON Mk 2 Limited should be expected to assume this role for an initial period). It may also be necessary to novate existing BSC Agent contracts from ELEXON Limited to BSC ProcureCo. National Grid has also indicated that some Transmission Licence changes may be required, for example, in relation to references to the secretarial body. Establishment of ELEXON Mk2 would require some process to enable the offer and purchase of shares. Existing BSCCo assets could be transferred to BSC ProcureCo or ELEXON Mk2 Limited. A mechanism



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would need to be established to deal with this. Going forward, the use of any BSCCo assets by other companies would be under commercial terms with appropriate protections.

**Costs to BSC Parties:** The one-off cost to BSC Parties for changing the BSC is likely to be broadly similar across all three models but establishing a BSC ProcureCo, BSC ServeCo and putting in place a contract between the two entities is likely to be more expensive than establishing New HoldCo as terms and conditions and service levels would need to be negotiated. Additional costs may be incurred if this involves a procurement process and novation of BSC Agent contracts.

**Timescales:** Model B cannot be implemented in full within timescales currently envisaged by DECC for (i) appointing the DCC (effectively excluding ELEXON from the DCC bidding process) and (ii) identifying organisations by the turn of the year to be the central bodies in its EMR delivery landscape. A phased implementation could allow ELEXON Ltd. to bid for the DCC, but as this is currently precluded by the Code a Modification would still be required. Such a phased introduction has not been explored by the Group.

## Model C

### 5.19. Observations

- Model C preserves the existing oversight of BSC activities by BSC Parties via the established BSC Panel and BSCCo Board governance.
- Under Model C all new activities would be brought under the BSC via a Modification or similar so as to fall within its scope. Activities would then be managed under the existing governance. Accordingly, the BSCCo Board would oversee the activities of BSCCo across a growing portfolio of services.

### 5.20. Protection for the BSC Arrangements (Design Objectives 2a, 2b and 2c)

- The checks and balances required to ensure appropriate ring-fencing of costs and liabilities for Model C must be captured in the BSC and in the Articles of Association of ELEXON Ltd as BSCCo. These protections would need to be re-considered and potentially revised each time a new activity



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is incorporated into the BSC. There are concerns that, as the BSC grows, BSC Parties may become exposed to a wider set of risks and liabilities.

- The existing BSC governance ensures funds are spent appropriately where needed. It also ensures that there is no risk of financial failure of the BSC service company (BSCCo) since the existing BSC funding arrangement (where BSC Parties fund BSCCo on a funding share basis) remains in place.
- However, an expanding portfolio of services set out under the BSC creates a risk of cross-subsidy as the same organisation would be undertaking several roles, using BSC Parties' funds. It is anticipated that these concerns would lead to differential charging arrangements evolving under the BSC.
- The model contains no specific features that will continue to ensure that core BSC services are maintained. It will fall to the BSCCo Board and the company's senior management team to ensure delivery of BSC obligations and continued good service.

## 5.21. Independence of BSC Services (Design Objective 1a)

- It was noted that BSCCo essentially retains its independence as a wholly owned subsidiary of National Grid delivering only the BSC. However, the Group was concerned that there may be an increased chance of conflict of interest and a perceived loss of independence where BSCCo is undertaking a wider set of activities under the BSC if these activities had a variety of different users and beneficiaries.

## 5.22. Funding and BSC Costs (Design Objectives 1d, 1e and 3c)

- Model C has a number of limitations that make funding the pursuit of business opportunities difficult and as such the Group felt it was not an appropriate funding model. It provides operational funding certainty at the expense of any ongoing provision for development of new ventures. The existing restrictions on BSCCo's ability to raise non-BSC funding would continue to be a barrier to business development. Subject to regulatory approval, all BSC Parties will be obliged to fund new activities under Model



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C. As such there is no investment discretion unless specific amendments to the BSC are made as part of each change on a case by case basis.

- The Group also noted that Model C carries costs associated with each Modification required to enable opportunities going forwards with no obvious driver to improve efficiencies in the delivery of the BSC. A commentary on implementation costs is provided in section 5.25 of this report.

## 5.23. Autonomy of ELEXON Ltd and Reflection of Stakeholder Interests (Design Objective 1b and 1c)

- Model C cannot deliver the agility sought because it is likely to be difficult and time consuming to gain consent for each new activity. A requirement to change the BSC to pursue new business would be a hindrance and is likely to restrict its suitability to very limited, low-risk, low-investment new activities closely related to the BSC.
- The Group acknowledged that all BSC Parties may influence the activities of BSCCo under Model C through the Modifications process. However, even though this is an open and transparent process it is unlikely to capture the views of all potential stakeholders for new services if such parties are not already BSC Parties. As the scope of the BSC grows it may not provide a fair reflection of all stakeholders in wider services unless the existing types of BSC Party also evolve. It is implied that more types of organisation (possibly operating in areas other than Electricity Balancing and Settlement) would become BSC Parties, potentially having influence over all BSC activities (in which they may have little interest).

## 5.24. Compatibility with Regulatory Frameworks (Design Objective 4)

- The Group identified significant concerns regarding Model C given that, over time, it could lead to increasing complexity in the BSC which will be required to deal with the relationship between the current, core BSC scope and any new activities. This could be seen to “pollute” the existing BSC arrangements with terms that do not seem to naturally fit under the BSC. Ultimately, the regulatory framework would not be as clean as Models A or B. For example, the DCC Licence role being undertaken within BSC would



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need to be established under the Transmission Licence where it may not be an appropriate fit.

## 5.25. Commentary on Implementation (Design Objectives 3a, 3b, 3c)

**Making the Required Changes (Legal Implications):** The BSC Incremental model would require an enabling Modification to the BSC in order to accommodate each new proposed activity, potentially re-casting BSC Parties rights, obligations and liabilities on each occasion. This creates uncertainty for existing and prospective BSC Parties in how these might evolve under the BSC going forwards. Although this is perhaps no different to the level of certainty arising from the BSC Modification procedures at the current time. National Grid has also indicated that the broader scope of the BSCCo under this model is likely to require changes and/or additions to the existing Applicable BSC Objectives to accommodate ELEXON's 'other' activities and that it would also be necessary to consider the extent to which the Transmission Licence could accommodate non-core activities for National Grid Electricity Transmission.

**Costs to BSC Parties:** The one-off cost to BSC Parties for changing the BSC is likely to be broadly similar across all three models. However, every new, non-BSC activity could potentially give rise to costs for BSC Parties. These costs would be the result of progressing Modifications required to accommodate new provisions.

**Timescales:** Model C could be implemented relatively swiftly but requires an enabling BSC Modification for every opportunity going forwards. Such updates to the BSC could take the form of a designation from the Secretary of State associated with specific primary legislation (as in the case of the recent "Warm Home" changes). Alternatively, they might arise from a Significant Code Review undertaken by Ofgem or they might be brought forward as a Modification by a BSC Party. In all these cases it is not clear whether such changes would be forthcoming or if they could be assessed, approved and implemented in time to take advantage of opportunities as they arise.



### **BSC Changes to Accommodate "Warm Homes"**

In accordance with Condition C3.5(c) of the Transmission Licence, NGET was directed by the Secretary of State to make a number of enabling Modifications to the BSC for the purposes of facilitating the establishment and operation of a reconciliation mechanism in connection with the Warm Home Discount Scheme established under Part 2 of the Energy Act 2010. The Secretary of State's direction also includes a number of changes to the Transmission Licence itself.

ORD004 was raised on 30 June 2011 and can be viewed at:

<http://www.elexon.co.uk/pages/ord004.aspx>



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## 6. Conclusions

- 6.1. All models preserve a level of oversight of BSC activities by BSC Parties via the established BSC Panel and a BSCCo Board (this is via the BSC ProcureCo Board managing and enforcing the BSC ServeCo contract in Model B). The Group recognised the importance of these roles in each of the models and expressed a desire that these bodies act robustly in the interests of the industry and BSC Parties in particular.
- 6.2. BSC Parties may be required to fund the costs associated with establishing either New HoldCo or BSC ProcureCo if alternative funding cannot be sourced. Outside this initial set-up, both Model A and Model B provide a framework which does not compel BSC Parties to fund new ventures or the pursuit of new ventures on an ongoing basis other than where there is a regulatory funding obligation such as under BSC.
- 6.3. Both Model A and Model B can be established to provide appropriate ring fencing and delivery of independent BSC Services to the existing level of service or better. However, the features of each Model raise some issues that would need to be addressed in the detail required for implementation. These matters are outlined below and the impact of these concerns may affect the initial viability of each model.

### Model A

- ELEXON proposes using BSC funds (as approved in the 2010/11 budget and business plan) for establishing an initial Special Purpose Vehicle (SPV) to undertake a bid to be the DCC. These funds could be re-paid to BSC Parties in due course based on appropriately agreed terms provided ELEXON Group was successful in its bid. If the BSC Panel or BSCCo Board withhold these funds the DCC SPV will need to seek alternative funding from a subset of BSC Parties or from non BSC Parties.
- Any BSC funds approved by the BSCCo Board for use in establishing a SPV may result in costs being imposed on BSC Parties and not returned if bids for commercial contracts are not awarded.



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- The Group recognised that New HoldCo and BSCCo are separate organisations that would be part of a company group. The Group acknowledged the importance of the BSCCo Board being able to drive BSCCo according to the needs of its stakeholders (BSC Parties). The Group felt that members of the BSCCo Board should be different / independent of the New HoldCo Board in order to ensure demonstrable separation between the two companies and to avoid any conflict of interest.

## Model B

- Under Model B there is a risk that no (or too few) organisations will acquire shares in ELEXON MK2 Ltd preventing the company from being set up and causing BSC ProcureCo to have to seek other providers for the BSC ServeCo contract.
- The Group's preference was that, under Model B, ELEXON MK2 Ltd would be awarded the initial service contract without a competitive tender process as a transition arrangement. This will provide ELEXON MK2 Ltd with a guaranteed revenue stream that will enable it to respond to commercial opportunities. However, it was recognised that this may be subject to advice from Ofgem on the requirement for a competitive procurement.
- Model B places great weight on establishing and managing a robust contract between BSC ProcureCo and BSC ServeCo. The effective, robust and active management of this contract is the vehicle for ensuring appropriate protections are in place for BSC Parties, no inappropriate cross-subsidies exist between BSC and non-BSC activities and that BSC services are delivered in an independent fashion. It therefore relies on establishing an effective, active and adequately resourced BSC ProcureCo.
- The Group recognised that BSC ProcureCo and BSC ServeCo would be separate organisations and not part of a company group. The Group acknowledged that the BSC ProcureCo Board must drive BSC ProcureCo management of the BSC ServeCo contract according to the needs of its stakeholders (BSC Parties). The Group felt that members of the BSC





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ProcureCo Board would need to be different / independent of the BSC ServeCo Board in order to avoid inherent conflicts of interest.

## Model C

- Many concerns arise under Model C which limit its viability as a vehicle to support new business opportunities. It is not agile to change and grants ELEXON little autonomy to actively pursue new business for the benefit of its customers. Concerns have been identified with the layers of incremental complexity that would be required to accommodate a changing customer base and the challenges this would lead to in the application of appropriate regulatory regimes.

## **Implementation**

- 6.4. The one-off cost to BSC Parties for changing the BSC is likely to be broadly similar across all three models.
- 6.5. Establishing a BSC ProcureCo, BSC ServeCo and putting in place a contract between the two entities is likely to be more expensive than establishing New HoldCo. Further time and expense would be incurred if this involves a procurement (i.e. if the BSC ServeCo service contract had to be tendered for).
- 6.6. Models A and C could be implemented relatively quickly. Model B cannot be fully implemented within timescales envisaged by DECC for appointing the DCC (Quarter 2 2012) – effectively excluding ELEXON from the DCC bidding process and potentially excluding ELEXON from being a central body in DECC's EMR delivery landscape (DECC to identify by the end of the year). However, a phased implementation could allow ELEXON Ltd. to bid for the DCC.
- 6.7. In any event both Models A and B equally require a Modification to the Code.
- 6.8. The Group also noted that legal advice would need to be sought on points of detail when seeking to implement any of these Models. In particular the Group highlighted the need for legal support in the drafting of appropriate protections to ring-fence the BSC arrangements from any other activities undertaken by ELEXON.



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## Ongoing Costs

6.9. All models allow for continued improvements in operational efficiency and commercial management to be driven by the BSCCo (or BSC ProcureCo) Board. In addition, the Group noted:

- For Model A it is further anticipated that BSC costs would reduce over time as new activities were taken on by the ELEXON group and could be defrayed as outlined in the business plan.
- With respect to Model B the group recognised the significance of establishing very clear service levels in the contract between BSC ProcureCo and BSC ServeCo such that all required services were captured and appropriate commercial drivers for improvement were embedded in the contract. The Group noted that the charges by BSC ServeCo for providing the BSC services under the BSC ServeCo contract may increase at first to reflect the profit element required as a return on the investment for BSC ServeCo shareholders and the contestable nature of the contract. The Group anticipated that these charges should reduce over time due to commercial drivers within the BSC ServeCo contract for the service provider to reduce costs and that these savings could be shared between BSC ServeCo and BSC ProcureCo (and therefore BSC Parties) subject to the provisions of the contract.
- Model C brings BSC costs with every future change to the BSC.

## Next Steps

6.10. This report has been presented to the BSC Panel and has been provided to Ofgem and is available from the ELEXON website.

6.11. The models presented in this report cannot be implemented via a Modification to the BSC in isolation. The Group recognises that amendments to documentation outside the BSC will be required depending upon the detailed design of any model which is progressed.

6.12. The Group therefore looks to both Ofgem and DECC to provide a clear direction that can deliver a way forward.



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6.13. The Group recognises that Ofgem has commissioned its own report into ELEXON's diversification and governance. There are some concerns associated with each of the models considered by the Issue 40 Group that need specific attention in order to resolve and the Group encourages Ofgem to take account of the views presented in this report as part of its work.



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## 7. Appendices & Attachments

- Appendix I - ELEXON's Current Role and Activities
- Appendix II - Transmission Licence and BSC Provisions Relating to National Grid
- Appendix III - Overview of Initial Proposals
- Appendix IV - The Gemserv Model
- Appendix V - Comparative Descriptions of Models
- Appendix VI - Significant Design Objectives
- Appendix VII - Assessment of Models against Design Objectives
- Appendix VIII - Issue 40 Meeting Participation
- Attachment 1 - Issue 40 Document



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## Appendix I – ELEXON’s Current Role and Activities

ELEXON Ltd currently fulfils the role of the Balancing and Settlement Code Company (BSCCo) as defined under the Balancing and Settlement Code (BSC). The BSC contains the rules and governance arrangements for electricity balancing and settlement in Great Britain, and ELEXON is responsible for ensuring its proper, effective and efficient implementation. The BSCCo is currently unable to pursue activities others than those set out in the BSC. Section C1.2.2 BSC makes it clear that new business development opportunities such as the DCC role cannot be pursued.

ELEXON’s service offerings are built on the obligations set out in the BSC and reflect its expertise in:

- Commercial management and procurement
- Service and operations management
- Customer support
- Assurance
- Government support
- Change assessment and implementation

### Governance and Committee Support

The Balancing and Settlement Code is governed by the BSC Panel and a number of committees and industry groups. They meet regularly to fulfil the duties of the BSC and discuss issues arising from day to day operations. ELEXON provides independent chairs for these committees together with the associated secretariat and administration services that support this governance.

### Service Management and Operational Delivery

ELEXON procures and manages services on behalf of BSC Parties. These systems and services underpin the balancing and settlement of electricity in accordance with the BSC.

BSC systems capture the contracted volumes from generators and suppliers to identify what they said they would produce or consume. The systems also capture data on actual supply and demand volumes. Any difference must be paid for. So, if a generator has supplied less than what it said it would for the half hour it must pay for the imbalance between its declared and actual position. Or, if a supplier’s offer to reduce demand for a half hour was accepted by National Grid, then it will be paid for that balancing action. Prices and payment are managed by ELEXON through the settlement process.

### Changes to the Systems and Processes of Settlement



# Issue 40 Findings Report

The BSC and its subsidiary documents, systems and processes are constantly evolving. Any BSC Party – such as a generator or a supplier – can raise a proposal to change them. ELEXON works with industry experts and the BSC Panel to assess the impact of each proposal and manage the consultation process.

The electricity regulator, Ofgem, makes the final decision on Modifications to the BSC itself, whereas BSC Panel Committees made up of industry experts oversee changes to the subsidiary documents. ELEXON then implements approved changes to the Code and subsidiary documents and manages any changes to central BSC systems.

## **Assurance that the BSC Arrangements Work.**

ELEXON's systems and processes are fundamental to the everyday work of generators, suppliers and National Grid, and those companies need be confident that they work. As BSC Parties, those companies also need to adhere to the obligations, performance standards and targets of the BSC.

ELEXON gives advice and guidance on the BSC and what parties should do to comply with it, and suggest corrective actions where they are not complying. ELEXON also provides independent assurance to the industry that electricity companies are abiding by the rules set out in the BSC and provides a Trading Disputes service to rectify any settlement errors.



# Issue 40 Findings Report

## Appendix II – Transmission Licence and BSC Provisions Relating to National Grid

### Overview of Transmission Licence Obligations in Relation to the BSC Arrangements

#### Current Licence / BSC Arrangements

NGET's main obligation under its licence<sup>1</sup> is to have in force a BSC document which outlines the terms of the balancing and settlement arrangements. The actual arrangements such as the establishment of a secretarial body to administer the BSC (i.e. BSCCo) are contained within the BSC. The ownership of the BSCCo (by the Transmission Company) is also contained within the BSC<sup>2</sup>, rather than the licence.

The Authority can direct the Transmission Company to transfer ownership under the BSC<sup>3</sup>. The Transmission Company cannot transfer ownership without such direction. NGET has no financial obligations, under the licence or the BSC<sup>4</sup>, to support BSCCo or its subsidiaries. Specifically, there are no obligations on NGET to be the 'provider of last resort'. This is explored in more detail below.

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<sup>1</sup> Standard Condition C3, paragraph 1

<sup>2</sup> BSC section C2.2.1

<sup>3</sup> BSC section C2.2.3

<sup>4</sup> BSC section C2.4.1



# Issue 40 Findings Report

## Overview of Financing and Step-In provisions under the BSC

### Funding Obligations

National Grid (NG), as BSCCo's sole shareholder, has no liability or obligation to provide any finance or financial support to BSCCo or any of its subsidiaries. The relevant BSC provisions are set out in Section C2.4. Emergency funding provisions are set out in Section D6.6.

### Step-in Provisions

In certain **limited** circumstances, the BSC provides that Ofgem may issue a direction to NG requiring it to undertake particular tasks that would otherwise be performed by ELEXON. These requirements are commonly known as "step in" provisions. The BSC obliges NG to step-in in the following **three** circumstances:

- **Accession to the BSC:** where ELEXON has failed to implement the Authority's instruction to allow a new entrant to Accede to the BSC. The relevant BSC provisions are set out in Section A2.3.
- **Operation of the Modification Procedure:** where ELEXON has failed to comply with the provisions of Section F. The relevant BSC provisions are set out in Section F1.7.
- **Publication of Data on the BSC Website and the provision of data to the Authority:** where ELEXON has either failed to publish data on the website or to make data available to Ofgem from its agents. The relevant BSC provisions are set out in Section C3.7.

This is explained further below with reference to the supporting BSC legal text.

These provisions are important from a regulatory perspective however, the step-in provisions are limited to the specific circumstances set out here. There is no overarching obligation (under the BSC or Transmission Licence) for NG to step in and perform ELEXON's role in settlement either on a temporary or enduring basis.

## Funding obligations

Section C: "BSCCo and its Subsidiaries" sub paragraph 2.4 states:

### **2.4 No obligation to finance**

2.4.1 "The Transmission Company as BSCCo Shareholder shall have no liability or obligation to provide any finance or financial support to BSCCo or any Subsidiary of BSCCo and shall have no obligation to Parties as BSCCo Shareholder other than as expressly provided in the Code".

In circumstances where there is either an urgent funding requirement or, ELEXON's agreed budget is insufficient to fund its activities, the BSC makes provision for these events as follows:





# Issue 40 Findings Report

**Emergency Funding<sup>5</sup>:** Emergency funding provisions are set out in Section D: “BSC Cost Recovery and Participation Charges”. In circumstances where ELEXON is unable to pay any of its costs, these provisions allow ELEXON, with the approval of Panel, to give notice to Trading Parties of the need for a cash call. Trading Parties are required to meet the cash call requirements on the specified date.

**Budget Overspend<sup>6</sup>:** Budget overspend provisions are set out in Section C: “BSCCo and its Subsidiaries”. In circumstances where ELEXON anticipates that the approved budget is insufficient to meet expenditure the provisions of Section C provide for ELEXON to request, and the Panel (note that the annual budget is approved by the ELEXON Board but additional funding requests are submitted to the Panel) are to approve, additional expenditure and for this to be reflected in an update to the annual budget.

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<sup>5</sup> Extract from Section D: “BSC Cost Recovery and Participation Charges”.

## **6.6 Emergency funding**

- 6.6.1 If at any time BSCCo is or anticipates that it will be unable to pay any BSC Costs falling due for payment before BSCCo will receive (from Trading Parties pursuant to invoices issued under paragraph 4.5) funds sufficient to enable it to pay such BSC Costs:
- (a) BSCCo may, with the approval of the Panel, give notice by way of cash call to Trading Parties:
    - (i) requiring them to pay in their Main Funding Shares for the month in which such notice is given such amount as BSCCo requires so as to be sufficiently funded; and
    - (ii) specifying the date (as approved by the Panel) for payment of such cash call, which shall not be less than 3 Business Days after the date of such notice;
  - (b) each Trading Party shall pay the amount so notified as payable by it, not later than the date specified for payment;
  - (c) amounts so payable by Trading Parties will be BSCCo Charges, treated as accruing due when so notified, and will be taken into account in determining the amounts subsequently payable as BSCCo Charges in the relevant BSC Year (by being taken into account in the invoicing of such charges pursuant to paragraph 4.3.1);
  - (d) BSCCo shall promptly after making such cash call provide to all Trading Parties an explanation of the circumstances which required it to be made, and (without prejudice to Section C6.5) a statement of whether the BSC Costs in question represent expenditure in excess of the amount in the Annual Budget.

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<sup>6</sup> Extract from Section C: “BSCCo and its Subsidiaries”

## **6.5 Budget overspend**

- 6.5.1 If the aggregate amount of BSCCo's expenditure in any BSC Year exceeds, or BSCCo anticipates that it may exceed, the amount contained in the Annual Budget, BSCCo shall promptly:
- (a) notify the Panel and all Parties, giving details of the excess expenditure and an explanation of the reasons therefore; and
  - (b) submit to the Panel and all Parties a draft revision of the Annual Budget, together with any possible options for modifying the Business Strategy which BSCCo considers may be appropriate so as to reduce or limit its expenditure in the relevant BSC Year (and an indication of the effect of such proposals on the Annual Budget).
- 6.5.2 After discussion with the Panel (and such consultation with Trading Parties as the Panel may stipulate), but subject to and taking account of any consequent revision of the Business Strategy which the Panel may have approved, BSCCo shall revise the Annual Budget so as to include the excess expenditure.



# Issue 40 Findings Report

It should be noted that the provisions on emergency funding and budget overspend only apply to Trading Parties (as defined in the BSC). As NG is not a Trading Party, these provisions do not apply to them.

## Step-in provisions

In certain **limited** circumstances, the BSC provides that Ofgem may issue a direction to NG requiring it to undertake particular tasks that would otherwise be performed by ELEXON. These requirements are commonly known as “step in” provisions.

Authority directions to NG are issued pursuant to condition C3 “Balancing and Settlement Code (BSC)” of the Transmission Licence.

Step-in provisions are as follows:

**Accession to the BSC<sup>7</sup>:** Section A sets out the procedures for new entrants to join the BSC and these are administered by ELEXON directly. If there is a dispute as to whether an applicant has fulfilled all of the BSC entry requirements, the entrant can appeal to the Authority.

In circumstances where the Authority determines that the applicant has met all of the requirements and instructed ELEXON to admit the entrant as a Party, if ELEXON fails to implement the Authority’s instruction, the Authority may instruct NG to step-in and complete the entry process.

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<sup>7</sup> Extract from Section A: “Parties and Participation”

### 2.3 Disputes as to admission

#### 2.3.1 If:

- (a) there is any dispute as to whether a Party Applicant has fulfilled the requirements in paragraph 2.2 (including paragraph 2.2.5) and is entitled to be admitted as a party to the Framework Agreement; and
- (b) the Authority determines, as provided by the Transmission Licence, that such Party Applicant has fulfilled such requirements and is entitled to be so admitted, subject to paragraph 2.2.5, such Party Applicant shall be admitted as a party to the Framework Agreement and BSCCo shall forthwith execute and deliver an Accession Agreement, duly executed by the Party Applicant, in order to effect such admission (and shall comply with the other provisions of paragraph 2.2.3).

#### 2.3.2 If BSCCo fails to comply with paragraph 2.3.1 and the Authority directs the Transmission Company to admit the Party Applicant as a party to the Framework Agreement pursuant to the Transmission Licence:

- (a) subject to paragraph 2.2.5, the Transmission Company shall prepare an Accession Agreement to admit such Party Applicant and shall, on behalf of all Parties, execute and deliver such Accession Agreement, duly executed by the Party Applicant, and provide a copy to BSCCo (to enable it to comply with paragraphs 2.2.3(b) and (c));
- (b) the Transmission Company shall be entitled to be reimbursed by BSCCo for its reasonable costs incurred in so doing.

#### 2.3.3 Where the Authority directs the Transmission Company to admit a Party Applicant as a party to the Framework Agreement pursuant to the Transmission Licence, each Party hereby irrevocably and unconditionally authorises the Transmission Company to execute and deliver on behalf of such Party an Accession Agreement, duly executed by such Party Applicant, to admit such Party Applicant.



# Issue 40 Findings Report

**Operation of the Modification Procedure<sup>8</sup>:** Section F sets out the procedures for proposing, assessing and implementing changes to the BSC. In certain limited circumstances the Authority may direct NG to assume responsibility for the modification procedure. In these circumstances the Panel, Panel Chairman and ELEXON is required to provide whatever assistance is necessary to enable NG to comply with the Authority's direction.

The circumstances where the Authority may make a direction are:

- Panel and/or ELEXON is failing to comply with the provisions of Section F;

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<sup>8</sup> Extract from Section F: Modification Procedures

## **1.7 Role of the Transmission Company**

1.7.1 If the Authority issues a direction to the Transmission Company pursuant to condition C3 of the Transmission Licence in the circumstances described in paragraph 1.7.3, the following provisions shall apply in relation to a particular Modification Proposal or Approved Modification:

- (a) the Transmission Company shall be entitled to, and shall, assume responsibility for the Modification Procedures to the extent, on the terms and for the period set out in such direction;
- (b) the Panel, the Panel Chairman, the Modification Secretary and BSCCo shall provide such assistance to the Transmission Company and shall take such steps as the Transmission Company may reasonably request to enable the Transmission Company to comply with such direction (and, in the case of BSCCo, such assistance shall include the provision at the cost of BSCCo of all necessary data, facilities, suitably qualified staff and other support and the exercise and enforcement, at the request of the Transmission Company, of relevant rights under the BSC Agent Contracts);
- (c) subject to paragraph 1.7.1(b), the powers, functions and duties of the Panel, the Panel Chairman, the Modification Secretary and BSCCo in relation to the Modification Procedures shall be suspended to the extent and for the period that the Transmission Company is to assume responsibility for the Modification Procedures as set out in such direction;
- (d) the Transmission Company shall assume (and there are hereby conferred on the Transmission Company) the powers, functions and duties of the Panel, the Panel Chairman, the Modification Secretary and BSCCo in relation to the Modification Procedures to the extent and for the period that the Transmission Company is to assume responsibility for the Modification Procedures as set out in such direction;
- (e) the Transmission Company shall operate the Modification Procedures in accordance with the provisions mutatis mutandis of this Section F and having regard, wherever possible, to the provisions of Section B and Section C as they relate to the Modification Procedures;
- (f) the costs and expenses of the Transmission Company properly incurred in the operation of the Modification Procedures pursuant to such direction (as approved by the Authority) shall be paid by BSCCo to the Transmission Company and recovered by BSCCo from Trading Parties in accordance with the provisions of Section D;
- (g) the benefit of Section B2.9.1 shall be extended to apply to the Transmission Company, as if references to a Panel Member were to the Transmission Company, to the extent that the Transmission Company is carrying out the functions of the Panel pursuant to this paragraph 1.7.

1.7.3 The circumstances referred to in paragraph 1.7.1 are that:

- (a) in the Authority's opinion, the Panel and/or BSCCo is failing or is likely to fail in any material respect to comply with the provisions of this Section F as they relate to the operation of the Modification Procedures and/or the implementation of Approved Modifications in respect of a particular Modification Proposal or Approved Modification; and
- (b) the Authority has given notice to the Modification Secretary requiring the Panel or BSCCo (as the case may be) to comply with such provisions within the time specified in such notice; and
- (c) the Panel or BSCCo (as the case may be) fails to do so in any material respect within the time specified in such notice (or such longer period as the Authority may agree).



# Issue 40 Findings Report

- The Authority has given notice to the Panel or ELEXON to comply with the provisions of Section F within specified timescales; and:
- The Panel or ELEXON fails to comply within the specified timescales.

**Publication of Data and Provision of Information to the Authority<sup>9</sup>:** Section C provides for the Authority to direct NG to “secure compliance with any relevant provision of the Code”. However, the powers of the Authority are specifically limited to circumstances where ELEXON has failed to meet its obligation to publish data (on the website or otherwise), or to provide information to the Authority.

The BSC requires ELEXON to provide any assistance required to enable NG to meet the Authority direction and authorises NG to make requests and issue instruction to BSC Agents.

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<sup>9</sup> Extract from Section C: BSCCo and its Subsidiaries

### **3.7 Matters relating to the Transmission Licence**

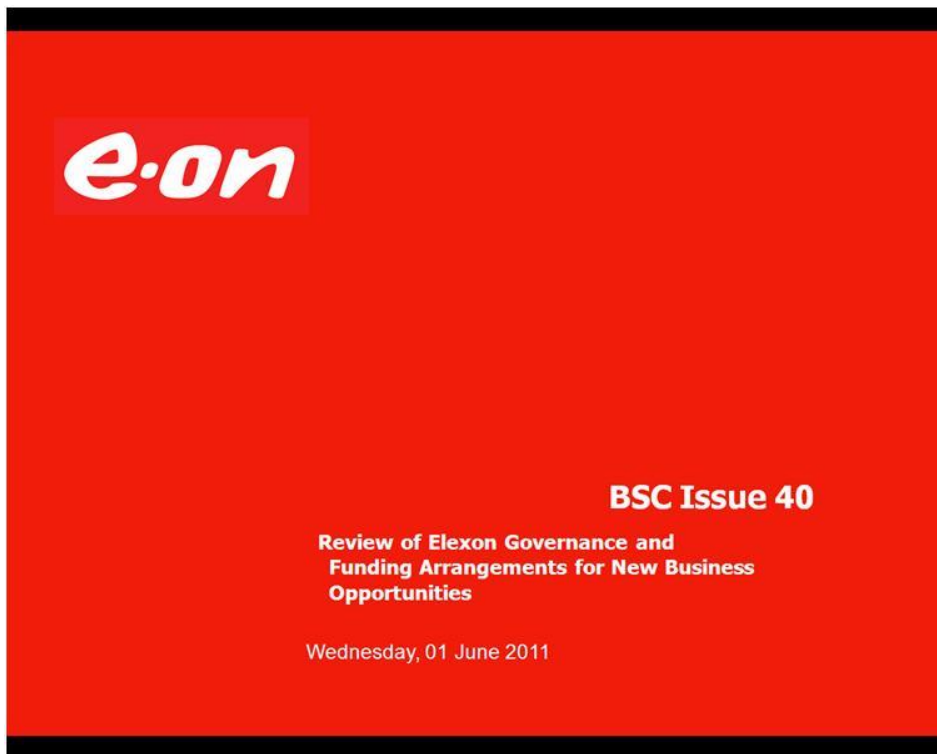
- 3.7.1 If the Authority issues a direction pursuant to the Transmission Licence to the Transmission Company to secure compliance with any relevant provision of the Code:
- (a) BSCCo shall provide all such assistance and take all such steps as the Transmission Company may reasonably require to comply or secure compliance with the relevant provision;
  - (b) without limitation of paragraph (a), BSCCo hereby appoints and authorises the Transmission Company to make any request of or issue any instruction to any BSC Agent or Market Index Data Provider on behalf of and in the name of BSCCo;
  - (c) the Transmission Company is hereby authorised by all Parties to provide to the Authority or (where the relevant provision of the Code so requires) place on the BSC Website or otherwise publish the information in question;
  - (d) the reasonable costs of the Transmission Company properly incurred in complying with such direction shall be paid by BSCCo to the Transmission Company.
- 3.7.2 For the purposes of paragraph 3.7.1 the relevant provisions of the Code are the provisions of paragraph 3.6.1 (subject to paragraph 3.6.3) and any provision of the Code which provides for any information to be placed on the BSC Website or otherwise published.



# Issue 40 Findings Report

## Appendix III – Overview of Initial Proposals

The slide pack set out below was used by the Issue 40 Group to develop its initial models from the proposals presented at its first meeting.



# Issue 40 Findings Report

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## Objectives of the Issue - for the group to consider

1. The extent to which Elexon should be permitted to pursue new business development opportunities,
2. The process for setting budgets, authorising expenditure and ensuring effective accountability to BSC parties.
3. Funding arrangements and the extent to which costs and risks should be allocated to BSC Parties that benefit from new business developments,
4. How surplus income generated from new business development opportunities are used including
  - (a) consideration of repayments to parties required to/choosing to fund such activities and/or
  - (b) reductions to BSCCo charges.
5. The separate accounting and ring fencing of new business activities from existing BSC activities, and whether new organisation or ownership structures are required,
6. The respective roles of the Board and BSC Panel, the Transmission Company and Trading Parties for each of the points 1) to 5).
7. An appropriate regulatory regime

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## Elexon – How can Elexon pursue new business development opportunities?

- Limitations of the BSC – currently the BSC prevents BSC Company from undertaking activities other than as provided for in the Code.
- Alternative industry models:
  - Gemserv – who provide services for MRASCO, The Gas Forum, UKRPA, Micro-generation Certification Scheme, and the Water Industry amongst others.
  - ElectraLink – who provide services for SPAA Ltd, DCUSA Ltd, The Data Transfer Network.

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# Issue 40 Findings Report



## The “Gemserv” Model

The MRASCO (Master Registration Agreement Services Company) was initially owned larger parties in the electricity industry and was set up to service the MRA arrangements after market opening.

Gemserv was incorporated in 2002 to allow the organisation who provided support services to the MRA to compete for other commercial activities.

Industry parties were offered shares in Gemserv – not all industry parties are shareholders. No direct link between MRA parties and Shareholding.

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## The “ElectraLink” Model

ElectraLink established in 1998 as a private limited company.

Shareholders are all Distribution Network Operators

ElectraLink offer data management and governance services to the gas and electricity industry

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# Issue 40 Findings Report

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## E.ON's preferred Option – The “Gemserv” Model

- Splits the core BSC Company work into 3 separate functions:
  1. Secretariat function for the Balancing & Settlement Code
  2. Administration of the BSC activities – Change Control/Helpdesk/meeting management/legal etc.
  3. Contract Management of BSC Services

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## Advantages


- Increases transparency on costs
- Promotes efficiency in resourcing of activities
- Award of services contract subject to competitive tender process
- Protects BSC parties from the speculative activities of a commercial company whose business plans can be more diverse
- Allows investment in Elexon from individuals/companies who are not BSC Parties
- Gives shareholders of Elexon more control over their business plan
- Retains their expertise in the industry and allows them to diversify and potentially compete for other industry contracts or offer new services outside the scope of Elexon's current activities

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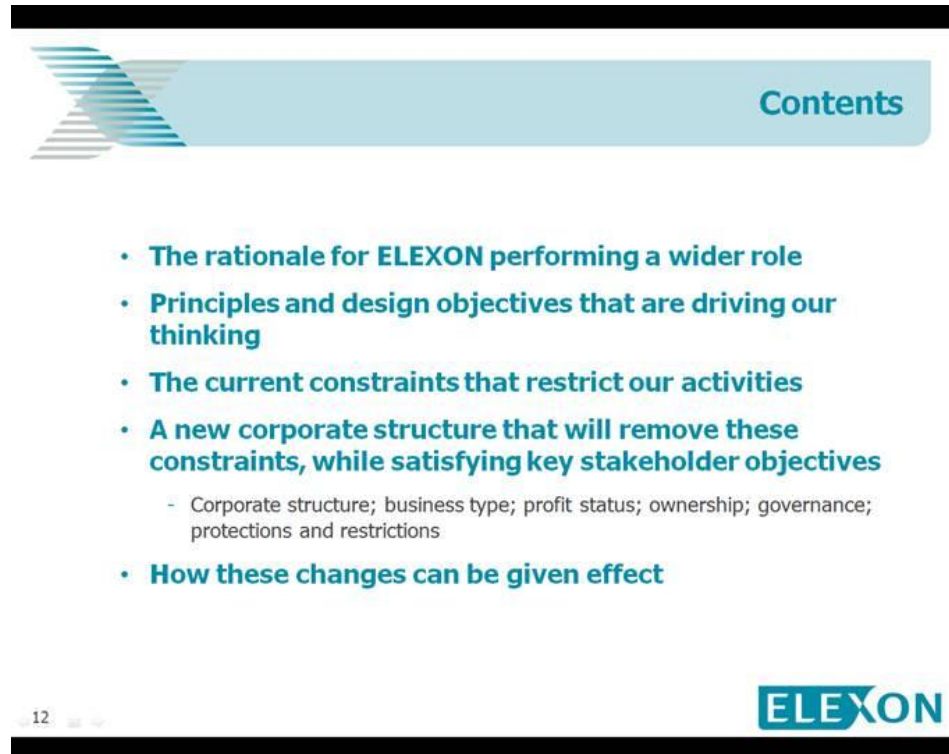
# Issue 40 Findings Report

The following slides were presented by ELEXON and outline its straw-man.



Issue 40  
ELEXON Restructure  
Proposals


Gareth Forrester  
May 2011



**Contents**

- **The rationale for ELEXON performing a wider role**
- **Principles and design objectives that are driving our thinking**
- **The current constraints that restrict our activities**
- **A new corporate structure that will remove these constraints, while satisfying key stakeholder objectives**
  - Corporate structure; business type; profit status; ownership; governance; protections and restrictions
- **How these changes can be given effect**

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# Issue 40 Findings Report

## Strategic rationale

- » **Enabling ELEXON to support a wider range of industry initiatives will:**
  - promote greater competition in central market services; and
  - offer better value and innovation in the delivery of central market services for the benefit of industry and, ultimately, the consumer.
  
- » **A decision to do nothing in light of the current market changes has inevitable implications:**
  - the latent value of ELEXON assets (expertise, systems, processes) will remain unrealised, or even dissipate; and
  - the industry will continue to spend more than is necessary on duplicated central arrangements.
  
- » **There are many areas of the emerging market where our existing capabilities and resources could be harnessed to enable policy, to deliver a cost-effective solution for the industry and, ultimately, to benefit consumers.**
  
- » **We've set out to create a vehicle for better supporting industry reform. But some enabling changes are needed to our corporate structure and governance to accommodate any substantive new activities.**

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## Principles

- » **Any restructure proposal must be:**

### 1. Achievable

In terms of timing - to enable ELEXON to participate in new licensable activities and other near/mid-term opportunities, these changes are required now.

In terms of scope – this is not an opportunity to introduce additional significant change, merely changes to enable ELEXON to apply its expertise in new areas

### 2. Acceptable to stakeholders

In particular ensuring that any reform does not introduce unacceptable cost or risk for the BSC arrangements

### 3. Aligned to a set of key design objectives

To ensure a fit for purpose ownership and structure model based on principles of best practice corporate governance, transparency and accountability.

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# Issue 40 Findings Report

## Design objectives

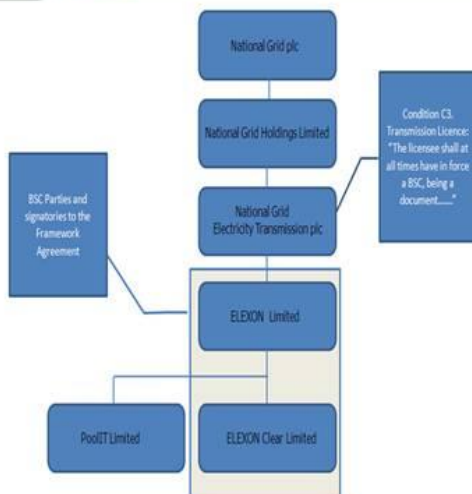
Our thinking has been driven by some key objectives:

1. Creating an appropriate corporate structure and governance for existing and new activities
2. Ensuring that our existing core BSC business services are maintained and that there is no dilution of BSC resources and expertise
3. Ensuring an appropriate legal and regulatory framework
4. Safeguarding our unique position of independence and our not for profit tradition
5. Allowing for fair reflection of all stakeholder interests
6. Ring-fencing and transparency of liabilities and costs for any new activities
7. Enabling appropriate funding to meet capital requirements, while avoiding inappropriate cross-subsidy or unfair competitive advantage

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## Current structure and ownership



- » ELEXON Limited is a wholly owned, but unconsolidated subsidiary of National Grid
- » Ownership of ELEXON is under National Grid (except where Ofgem (the Authority) otherwise directs);
- » National Grid has no obligation (financial, strategic, or otherwise) to ELEXON or its subsidiaries except as set out in the BSC;
- » Very limited NG step-in provisions (and these are by virtue of the licence/BSC, not by virtue of being the owner).

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# Issue 40 Findings Report

## There are a number of existing restrictions on ELEXON as BSCCo

### Restrictions currently imposed by the BSC on ELEXON include:

- » ELEXON and its subsidiaries are prevented from undertaking any business or other activity outside core BSC activities;
- » ELEXON is prevented from holding any interests in other legal entities for the purposes of delivering services outside the BSC;
- » ELEXON cannot seek independent investment in order to finance its activities.

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## There are three alternative basic structures that could be used

### BSC/BSCCo Incremental

- » All future roles are undertaken by ELEXON pursuant to the BSC – the BSC is expanded in scope.
- » ELEXON remains with its current structure and governance as set out in the BSC.
- » Ownership remains with National Grid.
- » Directorship, management structure and funding (via cost recovery solely from all BSC Parties) remains as is.
- » No subsidiary or other separate company (i.e. a "NewCo") is used.

### ELEXON Mark 2

- » BSC and all future roles are undertaken by the same entity (ELEXON)
- » ELEXON therefore undertakes both new activities and BSC activities.
- » The BSC restrictions on its activities and ability to raise independent (non-BSC funding) monies are removed.
- » Transparency obligations and budgetary controls may be removed or diluted.
- » The directorship appointment process and governance structure are changed.
- » Potentially also the shareholding is changed (e.g. to a class of Parties).

### NewCo




- » 'ELEXON BSCCo' remains as is and undertakes the BSC work under the BSC and recovers its costs as now.
- » The BSC remains essentially unchanged, other than to address relationship with affiliates and ensure protections for BSC Parties.
- » A NewCo is formed which undertakes all future non-BSC roles, either directly or through separate vehicles formed as appropriate for each.

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# Issue 40 Findings Report

## Assessment of these has lead to our strong preference for a 'NewCo' approach

BSC/BSCCo Incremental	ELEXON Mark 2	NewCo
<ul style="list-style-type: none"> <li>» Cost increases for Parties unless new ventures limited to those at no cost, marginal cost or funded from savings.</li> <li>» No ring fenced liability. BSC Parties liable for losses relating to non-BSC activity.</li> </ul>	<ul style="list-style-type: none"> <li>» Complex. Requires significant 'surgery' to existing BSCCo governance and funding arrangements.</li> <li>» Would not allow Parties to retain control over BSCCo spend or activities once initial freedom granted.</li> <li>» Difficult to establish confidence that BSC service would be maintained.</li> </ul>	<ul style="list-style-type: none"> <li>» Clear delineation of activities, financing and limitation of liability</li> <li>» BSCCo activities remain restricted – maintains Party control of BSC costs and activities</li> <li>» Parties could receive cost reductions through defrayed BSC costs.</li> <li>» As BSCCo is ring fenced, neutrality and independence as BSCCo would be unaffected.</li> </ul>
		
<p>Only suitable for very limited, low-risk, low-investment new activities closely related to the BSC.</p>	<p>Significant concerns for Parties re: control, cost certainty and risk to core BSC services.</p>	<p>Best meets both ELEXON's and industry's objectives, by balancing agility with checks and controls for BSC Parties.</p>

## Corporate structure proposal

A new umbrella holding company with a number of single purpose subsidiaries



- » These could include entities that are a mix of:
  - Not for profit
  - For profit, earning regulated returns
  - For profit including joint ventures and limited liability partnerships
- » Mimics a typical company structure
- » Different subsidiaries may operate different businesses and in different sectors
- » Subsidiaries may provide services to each other and 3rd parties
- » Businesses can be acquired and/or grown and if desired, sold off

# Issue 40 Findings Report

## New HoldCo profit status and treatment of surpluses

### » New HoldCo will be 'not for distribution'

- "Not for distribution" does not mean not commercially driven
- While some subsidiaries may return a profit to the holding company, the holding company itself will be 'not for dividend', i.e. it will not distribute profits to its owners.
- It will therefore re-invest any surpluses solely to further primary purpose (and therefore for the interests of its stakeholders).

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## Rationale for not-for-distribution status

### ELEXON Perspective

- **Principle:** Consistent with our vision to act in the greater good rather than for our own gain.
- **USP:** Safeguards our unique market position of independence, and not for profit tradition.
- **Differentiation:** Effectively differentiates us from alternative providers which are:
  - a. driven by profit motives;
  - b. pursuing short term financial objectives; and
  - c. owned by a subset of the industry.
- **Stability:** Defends against commercial takeover at the group level (but does not prohibit divestment of subsidiaries)
- **Stakeholder needs:** desire to have the support of stakeholders for the expanding strategy leads to the conclusion that the group should be not for profit

### Industry Perspective

- **Focus on value and service:** Gives comfort that the ELEXON Group is primarily concerned with providing long term value and service to its members (who are often its customers)
  - Not short term focus;
  - Not focus on returning profits to shareholders.
- **No competitive threat:** The absence of a distribution of profits to members, mitigates the risk that one member (or a class of members) may seek to unduly influence the Group for its own financial benefit (at the expense of other market participants).
- **Stability:**
  - Unlikely takeover target
  - Dependable

### Government/Regulator Perspective

- **Stability/Fit with regulatory framework:** Protects any regulated arrangements, e.g. the BSC (by avoiding takeover or shareholder capture)
- **Policy delivery:** Creates an appropriate vehicle for supporting industry policy or regulatory reforms, particularly where these require shared central market arrangements.
- **Independence:** no commercial drivers on third parties to influence to their financial advantage
- **Balance:** Allows these to be governed in a way that balances the needs of, and provides accountability to, a broad (and evolving) range of stakeholders, regardless of size.
- **Dependable and Reliable**

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# Issue 40 Findings Report

## Business type and characteristics of New HoldCo

### » A Company Limited by Guarantee (CLG)

- Owned by members (not shareholders) who guarantee (can be a nominal amount) on winding up; all members typically have equal holding; Members' liability is limited to amount of guarantee
- No distribution/dividends to members permitted
- Will have a defined purpose – e.g. *"promoting and delivering innovation, cost efficiency, and rationalisation through the provision of regulated and unregulated services to the utility sector for the benefit of industry, consumers, regulatory bodies and other legal authorities"*
- The interest (guarantee) is not tradeable but subsidiaries can be grown and sold
- Cannot demand equity from members, so must have no need or must rely on debt
- CLG seen as more "virtuous" compared to "commercial" CLS

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## Ownership Principles

- » **Membership should be constituted from the stakeholders that New HoldCo will benefit**
  - this should include stakeholders for current BSC activities and stakeholders in potentially new ELEXON Group activities;
- » **Membership requirements must be sufficiently flexible**
  - to allow for other additional parties to become members to reflect any further changes in ELEXON Group activities that have yet to be anticipated;
- » **The membership arrangements must not be capable of manipulation**
  - such that no member is able to exert undue influence to the detriment of other members, for example it is proposed that whilst different entities within a corporate group may be entitled to become members of New HoldCo, such corporate group will only be entitled to one vote (on behalf of that corporate group) in any members' resolution;
- » **The community of members should provide appropriately skilled and qualified people from which non executive directors may be nominated.**

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# Issue 40 Findings Report



## Ownership of New HoldCo

- » **As a CLG, owned by members rather than shareholders**
  - Members provide a Guarantee (usually a nominal sum of £1)
  
- » **Membership of this new entity will be voluntary, and open to a wide range of industry stakeholders, defined to reflect the industry communities that it will be serving**
  - Gas/electricity Licence holders
  - Signatories to gas/electricity codes
  - Relevant consumer representative organisations
  
- » **Members will have influence over the activities of HoldCo and its subsidiaries**
  - through the HoldCo Board
  - through any specific governance arrangements for regulated entities (e.g. BSCCo)

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## BSC Protections

- The BSC arrangements will remain substantively unaffected.
- In particular, all existing BSC protections will remain unchanged.
- The BSC company ("ELEXON BSC Co") will have no liability to any other ELEXON Group company (unless the BSC provides for it).
- The Board of ELEXON BSC Co is to:
  - approve any use of BSC resources for activities outside the BSC on arm's length commercial terms;
  - be satisfied that the use of such resources will not have an adverse effect on ELEXON BSC Co's ability to discharge its BSC obligations;
  - ensure that ELEXON BSC Co accounts for any income received in its financial results; and
  - ensure that the use of such resources is reported in ELEXON BSC Co's annual accounts.
- New HoldCo's constitution will prevent it from granting security over or otherwise encumbering ELEXON BSC Co.
- All ELEXON Group companies will be operationally and financially independent of ELEXON BSC Co.

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# Issue 40 Findings Report

## Implementation

- » Implementation will require changes to the BSC and the assistance of Ofgem and/or DECC.
- » Ofgem has the power under the BSC to direct National Grid to transfer its ownership of ELEXON to another entity.
- » We believe that there are a number of potential options to facilitate these changes.
- » We are engaged in discussions with Ofgem about how they might provide regulatory assistance to facilitate implementation.
- » Options also include the Secretary of State exercising powers under the Energy Act 2008 to direct changes to the BSC for purposes related to smart metering.
- » Implementation must be commenced, delay will result in the opportunity to apply ELEXON's expertise and experience being missed.

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## Scope of BSC changes

- » **Changes to the BSC will be required including:**
  1. the transfer of National Grid's obligations (in its capacity as BSCCo Shareholder) to New HoldCo; and
  2. detailing the relationship between affiliates of ELEXON, for example, between New HoldCo and ELEXON (see above)

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# Issue 40 Findings Report

## Our proposal in the context of Issue 40

Issue 40 elements	ELEXON proposal
1) The extent to which Elexon should be permitted to pursue new business development opportunities	The question becomes: If ELEXON (BSCCo) is part of a wider group, what are the appropriate enablers and protections for BSCCo?
2) The process for setting budgets, authorising expenditure and ensuring effective accountability to BSC parties	BSCCo budget approval, reporting and accountability to Parties would be completely unchanged under our proposal.
3) Funding arrangements and the extent to which costs and risks should be allocated to BSC Parties that benefit from new business developments	Only relevant to the extent that BSC funds are used to finance new group activities. We foresee complexities in differential charging, but are ultimately neutral on this.
4) How surplus income generated from new business development opportunities are used including (a) consideration of repayments to parties required to/choosing to fund such activities and/or (b) reductions to BSCCo charges	BSC surpluses will always be returned to BSC Parties, as now. ELEXON Group surpluses will be for HoldCo to allocate. But these will not come from BSCCo under existing BSC funding arrangements.
5) The separate accounting and ring fencing of new business activities from existing BSC activities, and whether new organisation or ownership structures are required	We believe that the only way to achieve the appropriate level of separation is through an alternative corporate structure. There are compelling reasons why this should not be via a subsidiary structure under BSCCo.
6) The respective roles of the Board and BSC Panel, the Transmission Company and Trading Parties for each of the points 1) to 5),	BSC governance will be fundamentally unchanged. So all of these roles will be entirely preserved. HoldCo governance will be separate, but will not take precedence over BSC governance in relation to BSC matters.
7) An appropriate regulatory regime.	This is one of our key objectives. Our proposal allows for separate regulated entities to co-exist, within a clear and logical legal and regulatory framework.

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## Summary

Our proposal meets the key reform objectives by:

<b>Adopting established best practice business approaches to create an appropriate corporate structure and governance.</b>	✓
<b>Preserving control, transparency and other protections for BSC Parties under existing the BSC governance and management framework to ensure that our core BSC business services are maintained.</b>	✓
<b>Clearly separating regulated and non-regulated activities in order to enable an appropriate legal and regulatory framework.</b>	✓
<b>Creating a not-for-distribution holding company to operate in the greater good of the industry, thereby safeguarding our unique position of independence and our not for profit tradition.</b>	✓
<b>Allowing for a wide and evolving membership community and governance arrangements that enable fair reflection of all stakeholder interests.</b>	✓
<b>Ring-fencing all liabilities and costs for any new activities within single-purpose vehicles.</b>	✓
<b>Enabling appropriate funding to meet capital requirements by allowing standard finance options for non-regulated entities, while leaving existing restrictions and controls in place.</b>	✓

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# Issue 40 Findings Report

## Appendix IV – The Gemserv Model

### Establishment process

In 2002, Gemserv was established by seeking start-up capital via loans from MRA parties i.e. electricity suppliers & distributors.

A total of £270k was raised (in the form of loan notes) with one initial share given to every MRA party. The loans were in proportion to the individual market share at that time and subject to the 66%/33% split between suppliers and distributors respectively. Rather than a cash transaction, the loans were offset against the MRASCo budget over-recovery in 2001/02.

Debt for equity swap in the form of shares was offered to the individual companies in proportion to the value of the loan notes (with a nominal number offered to those existing non-loan shareholders).

Not all MRA parties decided to take up the offer of this equity swap. Furthermore, since 2002 some companies have given up their shares or, more often, transferred to successor companies as a result of mergers and acquisitions.

In June 2010, Gemserv had 25 shareholders, the nine with the largest shares being:

Scottish & Southern	16%
British Gas	16%
Npower	14%
Scottish Power	13%
EDF	13%
Western Power	11%
UK Power Networks	8%
E.ON	6%
Electricity North West Ltd	3%

The Articles of Association stipulate that only holders of an electricity supply or distribution licence can be a shareholder. However this provision can be waived or varied by ordinary resolution. Furthermore any unissued shares can be offered to any persons as determined by the Gemserv Directors (subject to the provision above).

So, while the further offering of Gemserv shares is not automatic, any party could apply for shares.

If a new company was established in the context of Issue 40, while Gemserv's Articles could be used as a model, clearly they would be tailored to fit the circumstances & requirements of the initial, and future, shareholders.



# Issue 40 Findings Report

## Ongoing operation

Gemserv's Board comprises of seven Directors: two Executive Directors and five Non Executive Directors (of which three are shareholder reps). Therefore a majority are not representatives of shareholders. The Board is concerned with Gemserv's strategic direction and adopts a "hands off" approach to the operation of individual industry agreements.

A Service Agreement exists between MRASCo and Gemserv detailing the required services, associated performance standards and price. MRASCo is not obliged to appoint Gemserv as its service provider (subject to agreed contract duration) i.e. the relationship is subject to competitive pressures.

In 1998, when the MRA commenced, it cost approx. £10m p.a. (at today's prices) to run. For 2011/12, the annual MRA budget is £3.4m (excluding the operation of ECOES (an increased scope since 2006)).

Independence is one of Gemserv's key principles. The fact that we provide services to multiple parties – large and small electricity & gas suppliers, large and independent electricity & gas networks, trade associations, regulators and Govt departments – means that Gemserv has to demonstrate independence all day, every day. Our shareholder base actually means that our drive to operate independently is even greater.

*Examples:* DECC (Smart metering gas valve assessment, MCS), Gas Forum, IGT UNC, NIAUR, Ofwat, Ofgem

For industry agreements e.g. MRA, IGT UNC, the governance rules are set out in the agreement itself with decision-making powers totally resting with the industry parties. Gemserv cannot raise change proposals or vote on any resolutions/proposals.

**David Thorne**

**8th June 2011**



# Issue 40 Findings Report

## Appendix V – Comparative Descriptions of Models

### Key

"ELEXON Limited (BSCCo)"	ELEXON in its current form and role.
"New HoldCo"	The proposed parent company of a new ELEXON Group.
"ELEXON Group"	The proposed group of affiliates under New HoldCo, including ELEXON Limited (BSCCo).
"Regulated Affiliate"	An affiliate of New HoldCo which is a licensed entity or an industry code administrator, e.g. ELEXON Limited (BSCCo).
"ELEXON Mk2 Limited"	Under Model B, the reformed version of ELEXON Limited (BSCCo), with different ownership, governance, funding, profit status and vires from present.
"BSC ProcureCo"	New company proposed under Model B to procure BSC services company.
"BSC ServeCo"	Under Model B, the company providing BSC services under contract to BSC ProcureCo.

### Structure

Attribute	Model A	Model B	Model C
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# Issue 40 Findings Report

Attribute	Model A	Model B	Model C
<b>1</b> <b>Overview</b>	<ul style="list-style-type: none"> <li>• A new umbrella holding company (<b>New HoldCo</b>) is established to be the parent of an <b>ELEXON Group</b>.</li> <li>1. <b>ELEXON Limited (BSCCo)</b> becomes a wholly owned subsidiary of <b>New HoldCo</b>, but is otherwise unchanged.</li> <li>• <b>New HoldCo</b> undertakes all future non-BSC roles, either directly or through separate special purpose vehicles formed as appropriate for each opportunity.</li> <li>• Panel representation, Board composition and oversight of <b>ELEXON Limited (BSCCo)</b> is not affected by this change.</li> <li>• The <b>ELEXON Group</b> subsidiaries will be a combination of:               <ul style="list-style-type: none"> <li>○ regulated not for profit entities e.g. <b>ELEXON Limited (BSCCo)</b> and Warm Homes Limited;</li> <li>○ for profit entities earning regulated returns e.g. (if selected) the DCC; and</li> <li>○ for profit entities (including joint ventures).</li> </ul> </li> <li>• <b>New HoldCo</b> is a company limited by guarantee (CLG) whose membership is voluntary.</li> <li>• Profits within the <b>ELEXON Group</b> are not distributed to <b>New HoldCo's</b> members, but remain in the group.</li> </ul>	<ul style="list-style-type: none"> <li>• A new 'thin' company (<b>BSC ProcureCo</b>) is created under the BSC to procure and manage a BSC services company (<b>BSC ServeCo</b>) which provides all the services that <b>ELEXON Limited (BSCCo)</b> does today. It is anticipated that BSC ProcureCo will require a small pool of full-time staff to ensure pro-active management of BSC ServeCo.</li> <li>• All BSC Parties hold an equal share in <b>BSC ProcureCo</b>. Each new Party that accedes to the BSC is allocated a share in <b>BSC ProcureCo</b>.</li> <li>• The vires, ownership, governance, funding and profit status of <b>ELEXON Limited (BSCCo)</b> is changed (becoming <b>ELEXON Mk2 Limited</b>)</li> <li>• All existing BSC parties are offered shares in <b>ELEXON Mk2 Limited</b>. Shares can be acquired by existing BSC Parties or other organisations at the time of the sale and do not have to be related to existing market share.</li> <li>• <b>ELEXON Mk2 Limited</b> is a company limited by shares (CLS), returning dividends to its shareholders (owners).</li> <li>• <b>ELEXON Mk2 Limited</b> can bid for the <b>BSC ServeCo</b> contract, as well as competing for other non-BSC activities.</li> <li>• BSC services and all other non-BSC roles are undertaken by the same corporate entity (<b>ELEXON Mk2 Limited</b>).</li> </ul>	<ul style="list-style-type: none"> <li>• All future roles are undertaken by <b>ELEXON Limited (BSCCo)</b> pursuant to the BSC – the BSC is expanded in scope.</li> <li>• <b>ELEXON Limited (BSCCo)</b> remains with its current structure and governance as set out in the BSC.</li> <li>• Ownership of <b>ELEXON Limited (BSCCo)</b> remains with National Grid.</li> <li>• No subsidiary or other separate company (i.e. a "NewCo") is used.</li> <li>• Panel representation, Board composition and oversight of <b>ELEXON Limited (BSCCo)</b> is not affected by this change.</li> </ul>



# Issue 40 Findings Report

Attribute	Model A	Model B	Model C
<p><b>2</b></p> <p>Permitted activities of BSC services company (equivalent to ELEXON Limited today)</p>	<ul style="list-style-type: none"> <li>• <b>ELEXON Limited (BSCCo)</b> undertakes only activities as permitted under the BSC as now. Any other (non-BSC) activities are provided via separate group companies.</li> <li>• Any support/activities provided by <b>ELEXON Limited (BSCCo)</b> to non-BSC affiliates requires approval under BSC governance (see later).</li> </ul>	<ul style="list-style-type: none"> <li>• <b>ELEXON Mk2 Limited</b> (if awarded <b>BSC ServeCo</b> contract by <b>BSC ProcureCo</b>) must fulfil commercial service obligations under that contract, to specified service levels.</li> <li>• Any support/activities provided by <b>ELEXON Mk2 Limited</b> to non-BSC affiliates does not require approval under BSC governance.</li> <li>• Services include Secretariat function for BSC; Administration of BSC activities (Change, Helpdesk, meeting management, legal, etc.); and contract management of BSC Services.</li> <li>• However, <b>ELEXON Mk2 Limited</b> may also compete for other industry contracts or offer new services outside the scope of its BSC activities.</li> </ul>	<ul style="list-style-type: none"> <li>• Only such activities as expressly permitted under the terms of the BSC.</li> </ul>
<p><b>3</b></p> <p>Permitted new non-BSC activities ("vires")</p>	<ul style="list-style-type: none"> <li>• The principal purpose of <b>New HoldCo</b> will be enshrined in its legal constitution.</li> <li>• E.g. "The promotion of innovation and efficiency through the provision of regulated and unregulated services to the utilities sector for the benefit of industry, consumers, regulatory bodies and other legal authorities."</li> <li>• New <b>ELEXON Group</b> activities will be restricted to only those that demonstrably further this principal purpose.</li> <li>• New activities must be approved by <b>New HoldCo</b> Board. (Note that the Board is appointed under the constitution of the CLG)</li> </ul>	<ul style="list-style-type: none"> <li>• Primary object is to carry on business to return dividends to shareholders.</li> <li>• May undertake any commercial activities as agreed by Board/shareholders.</li> <li>• Scope of activities may be limited by company constitution, but these are generally framed widely by default (See e.g. Gemserv Mem&amp;Arts) but should not be completely open in this case. It is anticipated that these limitations would permit activities related to the utilities sector and could be the same as those envisaged for Model A.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>ELEXON Limited (BSCCo)</b> activities can only be expanded by means of BSC modifications (including upon direction from the Secretary of State as in the case of Warm Homes).</li> </ul>



# Issue 40 Findings Report

Attribute	Model A	Model B	Model C
<b>4</b> <b>Funding of BSC services</b>	<ul style="list-style-type: none"> <li>• <b>ELEXON Limited (BSCCo)</b> will be funded via BSC funding arrangements as defined in BSC, as now.</li> <li>• Cost pass through for all BSC activities, as now.</li> <li>• BSC funding not to be used for other businesses save as permitted by BSC, i.e. as now.</li> <li>• BSC Party scrutiny of <b>ELEXON Limited (BSCCo)</b> costs as now.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>BSC ProcureCo</b> funded on a cost pass through basis by all BSC Parties under funding arrangements defined in BSC, i.e. as now.</li> <li>• <b>BSC ServeCo</b> receives payment under terms of commercial BSC services agreement. Possibly on a fixed price/cost plus/cost pass through/combination basis, tbc.</li> <li>• Still likely to be significant level of cost pass through under BSC services agreement for <b>BSC ServeCo's</b> fixed and demand-led cost base (e.g. BSC Agent contract costs, BSC systems investments, BSC Mod implementation, etc.).</li> <li>• BSC Party scrutiny of <b>BSC ProcureCo</b> costs, but not <b>BSC ServeCo</b> costs.</li> </ul>	<ul style="list-style-type: none"> <li>• Funding (via cost recovery solely from all BSC Parties) remains as is.</li> <li>• This arrangement would quickly create a need/desire to implement differential charging for services as activities of BSCCo. diversify.</li> </ul>



# Issue 40 Findings Report

Attribute	Model A	Model B	Model C
<p><b>5</b></p> <p><b>Funding of new (non-BSC) ventures</b></p>	<ul style="list-style-type: none"> <li>• Initial Start-up:               <ul style="list-style-type: none"> <li>○ Use of BSC funds required for start-up of <b>New HoldCo</b>.</li> <li>○ Start-up of <b>New HoldCo</b> will not be funded by BSC funds unless authorised under BSC governance.</li> </ul> </li> <li>• Enduring Operation:               <ul style="list-style-type: none"> <li>○ New ventures cannot be funded by BSC funds, unless permitted by BSC.</li> <li>○ <b>New HoldCo</b> cannot demand equity from members.</li> <li>○ <b>ELEXON Group</b> subsidiaries can use <b>New HoldCo</b> reserves, equity from 3<sup>rd</sup> parties, debt or joint ventures as appropriate.</li> </ul> </li> <li>• General:               <ul style="list-style-type: none"> <li>○ Use of BSC funds for start-up of <b>New HoldCo</b> or for new ventures (if permitted by the BSC) does not constitute the purchase of equity in <b>New HoldCo</b> or its subsidiaries and it does not grant BSC Parties further rights and powers in respect of <b>New HoldCo</b> activities save for those set out in the BSC or as agreed under appropriate commercial arrangements between BSCCo and any affiliate.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Initial Start-up:               <ul style="list-style-type: none"> <li>○ Use of BSC funds required for start-up of <b>BSC ProcureCo</b>.</li> <li>○ Establishment of <b>ELEXON Mk2 Limited</b> will require investment by shareholders (anticipated to be some or all of the current BSC Parties in the first instance)</li> </ul> </li> <li>• Enduring Operation:               <ul style="list-style-type: none"> <li>○ New ventures cannot be funded by BSC funds, unless permitted by BSC.</li> <li>○ <b>ELEXON Mk2 Limited</b> new ventures can be funded from profits generated by BSC services contract (and other activities).</li> <li>○ Shareholder equity, debt and joint ventures also available as appropriate.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Enduring Operation:               <ul style="list-style-type: none"> <li>○ Funding (via cost recovery solely from all BSC Parties) remains as is</li> <li>○ Cost increases for BSC Parties unless new ventures limited to those at no cost, marginal cost or funded from savings.</li> <li>○ BSC may be modified to introduce 'user pays' arrangements for different classes of service.</li> </ul> </li> </ul>



# Issue 40 Findings Report

Attribute	Model A	Model B	Model C
<b>6</b> Treatment of losses and financial liabilities of BSCCo	<ul style="list-style-type: none"> <li>• <b>ELEXON Limited (BSCCo)</b> losses and liabilities effectively underwritten by all BSC Parties, as now.</li> <li>• <b>ELEXON Limited (BSCCo)</b> cannot become insolvent due to pass-through BSC funding arrangements.</li> <li>• <b>ELEXON Limited (BSCCo)</b> will have no liability to any other <b>ELEXON Group</b> company (unless agreed under BSC).</li> </ul>	<ul style="list-style-type: none"> <li>• Some contractual risk would be borne by <b>BSC ServeCo</b>. Conceivable that <b>BSC ServeCo</b> could become insolvent.</li> <li>• May require 'BSC provider of last resort/special administration arrangements and increased regulatory controls (e.g. step-in rights) to mitigate this risk.</li> <li>• Likely that some risks would have to be borne by <b>BSC ProcureCo</b>/BSC Parties on a pass-through basis, as a number of BSC costs and risks are outwith the control of <b>BSC ServeCo</b>.</li> <li>• Liability risk of <b>BSC ServeCo</b> will be heavily dependent on whether it (i) holds BSC Agent contracts as a principal; or (ii) <b>BSC ProcureCo</b> holds them with <b>BSC ServeCo</b> merely "arranging" them as its agent. It is envisaged that option (ii) will prevail.</li> </ul>	<ul style="list-style-type: none"> <li>• Passed through to BSC Parties, as now.</li> </ul>
<b>7</b> Treatment of losses and financial liabilities from new ventures	<ul style="list-style-type: none"> <li>• <b>New HoldCo</b> is a company limited by guarantee, so members' liability is limited to amount of guarantee - only obliged to contribute a nominal amount (£1) on winding up, but nothing more.</li> <li>• <b>New HoldCo</b> subsidiaries will all be established as special purpose vehicles with limited liability.</li> </ul>	<ul style="list-style-type: none"> <li>• Any losses and/or liabilities arising from new ventures would be borne by <b>ELEXON Mk2 Limited</b>.</li> <li>• The liability of <b>ELEXON Mk2 Limited</b> shareholders is limited to their shareholding.</li> </ul>	<ul style="list-style-type: none"> <li>• No ring fenced liability. BSC Parties liable for losses relating to a broader set of BSC activities.</li> </ul>
<b>8</b> Treatment of BSC surpluses	<ul style="list-style-type: none"> <li>• All BSC surpluses are returned to BSC Parties, as now.</li> </ul>	<ul style="list-style-type: none"> <li>• Any under-spend by <b>ProcureCo</b> against the BSC budget will be returned to BSC Parties as now. This will be dependent upon the nature of the budgeting process and the contracts established by <b>ProcureCo</b> under the BSC.</li> <li>• Profits generated under the BSC services contract are retained by <b>ELEXON Mk2 Limited</b> and/or distributed to its shareholders by means of dividend.</li> </ul>	<ul style="list-style-type: none"> <li>• Returned to BSC Parties, as now.</li> </ul>



# Issue 40 Findings Report

Attribute	Model A	Model B	Model C
<b>9</b> <b>Treatment of surpluses from new ventures</b>	<ul style="list-style-type: none"> <li>• No distribution of profits to Members, of <b>New HoldCo</b> as established as a not-for-distribution CLG.</li> <li>• Profits created by <b>ELEXON Group</b> subsidiaries and remitted to <b>New HoldCo</b> will be allocated at the discretion of the <b>New HoldCo</b> Board (but only to further the defined overall purpose of the group).</li> <li>• Agreed levels of profit may be returned to investment partners in specific JV subsidiaries.</li> </ul>	<ul style="list-style-type: none"> <li>• All operating profits are retained, reinvested and/or distributed to <b>ELEXON Mk2 Limited</b> shareholders by means of dividend.</li> </ul>	<ul style="list-style-type: none"> <li>• Not for profit</li> <li>• Returned to BSC Parties, as now.</li> </ul>
<b>10</b> <b>Corporate structure</b>	<ul style="list-style-type: none"> <li>• Company Limited by Guarantee (CLG)</li> </ul>	<ul style="list-style-type: none"> <li>• Company Limited by Shares (CLS)</li> </ul>	<ul style="list-style-type: none"> <li>• CLS, as now</li> </ul>



# Issue 40 Findings Report

Attribute	Model A	Model B	Model C
<p><b>11</b></p> <p><b>Ownership/Membership of BSC services company</b></p>	<ul style="list-style-type: none"> <li>• <b>ELEXON Limited (BSCCo)</b> is a wholly owned subsidiary of <b>New HoldCo</b>.</li> <li>• <b>ELEXON Limited (BSCCo)</b> is a special purpose vehicle to deliver only the BSC service and, under terms of the BSC, cannot be sold by <b>New HoldCo</b>.</li> <li>• <b>New HoldCo</b> would accede to the BSC to provide appropriate protections to BSC Parties (see attributes 15 and 17).</li> <li>• The Authority retains the power under the BSC to direct the transfer of ownership of <b>ELEXON Limited (BSCCo)</b> in defined circumstances.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>BSC ProcureCo</b> is owned by BSC Parties. All Parties have 1 share each and new Parties that Accede to the BSC will each receive a share in <b>BSC ProcureCo</b>.</li> <li>• Shares in <b>BSC ProcureCo</b> cannot be sold or traded.</li> <li>• <b>ELEXON Mk2 Limited</b> is owned by private shareholders.</li> <li>• Not all interested parties are entitled to become shareholders. Ownership will be restricted to those BSC Parties (or interested others – see Attribute 1) at time of initial share offer entitled to subscribe for <b>ELEXON Mk2 Limited</b> shares.</li> <li>• New BSC Parties would not have an automatic right to shares in <b>ELEXON Mk2 Limited</b> and could not dilute the position of existing shareholders without the approval of the existing Board/Shareholders.</li> <li>• <b>ELEXON Mk2 Limited</b> Arts&amp;Mems would limit who shares could be sold to, it is anticipated that this might be all current BSC Parties at the time of the sale. However this provision can be waived or varied by ordinary resolution. Furthermore any un-issued shares can be offered to any persons as determined by the Elexon MK2 Ltd directors (subject to the provision above). Otherwise, shareholdings in <b>ELEXON Mk2 Limited</b> will be transferable in the normal manner.</li> <li>• It is envisaged that the provisions of the BSC and the contract between <b>BSC ProcureCo</b> and <b>BSC ServeCo</b> will provide protection for new BSC Parties who are not shareholders in <b>ELEXON Mk2 Limited</b> and existing BSC Parties that choose not to invest.</li> </ul>	<ul style="list-style-type: none"> <li>• Wholly-owned subsidiary of National Grid, as now. NG has no control of <b>ELEXON Limited (BSCCo)</b> (as now).</li> <li>• NG has no right to sell or transfer ownership.</li> <li>• The Authority retains the power under the BSC to direct NG to transfer ownership of <b>ELEXON Limited (BSCCo)</b>.</li> </ul>



# Issue 40 Findings Report

Attribute	Model A	Model B	Model C
<p><b>12</b></p> <p><b>Ownership/Membership of new entity/entities undertaking new, non-BSC ventures</b></p>	<ul style="list-style-type: none"> <li>• <b>New HoldCo</b> owned by members (not shareholders) who guarantee (can be a nominal amount) on winding up.</li> <li>• All members have equal holding.</li> <li>• Membership of this new entity will be voluntary, and open to a wide range of stakeholders, defined to reflect the communities that it will be serving, e.g.:               <ul style="list-style-type: none"> <li>○ Gas/electricity Licence holders</li> <li>○ Signatories to gas/electricity codes</li> <li>○ Relevant consumer representative organisations and other stakeholder groups as appropriate</li> </ul> </li> <li>• Membership will be open to new entrants.</li> <li>• Members will be free to cease their membership.</li> <li>• Subsidiaries may include JVs.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>ELEXON Mk2 Limited</b> shareholders, as above.</li> </ul>	<ul style="list-style-type: none"> <li>• Uncontrolled wholly-owned subsidiary of National Grid, as now.</li> </ul>
<p><b>13</b></p> <p><b>Owners/Members control/influence</b></p>	<ul style="list-style-type: none"> <li>• BSC Parties' influence over <b>ELEXON Limited (BSCCo)</b> through specific BSC governance arrangements is unchanged. <b>New HoldCo</b> governance cannot take precedence over this.</li> <li>• Members' influence over <b>New HoldCo</b> is via members' appointment of Directors and members' resolutions.</li> <li>• Normal constitutional rights and thresholds apply to protect <b>New HoldCo</b> Members.</li> <li>• Equal voting rights for all <b>New HoldCo</b> Members.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>ELEXON Mk2 Limited</b> shareholders have the right to appoint directors and participate in shareholders' meetings.</li> <li>• The matters reserved for <b>ELEXON Mk2 Limited</b> shareholders' determination may be set out in the articles of association or Shareholders Agreement.</li> <li>• Potentially enhanced voting rights for <b>ELEXON Mk2 Limited</b> major shareholders (e.g. on director appointments and other resolutions).</li> <li>• BSC Parties would have influence over <b>BSC ProcureCo</b> through BSC governance arrangements.</li> </ul>	<ul style="list-style-type: none"> <li>• BSC Party influence through BSC governance arrangements as now.</li> <li>• No shareholder (NG) influence.</li> </ul>



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Attribute	Model A	Model B	Model C
<b>14</b> <b>Restrictions on Change of Ownership</b>	<ul style="list-style-type: none"> <li>• <b>New HoldCo</b> (as a BSC Party) would agree via the BSC not to transfer ownership of <b>ELEXON Limited (BSCCo)</b> in the absence of regulatory approval.</li> <li>• Ofgem has right to direct change of ownership of <b>ELEXON Limited (BSCCo)</b> in limited circumstances e.g. insolvency of <b>New HoldCo</b>.</li> <li>• Members' interests in <b>New HoldCo</b> (guarantee) are not transferable, i.e. <b>New HoldCo</b> cannot be sold by its members. However, it is possible for members to give up their membership.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>ELEXON Mk2 Limited</b> shares can be transferred by shareholders in accordance with company law.</li> <li>• Constitution may place restrictions on transferability of shareholdings.</li> <li>• It would not be possible to sell <b>ProcureCo</b> without regulatory consent.</li> </ul>	<ul style="list-style-type: none"> <li>• Ofgem has power to direct change of ownership of <b>ELEXON Limited (BSCCo)</b>, as now.</li> <li>• NG has no right to transfer its share in <b>ELEXON Limited (BSCCo)</b>.</li> </ul>



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Attribute	Model A	Model B	Model C
<p><b>15</b> Other special protections/restrictions</p>	<ul style="list-style-type: none"> <li>• <b>New HoldCo's Regulated Affiliates</b> activities and finances will be ring fenced from the remaining <b>ELEXON Group</b>. It is anticipated that additional restrictions on such <b>Regulated Affiliates</b>, for example, in relation to the issue or grant of security, provision of loans or credit and entering into financial commitments will be dealt with explicitly in the relevant industry codes (as is the case under the BSC).</li> <li>• The Board of <b>ELEXON Limited (BSCCo)</b> must:               <ul style="list-style-type: none"> <li>○ approve the use of BSC resources by an ELEXON Affiliate on arm's length commercial terms;</li> <li>○ be satisfied that the use of such resources will not have an adverse effect on <b>ELEXON Limited (BSCCo)</b>'s ability to discharge its BSC obligations;</li> <li>○ (in accordance with current practice) ensure that <b>ELEXON Limited (BSCCo)</b> accounts for any income received in its financial results; and</li> <li>○ ensure that the use of such resources is recorded in <b>ELEXON Limited (BSCCo)</b>'s annual accounts.</li> </ul> </li> <li>• <b>New HoldCo's</b> constitution will prevent it from facilitating the grant of security or otherwise the creation of any encumbrance over <b>ELEXON Limited (BSCCo)</b>.</li> <li>• As a Party to the BSC, <b>New HoldCo's</b> constitution will prevent it from breach of the BSC.</li> <li>• All <b>ELEXON Group</b> companies will have independent and distinct financial accounting and management. They will be operationally and financially independent of <b>ELEXON Limited (BSCCo)</b>.</li> <li>• Funds may flow between <b>ELEXON Limited (BSCCo)</b>, and <b>ELEXON Group</b> companies if approved under the provisions of the BSC in line with the powers and functions of the BSC Panel and the BSCCo. Board.</li> <li>• Adherence to company law will protect against any conflicts of interest for directors of <b>ELEXON Group</b> companies including <b>ELEXON Limited (BSCCo)</b>.</li> <li>• Within the scope of the annual statutory financial audit, the auditors will ensure that costs and liabilities are correctly identified and recorded, and that any inter-company transactions are accounted for at arm's length</li> </ul>	<ul style="list-style-type: none"> <li>• <b>BSC Procure Co</b> may require PCG to protect the discharge of BSC ServeCo contractual obligations in a group structure.</li> <li>• <b>BSC ProcureCo.</b> would be subject to annual statutory financial audit and BSC Audit provisions as now. The findings presented to the <b>BSC ProcureCo</b> Board and BSC Panel respectively.</li> <li>• <b>ELEXON Mk2 Limited</b> would be subject to annual statutory financial audit. The findings presented to its Board and Shareholders.</li> </ul>	<ul style="list-style-type: none"> <li>• Existing BSC restrictions and protections, as now.</li> </ul>



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Attribute	Model A	Model B	Model C
<b>16</b> <b>Corporate governance</b>	<ul style="list-style-type: none"> <li>• BSC transparency, reporting, scrutiny, and oversight provisions are unchanged.</li> <li>• Appointment of <b>New HoldCo</b> Directors subject to ratification by Members at AGM.</li> </ul>	<ul style="list-style-type: none"> <li>• The BSC ProcureCo. Board (which will continue to include BSC Panel members elected as Board members of BSCCo) have approval and oversight of BSC services contract</li> <li>• BSC Panel no longer approves <b>ELEXON Mk2 Limited</b> Business Plan/Budget.</li> <li>• <b>ELEXON Mk2 Limited</b> Board appointed by shareholders.</li> <li>• <b>BSC ProcureCo</b> Board appointed under provisions of BSC.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>ELEXON Limited (BSCCo)</b> Board composition and appointment defined and restricted under BSC, as now.</li> <li>• Any subsidiary must have same directors as <b>ELEXON Limited (BSCCo)</b>.</li> </ul>
<b>17</b> <b>Regulatory framework</b>	<ul style="list-style-type: none"> <li>• <b>New HoldCo</b> would be a party to the BSC. In this way requirements could be placed on <b>New HoldCo</b> through obligations in the BSC e.g. to restrict it from placing liabilities on BSC Parties by embedding restrictions in its Mem&amp;Arts.</li> <li>• <b>New HoldCo</b> would be a singular class of Party with restrictions preventing more than one organisation falling into this class of BSC Party at any one time.</li> <li>• It is not envisaged that <b>New HoldCo</b> would be permitted to raise Modifications to the BSC.</li> <li>• <b>ELEXON Limited (BSCCo)</b> 'regulated' via BSC which is subject to Panel and Ofgem approvals</li> <li>• All regulated/licensed entities are separate (e.g. DCC, BSCCo, etc.)</li> </ul>	<ul style="list-style-type: none"> <li>• <b>ELEXON Mk2 Limited</b> would not be signatory to BSC, therefore no direct relationship with regulator</li> <li>• <b>BSC ProcureCo</b> would be a signatory to the BSC.</li> </ul>	<ul style="list-style-type: none"> <li>•</li> </ul>
<b>18</b> <b>Commercial basis of BSC services</b>	<ul style="list-style-type: none"> <li>• Evergreen arrangement.</li> <li>• Service obligations defined in BSC, as now.</li> <li>• Cost pass-through (subject to budget approval).</li> </ul>	<ul style="list-style-type: none"> <li>• Profit margin</li> <li>• Contestable</li> <li>• Fixed term BSC services agreement</li> <li>• Demand Led Services (such as change management costs) will be set out on a schedule of charges, however the nature of the work is determined by the amount of industry change directed by the BSC Panel, as such cost recovery will be on the basis as set out in the BSC Section D</li> </ul>	<ul style="list-style-type: none"> <li>• BSC, as now</li> </ul>



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Attribute	Model A	Model B	Model C
<b>19</b> Intra Group Services	<ul style="list-style-type: none"> <li>• Arms length commercial arrangements</li> <li>• Fair value for any resources or services provided between affiliates</li> </ul>	<ul style="list-style-type: none"> <li>• Not applicable, as single entity</li> </ul>	<ul style="list-style-type: none"> <li>• Not applicable, as single entity</li> </ul>
<b>20</b> Implementation steps and timing	<ul style="list-style-type: none"> <li>• Ofgem led regulatory/legal implementation route</li> <li>• BSC modification required</li> <li>• Existing Ofgem power to direct <b>ELEXON Limited (BSCCo)</b> ownership change</li> <li>• Avoids significant TUPE issues</li> <li>• Pensions issue (but manageable)</li> <li>• Voluntary membership – only need one member to establish</li> <li>• Existing BSCCo assets would remain with <b>ELEXON Limited (BSCCo)</b></li> </ul>	<ul style="list-style-type: none"> <li>• Ofgem could lead</li> <li>• Ofgem directs share transfer to new shareholders under existing powers.</li> <li>• BSC mod</li> <li>• Requires development of contract and service lines</li> <li>• Creation of <b>BSC ProcureCo</b></li> <li>• Industry negotiations and agreement to establish <b>ELEXON Mk2 Limited</b> Shareholder agreement</li> <li>• Initial procurement of <b>BSC ServeCo</b> may be required</li> <li>• EU compliant procurement may be required</li> <li>• Existing BSCCo assets could be transferred to <b>BSC ProcureCo</b> or <b>ELEXON Mk2 Limited</b>. A mechanism would need to be established to deal with this.</li> <li>• TUPE issues may arise under re-tender</li> <li>• Pensions issues</li> </ul>	<ul style="list-style-type: none"> <li>• No significant changes required, other than modifications to extend scope of BSC.</li> <li>• Existing BSCCo assets would remain with <b>ELEXON Limited (BSCCo)</b></li> </ul>



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## Appendix VI – Significant Design Objectives

The following table presents a summary of the views collected from Issue Group members at meeting 3 on 11 July 2011.

Objective	Significance <sup>10</sup>				Tot. <sup>11</sup>	Rank	Summary of Rationale Themes
	1	2	3	4			
<b>2c – Maintaining BSCCo. Performance</b>	13	0	0	0	39	1	All agreed this was of paramount importance
<b>2a – Ring-Fencing BSC</b>	10	2	1	0	35	2	The majority of people agreed with ring fencing/ thought it was key/required to protect BSC arrangements. One thought that ring fencing might lead to failure to take advantage of synergies.
<b>1e – Does not Compel Involvement</b>	5	8	0	0	31	3	Four said that no party should be compelled to fund anything. One argued that Compulsion is less of an issue if funding arrangements are appropriate. One noted that it gives a choice of risk/reward and means the company has to develop a business case.
<b>3b – Legally Robust &amp; Clear</b>	6	5	2	0	30	4	Most agreed or thought this was self evident.
<b>1a – BSCCo Independence</b>	4	7	2	0	28	5	Overwhelming view was the importance of safeguarding BSC arrangements
<b>2b – No Inappropriate Cross-subsidy</b>	7	5	0	1	28	5	Everyone agreed this was important except for one who said that they thought the same as they did about this as they did ring fencing and that it might lead to a failure to take advantage of synergies
<b>1d – Funding New Ventures</b>	3	8	2	0	27	7	Two mentioned safeguarding BSC/BSC Parties. Two mentioned aversion to enforcing a funding obligation. One noted that a good business model will attract investors
<b>4 – Regulatory Framework</b>	4	8	0	1	25	8	The majority view was that this was self evident/goes without saying/ could only be a priority/is essential. One person said it was irrelevant. One person asked if this was just a legal requirement, another said it shouldn't need to be scored as it was a 'no brainer'
<b>3c – Costs and Savings</b>	3	9	0	1	24	9	Most felt that there should be a balance of costs and benefits. One thought that it was more important than ring-fencing. One commented it would be an important consideration if they were to invest in any new activities One felt it was not relevant as this is normal business BAU.
<b>1b – Autonomy for New Activities</b>	2	6	5	0	23	10	Five thought it should not risk current business - must be delivered effectively/efficiently. Three noted it was a lower priority and one said they were 'not interested'
<b>1c – Reflect Stakeholder Interests Fairly</b>	3	7	2	1	22	11	Mixture of comments - protect BSC arrangements for future stakeholders; no party should be disadvantaged; existing stakeholders important; needs to reflect those funding the business; small suppliers would like to have an influence but those with a greater share may want to invest
<b>3a – Near/Mid-Term Implementation</b>	3	2	7	1	17	12	General view is that it's a nice to have but not high priority. Four thought that transitional options should be looked at

<sup>10</sup> Significance: 1 = Very Important, 2 = Important, 3 = Desirable but not essential, 4 = Undesirable

<sup>11</sup> Total = ([Sig1] x 3) + ([Sig2] x 2) + ([Sig3] x 1) - ([Sig4] x 3)



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## Appendix VII – Assessment of Models against Design Objectives

This appendix contains the assessment comments as captured in the Issue 40 Group meeting 2 on 27 June 2011 and as refined at meeting 4 (26 July 2011) and meeting 5 (28<sup>th</sup> July 2011). Each matter considered has been characterised as either:

- **Substantive (S):** a specific, objective and significant matter; a clear benefit or issue to be overcome
- **Minor (M):** a marginal benefit or issue; a matter which is effectively immaterial
- **Potential (P):** a benefit or concern which may be realised in limited circumstances
- **All (A):** applies to all models in broadly similar ways so is effectively of neutral impact when drawing comparison

Substantive matters are highlighted in bold text. A summary for each Design Objective is set out below followed by the detailed assessment comments.

Ref	Design Objective	Model A	Model B	Model C
<b>1a</b>	<b>Safeguards BSCCo's unique position of independence such that no BSC Party can have a controlling interest in BSCCo.</b>	●	●	◐
<b>1b</b>	<b>Enables ELEXON Ltd to pursue new activities in an autonomous and agile fashion</b>	●	●	○
<b>1c</b>	<b>Allows for fair reflection of all existing and future stakeholder interests</b>	●	◐	◐
<b>1d</b>	<b>Enables appropriate funding to meet capital requirements for new ventures</b>	◐	●	○
<b>1e</b>	<b>Enables those parties that wish to be part of any new ventures to participate, without compelling those that do not</b>	●	◐	○
<b>2a</b>	<b>Ring-fencing and ensuring transparency of liabilities and costs for any new activities</b>	●	●	◐
<b>2b</b>	<b>Avoiding inappropriate cross-subsidy or unfair competitive advantage</b>	●	●	◐
<b>2c</b>	<b>Ensuring that existing core BSC business services are maintained</b>	●	●	●
<b>3a</b>	<b>Enables ELEXON Ltd to apply its expertise in new areas in the near/mid-term including enabling ELEXON Ltd to participate in the competitive process for award of the DCC licence</b>	●	○	●
<b>3b</b>	<b>Is legally robust with clearly articulated rights, obligations and liabilities</b>	●	●	◐
<b>3c</b>	<b>Enables an appropriate balance between implementation costs and the realisation of any efficiency savings for BSC Parties</b>	●	●	○
<b>4</b>	<b>Ensures an appropriate regulatory framework for any regulated activities that ELEXON may undertake</b>	●	●	○

- = Fulfils Design Objective (any concerns could be addressed in detailed solution)
- ◐ = Largely delivers Design Objective (a mix of concerns which may be more complex to address)
- = Unable to deliver the Design Objective (features concerns which are unlikely to be overcome).

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## Summary

ELEXON reported that it had received legal advice in respect of certain elements of its straw-man which were relevant to Model A. This advice was procured under legal privilege and has therefore not been reviewed by the Group. This has been acknowledged by the Group and referenced in the assessment tables below. The Group agreed that it would not seek additional legal advice at this stage, recognising that a legal view would be more valuable in respect of defined drafting when any proposed model was being developed for implementation.

Ref	Design Objective	Model A	Model B	Model C	Commentary
1a	<b>Safeguards BSCCo's unique position of independence such that no BSC Party can have a controlling interest in BSCCo.</b>	●	●	◐	<p>Both Model A and Model B can be established in a manner that would safeguard BSCCo's unique position of independence. This is an intrinsic design element of Model A and would need to be supported through robust contractual arrangements being actively managed by BSC ProcureCo in Model B.</p> <p>There are some concerns around Model C where BSCCo would be undertaking a wider set of activities under the BSC. If these have different users and beneficiaries, this may increase potential for conflict of interest and perceived loss of independence.</p>
1b	<b>Enables ELEXON to pursue new activities in an autonomous and agile fashion</b>	●	●	○	<p>Both Model A and Model B permit either the ELEXON Group or ELEXON Mk2 Ltd to pursue activities in an autonomous and agile fashion. Under Model A these activities would be restricted to those enshrined in its legal constitution (suggested to be: the promotion of innovation and efficiency through the provision of regulated and unregulated services to the utilities sector for the benefit of industry, consumers, regulatory bodies and other legal authorities) Under Model B it is anticipated that additional activities would be restricted to those acceptable to shareholders.</p> <p>Model C cannot deliver the agility sought because it is likely to be difficult and time consuming to gain consent for each new activity. The requirement to change the BSC to pursue new business would be a hindrance and would restrict its suitability to very limited, low-risk, low-investment new activities closely related to the BSC.</p>
1c	<b>Allows for fair reflection of all existing and future stakeholder interests</b>	●	◐	◐	<p>All models preserve the existing oversight of BSC activities by BSC Parties via the established BSC Panel and a BSCCo Board (this is effectively the BSC ProcureCo Board in Model B).</p> <p>Model A provides complete flexibility to ensure that all existing and future stakeholder interests are reflected in the activities undertaken by the ELEXON Group of companies. As a Company Limited by Guarantee, members have influence over New HoldCo via their responsibility to elect New HoldCo Board members. One member one vote means equal say for all members at New HoldCo level. Membership is adaptable to reflect all future stakeholder communities that the ELEXON Group might serve through new ventures. New entrants are not excluded. More specifically, any investors (shareholders) in a New Hold Co subsidiary (Special Purpose Vehicles) who wish to ensure an appropriate commercial return for any new ventures have oversight of new activities undertaken via each Special Purpose Vehicle (SPV) via that SPV's Board.</p> <p>The influence of stakeholders (BSC Parties) over BSC ServeCo depends on ensuring the contract established by Procure Co is robust and actively managed. Investors (shareholders) in ELEXON Mk2 Ltd who wish to ensure an appropriate commercial return for any new ventures have oversight (via the ELEXON Mk2 Ltd Board) of new activities undertaken by ELEXON Mk2 Ltd. The ownership of ELEXON Mk2 Ltd. can only evolve to reflect a changing customer base at the discretion of the existing shareholders via the ELEXON Mk2 Board. This may exclude stakeholders of new services</p>

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Ref	Design Objective	Model A	Model B	Model C	Commentary
					<p>provided by ELEXON Mk2 Ltd from ownership and influence. Therefore the influence of stakeholders over new activities undertaken by ELEXON Mk2 Limited would depend upon the governance around these activities.</p> <p>All BSC Parties may influence the activities of BSCCo under Model C through the Modifications process. This model may not provide for a fair reflection of all future stakeholders in wider services were the existing types of BSC Party not to evolve. Alternatively, more types of organisation (possibly operating in areas other than Electricity Balancing and Settlement) would become BSC Parties and have influence over all BSC activities. For all models there is a risk that BSC parties do not want the ELEXON Group / ELEXON Mk2 Ltd or the existing BSCCo to undertake work beyond the Balancing &amp; Settlement regime.</p>
1d	Enables appropriate funding to meet capital requirements for new ventures	◐	●	○	<p>Model A proposes BSC Parties as the source of funding for the initial new business venture (use of these funds would be at the discretion of the BSCCo Board in the delivery of a BSC Strategy set by the BSC Panel). This is the root of concerns that BSC Parties may have no choice but to invest in (at least the initial) future ventures. This forced funding of the initial set-up of New HoldCo and its initial subsidiaries may result in costs being imposed on BSC Parties and not returned if any commercial contract bids for work are not awarded. On an ongoing basis New HoldCo cannot receive profits from BSC Services so there are no profits available from BSC services to re-invest in new, non-BSC activities, however, individual entities within the ELEXON Group are not prohibited from attracting alternative sources and types of finance dependent on nature of each venture.</p> <p>Model B provides for great flexibility in funding and addresses the substantive concern around the funding of an initial venture. ELEXON Mk2 Limited can self-fund an initial venture through shareholder investment and can attract the full diversity of available funding sources (equity, debt, joint ventures, etc.), using the recognised ELEXON brand and experience.</p> <p>Model C has a number of significant issues that undermine an appropriate funding model. Subject to regulatory approval, all BSC Parties will be obliged to fund new activities under Model C. This provides operational funding certainty at the expense of any ongoing provision for development of new ventures. The existing restrictions on BSCCo's ability to raise non-BSC funding would continue to be a barrier to business development.</p>
1e	Enables those parties that wish to be part of any new ventures to participate, without compelling those that do not	●	◐	○	<p>BSC Parties will be compelled to fund the costs associated with establishing either New HoldCo. or BSC ProcureCo. Outside this initial set-up, both Model A and Model B provide a framework which does not compel BSC Parties to fund new ventures on an ongoing basis other than where there is a regulatory funding obligation such as under BSC. However, there are some significant differences between the two models.</p> <p>Under Model A, as each new opportunity arises over time, and where Special Purpose Vehicles are established to deliver new activities, potential investors can make an informed decision to participate or not.</p> <p>Because BSC Parties are not compelled to invest in ELEXON Mk2 Ltd. at its start-up it is felt that those that do will be fully engaged in the new company. However, future investors can only invest in ELEXON Mk2 Ltd or any subsidiary at the discretion of the existing shareholders.</p> <p>No investment discretion exists under Model C as all BSC Parties would be obliged to fund new activities once approved for inclusion within the BSC.</p>
2a	Ring-fencing and ensuring transparency of liabilities and costs for any	●	●	◐	<p>Both Model A and Model B can be established to provide appropriate ring fencing. However, the features of each raise some issues to be addressed in the detail required for implementation. The impact of these concerns may affect the initial viability of each model. For example, under Model A, the BSC Panel may not endorse a strategy which allows for the provision of BSC funds for an the set up of the initial Special Purpose Vehicles (SPV). Alternatively, the BSCCo Board BSC may not release funds for such a venture. This will require New HoldCo to seek alternative funding arrangements for its initial new business venture. Under Model B there is a risk that no (or too few) organisations will take shares in</p>



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Ref	Design Objective	Model A	Model B	Model C	Commentary
	<b>new activities</b>				<p>ELEXON Mk2 Ltd preventing the company from being set up and causing BSC ProcureCo to seek other providers for the BSC ServeCo contract.</p> <p>Under Model A all new (non-BSC) activities undertaken through limited liability SPVs to ensure that all ELEXON Group companies will be operationally and financially independent of ELEXON Limited (BSCCo). The checks and balances required to ensure appropriate ring-fencing of costs and liabilities for Model A would need to be captured in the BSC and in the Arts &amp; Memos of New HoldCo, the BSCCo as one of its subsidiaries and any other New HoldCo subsidiaries as required. In particular, the BSC must contain protections for failure by Hold Co or its subsidiaries to pay inter-company debts to BSC Co.</p> <p>Any use of BSC assets and resources for non-BSC activities would be charged at arms-length rates with the consent of the BSCCo. Board. Appropriate protections would be provided in any such contracts established by BSCCo for the provision of such BSC assets and resources to other companies (including ELEXON Group SPVs).</p> <p>It is envisaged that bad debt would be handled as it currently is under the existing BSC. That is: BSCCo may have to accommodate this bad debt by calling for funds from BSC Parties to cover the loss, since the BSC cannot be under-funded. Accordingly, should any inter-company charge (including one from BSCCo to another ELEXON Group subsidiary) not be met, there is a risk that BSC Parties have funded services to companies which may not be able to meet their liabilities, potentially requiring BSC Parties to cover the loss. Further, any BSC funds approved by the BSCCo Board for use in establishing a SPV may result in costs being imposed on BSC Parties and not returned if any bids for commercial contracts are not awarded.</p> <p>Under Model B ELEXON Mk2 Ltd will undertake new (non-BSC) activities which may or may not be undertaken through limited liability Special Purpose Vehicles (SPVs) on a case by case basis. The checks and balances required to ensure appropriate ring-fencing of costs and liabilities must be captured in the BSC, in the contract between BSC ProcureCo and BSC ServeCo and in the Arts &amp; Memos of both BSC ProcureCo and BSC ServeCo.</p> <p>Ring-fencing of new venture costs and risks is probably less of an issue under any arms-length contract between Procure Co and Serve Co with appropriate and transparent SLs, KPIs, etc. Such an outsourced arrangement protects non-shareholders (BSC Parties) from liability for failure of new ventures.</p> <p>However, where ELEXON Mk2 is undertaking multiple roles without Special Purpose Vehicles, the transparency of costs is reduced across the total portfolio of services. It should be noted that on the face of it there may be less transparency for BSC Parties in how ELEXON Mk2 Ltd. pursues its new business opportunities; nevertheless it will be accountable to its shareholders.</p> <p>The checks and balances required to ensure appropriate ring-fencing of costs and liabilities for Model C must be captured in the BSC and in the Arts &amp; Memos of ELEXON Ltd as BSCCo. and potentially revised each time a new activity is incorporated into the BSC. There are concerns that, as the BSC grows, BSC Parties potentially may become exposed to a wider set of risks and liabilities.</p>
<b>2b</b>	<b>Avoiding inappropriate cross-subsidy or unfair competitive advantage</b>	●	●	◐	<p>Company directors have a primary responsibility to act in the interests of the company. Under Model A, the BSCCo Board must therefore act wholly independently of the New HoldCo Board and the Boards of other New HoldCo subsidiaries. Under Model B the BSC ProcureCo Board must act wholly independently of the BSC ServeCo Board.</p> <p>As noted in 2a, Model A requires all ELEXON Group companies to have independent and distinct financial accounting and management. They will be operationally and financially independent of ELEXON Limited (BSCCo). The BSCCo Board must approve the use of BSC resources by an ELEXON affiliate on arms-length commercial terms for cross-charging. New HoldCo's constitution will prevent it from facilitating the grant of security or</p>



# Issue 40 Findings Report

Ref	Design Objective	Model A	Model B	Model C	Commentary
					<p>otherwise the creation of any encumbrance over BSCCo.</p> <p>ELEXON reported on legal advice it had received under legal privilege (and therefore not available to the Group for review). This advice confirmed the use of BSC funds to establish New HoldCo and for use in an initial venture is not anticompetitive and, as noted in 2a, there is a risk that BSC Parties may have to cover the loss arising from bad debt associated with any inter-company charge (including one from BSCCo to another ELEXON Group subsidiary) not being met.</p> <p>Cross-charging is not an issue for the BSC under the outsourced contract model proposed by Model B. The establishment of a robust, actively managed BSC Contract by Procure Co will reduce the likelihood of resources being used to inappropriately cross subsidise new business ventures which means ELEXON Mk 2 Ltd is not given an unfair competitive advantage in competing for new work. As noted in 2a, while there may be less transparency for BSC Parties in how ELEXON Mk2 Ltd. pursues its new business opportunities; it will ultimately be accountable to its shareholders. The existing BSC governance ensures funds are spent appropriately where needed. However, there is a high risk of cross-subsidy as the same organisation would be undertaking several roles, using BSC Parties' funds. It is anticipated that these concerns would lead to differential charging arrangements evolving under the BSC.</p>
2c	<b>Ensuring that existing core BSC business services are maintained</b>	●	●	●	<p>All models contain features that will continue to ensure that core BSC services are maintained through the responsibilities of the company boards and the protections established in any service agreements. BSC Parties retain their existing oversight of BSC activities in each case, either via BSCCo (Models A and C) or via Procure Co (Model B).</p> <p>Under Model A, the BSCCo Board must be satisfied that any activities do not compromise ability to discharge its BSC obligations. There is no risk of financial failure of the BSC service company (BSCCo) since the existing BSC funding arrangement remain in place. ELEXON reported that it has received legal advice under legal privilege (and therefore not reviewed by the Group) that confirms that there is no impact on BSCCo if New HoldCo fails as BSCCo is its subsidiary.</p> <p>Under Model B there is a slightly increased risk of disruption to BSC activities arising from financial failure of ServeCo. This is not seen as a significant concern since it is envisaged that an administrator would step in to ensure that ServeCo would continue to ensure a managed transition to a new service provider.</p> <p>Under model C there is no risk of financial failure of BSC service company (BSCCo) since the existing BSC funding arrangement remain in place.</p>
3a	<b>Enables ELEXON to apply its expertise in new areas in the near/mid-term including enabling ELEXON to participate in the competitive process for award of the</b>	●	○	●	<p>Model A can be implemented in a relatively short timescales (e.g. 3-6 months minimum). This is based on the transfer of the single National Grid share in ELEXON Ltd to New HoldCo.</p> <p>Model B cannot be fully implemented within timescales envisaged by DECC – effectively excluding ELEXON from the DCC bidding process. A phased implementation could allow ELEXON Ltd. to bid for the DCC, but as this is currently precluded by the code anyway a code Modification would still be required. Such a transition arrangement was not explored by the Group.</p> <p>Model C could be implemented relatively swiftly but requires an enabling BSC modification for every opportunity going forwards</p>



# Issue 40 Findings Report

Ref	Design Objective	Model A	Model B	Model C	Commentary
	<b>DCC licence</b>				
<b>3b</b>	<b>Is legally robust with clearly articulated rights, obligations and liabilities</b>	●	●	◐	<p>Implementation of Model A will require the Authority to direct National Grid to transfer its ownership of ELEXON to the New HoldCo. A Modification to the BSC will be required to effect the restructure and include the proposed protections for BSC Parties relating to New Hold Co. There would need to be a process to attract members to New HoldCo, however establishment of New HoldCo could be realised as soon as a single first member is found and this is felt to be a minor matter.</p> <p>Similarly, a direction from the Authority would be needed to effect the change of ownership in ELEXON under Model B. A Modification to the BSC will also be required to create and define the ownership, role, governance and funding arrangements for the new BSC ProcureCo. It would be necessary to create an appropriate commercial services agreement for the delivery of BSC services and potentially to procure and negotiate a contract with an organisation to fulfil the role of BSC ServeCo. National Grid has also indicated that some Transmission Licence changes may be required, for example, in relation to references to the secretarial body. ELEXON Mk2 would require some process to enable the offer and purchase of shares, however, this is felt to be a minor matter.</p> <p>Model C requires an enabling BSC Modification for every opportunity going forwards, potentially re-casting BSC Parties rights, obligations and liabilities on each occasion – this creates uncertainty for existing and prospective BSC Parties in how these might evolve under the BSC going forwards. National Grid has also indicated that the broader scope of the BSCCo under this model is likely to require changes and/or additions to the existing Applicable BSC Objectives to accommodate ELEXON's new activities and that it would also be necessary to consider the extent to which the Transmission Licence could accommodate non-core activities for National Grid Electricity Transmission.</p>
<b>3c</b>	<b>Enables an appropriate balance between implementation costs and the realisation of any efficiency savings for BSC Parties</b>	●	●	○	<p>The initial implementation cost of Model A is anticipated to be lower than Model B but greater than Model C. It is recognised that there is a need to solve initial transitional funding issue. But a solution to this has been suggested through the BSC Business Plan process and can be agreed swiftly under existing BSC governance. It is anticipated that BSC costs would reduce over time as new activities were taken on by the group and could be defrayed as outlined in the business plan (see plan).</p> <p>Model B features no transitional funding issues as only willing investors would fund the new business opportunities. It is also anticipated that, through robust management, the costs of running BSC ServeCo may reduce over time due to commercial drivers within the BSC ServeCo contract and that these could be shared between BSC ServeCo and BSC ProcureCo (and therefore BSC Parties) subject to the contract.</p> <p>Model C carries costs associated with each Modification required to enable opportunities going forwards on a case by case basis with no obvious driver to improve efficiencies in the deliver of the BSC going forward.</p>
<b>4</b>	<b>Ensures an appropriate regulatory framework for any regulated activities that ELEXON may undertake</b>	●	●	○	<p>Both Model A and Model B provide for flexibility in the application of appropriate regulatory frameworks. It allows for separate entities to be established for all regulated activities with separate boards and governance for these entities. The separation provides transparency for the regulator and users of regulated services. Overall, Model A supports a clean legal and regulatory framework by avoiding the situation where one set of regulated arrangements are polluted by the inclusion of activities/provisions relating to another unrelated set.</p> <p>There are significant concerns regarding Model C given that, over time, it will lead to increasing complexity in BSC which will be required to deal with the relationship between the current, core BSC scope and any new activities. This would could be seen to "pollute" the existing BSC with "non-BSC" requirements. Ultimately, the regulatory framework would not be clean. For example, the DCC Licence role being undertaken within BSC would need to be established under Transmission Licence where it may not be an appropriate fit.</p>





# Issue 40 Findings Report

## Detailed Assessment Comments

1a Appropriateness - Safeguards BSCCo's unique position of independence such that no BSC Party can have a controlling interest in BSCCo			
	Model A	Model B	Model C
Observations	<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li><b>P:</b> This model requires robust contractual arrangements to be established between BSC ProcureCo and BSC ServeCo in order to ensure the delivery of an impartial, independent service by BSC ServeCo.</li> </ul>	<ul style="list-style-type: none"> <li>None</li> </ul>
Benefits	<ul style="list-style-type: none"> <li><b>S:</b> BSCCo. does not undertake any activities that might compromise its independence and integrity.</li> <li><b>M/A:</b> BSCCo. continues to operate on a fully "not for profit" basis for all BSC services.</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> No BSC Party has a controlling stake in BSC ProcureCo (it is established with 1 share per BSC Party)</li> <li><b>M/A:</b> BSC ProcureCo continues to operate on a fully "not for profit" basis for all BSC Services.</li> </ul>	<ul style="list-style-type: none"> <li><b>M/A:</b> BSCCo. Continues to operate on a fully "not for profit" basis for all BSC services.</li> </ul>
Concerns	<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li><b>M/P:</b> May have different constituencies on either side of the BSC services contract (i.e. BSC Parties ≠ ELEXON shareholders), leading to possible conflict of interests.</li> <li><b>P:</b> BSC ServeCo may tend to act in shareholder interests when interpreting service requirements wherever any choice exists over how to discharge these. However, the risk is smaller if there is a high degree of alignment of shareholder and BSC Party interests and can be mitigated through active management by BSC ProcureCo of the contract with BSC ServeCo.</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> Under this model ELEXON Limited (BSCCo) is potentially undertaking a wider set of activities under the BSC. If these have different users and beneficiaries, this may increase potential for conflict of interest and perceived loss of independence.</li> </ul>



# Issue 40 Findings Report

## 1b Appropriateness - Enables ELEXON to pursue new activities in an autonomous and agile fashion

	Model A	Model B	Model C
Observations	<ul style="list-style-type: none"> <li>• <b>S:</b> Activities of the ELEXON Group will be restricted to those enshrined in its legal constitution (e.g. "The promotion of innovation and efficiency through the provision of regulated and unregulated services to the utilities sector for the benefit of industry, consumers, regulatory bodies and other legal authorities").</li> <li>• <b>M:</b> Any new ventures would be based on appropriate business cases being made, scrutinised and approved by the New HoldCo Board</li> </ul>	<ul style="list-style-type: none"> <li>• <b>S:</b> Activities of ELEXON Mk2 Ltd could be restricted to those acceptable to shareholders although one might expect a high degree of alignment of stakeholder and shareholder interests.</li> <li>• <b>M:</b> Any new ventures would be based on appropriate business cases being made, scrutinised and approved by the ELEXON Mk2 Ltd Board.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>M:</b> Uses existing tried and test governance process</li> </ul>
Benefits	<ul style="list-style-type: none"> <li>• <b>M:</b> Allows for any number of ring fenced subsidiaries within the ELEXON Group, which can be appropriately tailored to the nature of each specific venture, thus allowing for a broad range of business and funding models.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>M:</b> Having a contract in place already with a guaranteed income stream (assuming appointment as BSC ServeCo) makes ELEXON Mk2 Ltd more likely to be able to attract funding compared to a shell company with no assets, making it suitable for higher-risk, higher-investment new activities related or not to the BSC because.</li> <li>• <b>M:</b> Does not require ELEXON Mk2 Ltd to establish Special Purpose Vehicles to take on new work (although the model provides for this facility if required) so it may be marginally more agile than Model A.</li> </ul>	<ul style="list-style-type: none"> <li>• None</li> </ul>



# Issue 40 Findings Report

## 1b Appropriateness - Enables ELEXON to pursue new activities in an autonomous and agile fashion

	Model A	Model B	Model C
Concerns	<ul style="list-style-type: none"> <li><b>M:</b> Envisages that Special Purpose Vehicles are established for the delivery of new work which may be marginally less agile than Model B.</li> </ul>	<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> Unwieldy - no agility or responsiveness to new opportunities – as requires BSC modification for every new activity. This would hinder delivery against an overall strategic direction.</li> <li><b>S:</b> Likely to be difficult and time consuming to gain consent for new activities. The requirement to change the BSC to pursue new business would be a hindrance</li> <li><b>M:</b> Only suitable for very limited, low-risk, low-investment new activities closely related to the BSC.</li> </ul>



# Issue 40 Findings Report

## 1c Appropriateness - Allows for fair reflection of all existing and future stakeholder interests

	Model A	Model B	Model C
Observations	<ul style="list-style-type: none"> <li>• <b>S:</b> As a Company Limited by Guarantee, members have influence over New HoldCo via their responsibility to elect New HoldCo Board members.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>S:</b> Influence of stakeholders over BSC ServeCo depends on ensuring the contract established by Procure Co is robust and actively managed.</li> <li>• <b>S:</b> Influence of stakeholders over other activities undertaken by ELEXON Mk2 Limited would depend upon the governance around these activities.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>S:</b> All BSC Parties may influence activities through the Modifications process.</li> </ul>
Benefits	<ul style="list-style-type: none"> <li>• <b>S:</b> One member one vote means equal say for all members at New HoldCo level.</li> <li>• <b>S:</b> Membership is adaptable to reflect all future stakeholder communities that the ELEXON Group might serve through new ventures. New entrants are not excluded.</li> <li>• <b>S:</b> Investors (shareholders) in a New Hold Co subsidiary (Special Purpose Vehicles) who wish to ensure an appropriate commercial return for any new ventures have oversight of new activities undertaken via each Special Purpose Vehicle (SPV) via that SPV's Board.</li> <li>• <b>M:</b> All members can nominate candidates to be HoldCo Directors, so corporate governance reflective of widest stakeholder community (including e.g. consumer representatives).</li> <li>• <b>M:</b> Defined purpose of ELEXON Group ensures that organisation's decisions seek to facilitate stakeholder interests as opposed to a group of shareholders.</li> <li>• <b>M/A:</b> For BSC, existing membership and governance (and so the level of BSC Party influence) is unchanged.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>S:</b> Investors (shareholders) in ELEXON Mk2 Ltd who wish to ensure an appropriate commercial return for any new ventures have oversight (via the ELEXON Mk2 Ltd Board) of new activities undertaken by ELEXON Mk2 Ltd.</li> <li>• <b>M:</b> Provides the opportunity for Shares to be available for staff related performance schemes, ensuring that the management of Service Co have a personal stake in the success of the company.</li> <li>• <b>M/A:</b> BSC ProcureCo ownership open to all BSC Parties. Existing provisions in the BSC ensure that all current and future stakeholders in BSC ProcureCo have an equal say in BSC activities.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>M/A:</b> Existing level of BSC Party influence retained for BSC arrangements.</li> </ul>



# Issue 40 Findings Report

## 1c Appropriateness - Allows for fair reflection of all existing and future stakeholder interests

	Model A	Model B	Model C
<b>Concerns</b>	<ul style="list-style-type: none"> <li><b>M/A:</b> There is a risk that BSC parties do not want New HoldCo and the ELEXON Group to undertake work beyond the Balancing &amp; Settlement regime.</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> The ownership of ELEXON Mk2 Ltd. can only evolve with a changing customer base at the discretion of the existing shareholders via the ELEXON Mk2 Board. This may exclude stakeholders of new services provided by ELEXON Mk2 Ltd from ownership and influence.</li> <li><b>M/A:</b> There is a risk that BSC Parties do not want ELEXON Mk2 Ltd. to undertake work beyond the Balancing &amp; Settlement regime.</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> Only BSC Parties have a say over the activities of BSCCo (through BSC governance arrangements). This model may not provide for a fair reflection of all future stakeholders in wider services. Alternatively, more types of organisation (possibly operating in areas other than Electricity Balancing and Settlement) would become BSC Parties and have influence over all BSC activities.</li> <li><b>M/A:</b> There is a risk that BSC Parties do not want ELEXON Ltd (BSCCo) to undertake work beyond the Balancing &amp; Settlement regime.</li> </ul>



# Issue 40 Findings Report

## 1d Appropriateness - Enables appropriate funding to meet capital requirements for new ventures

	Model A	Model B	Model C
Observations	<ul style="list-style-type: none"> <li><b>S:</b> Uses BSC parties as the primary source of funding for initial new business ventures.</li> <li><b>M:</b> Preserves the funding arrangements for BSCCo whilst allowing both existing and new parties to provide funds to support new business ventures.</li> </ul>	<ul style="list-style-type: none"> <li><b>M:</b> Preserves the funding arrangements for BSCCo whilst allowing both existing and new parties to provide funds to support new business ventures.</li> </ul>	<ul style="list-style-type: none"> <li>None</li> </ul>
Benefits	<ul style="list-style-type: none"> <li><b>S:</b> Individual entities within group are not prohibited from attracting alternative sources and types of finance dependent on nature of each venture.</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> ELEXON Mk2 Limited can attract the full diversity of available funding sources (equity, debt, joint ventures, etc.), using the recognised ELEXON brand and experience.</li> <li><b>S:</b> ELEXON Mk2 Limited can self-fund initial venture through shareholder investment. Potentially by share offering to wider community beyond BSC Parties</li> <li><b>M:</b> Any profits made by ELEXON Mk2 Ltd (e.g. from efficiency improvements to BSC Services) can be used to fund new ventures.</li> <li><b>M:</b> Having a contract in place already with a guaranteed income stream (assuming appointment as BSC ServeCo) makes ELEXON Mk2 Ltd more likely to be able to attract funding compared to a shell company with no assets, making it suitable for higher-risk, higher-investment new activities related or not to the BSC because.</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> Subject to regulatory approval, all BSC Parties will be obliged to fund new activities, so provides operational funding certainty.</li> </ul>



# Issue 40 Findings Report

## 1d Appropriateness - Enables appropriate funding to meet capital requirements for new ventures

	Model A	Model B	Model C
<b>Concerns</b>	<ul style="list-style-type: none"> <li>• <b>S:</b> New HoldCo cannot receive profits from BSC Services so there are no profits available from BSC services to re-invest in new, non-BSC activities.</li> <li>• <b>S:</b> BSC Parties may have no choice but to invest in (at least the initial) future ventures. This forced funding of the initial set-up of New HoldCo and its initial subsidiaries may result in costs being imposed on BSC Parties and not returned if any commercial contracts bid for are not awarded.</li> <li>• <b>M:</b> The complex ring fencing arrangements of the different subsidiaries may put a small cost burden on BSC Parties who do not wish to participate in the widening role of Hold Co.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>M:</b> There is a risk that shareholders of ELEXON Mk 2 Ltd will end up covering any losses arising as a result of the Procure Co contract for running the BSCCo, but as willing investors this seems fair.</li> <li>• <b>M/P:</b> The complex ring fencing arrangements of different subsidiaries may put a small cost burden on BSC Parties who do not wish to participate in the widening role of ELEXON Mk2 Ltd if it decide to use ring-fenced Special Purpose Vehicles.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>S:</b> Funding limited to activities defined in BSC. No ongoing provision for development of new ventures.</li> <li>• <b>S:</b> Existing restrictions on ability to raise non-BSC funding would continue to be a barrier to business development.</li> <li>• <b>M:</b> Likely to drive towards 'user pays' differential charging for different services and communities.</li> </ul>



# Issue 40 Findings Report

## 1e Appropriateness - Enables those parties that wish to be part of any new ventures to participate, without compelling those that do not

	Model A	Model B	Model C
Observations	<ul style="list-style-type: none"> <li><b>M:</b> BSC Parties will be compelled to fund the costs associated with establishing New HoldCo.</li> </ul>	<ul style="list-style-type: none"> <li><b>M:</b> BSC Parties will be compelled to fund the costs associated with establishing BSC ProcureCo.</li> <li><b>M/P:</b> ELEXON Mk2 Limited could establish special purpose vehicles as under Model A which might have separate and distinct shareholders (allowing new shareholders to invest in specific ventures). This would be at the discretion of existing shareholders.</li> <li><b>M/P:</b> Shares in ELEXON Mk2 limited and/or its subsidiaries could be bought and sold.</li> </ul>	<ul style="list-style-type: none"> <li>None</li> </ul>
Benefits	<ul style="list-style-type: none"> <li><b>S:</b> There is no compulsion to invest in the activities of New HoldCo or the ELEXON Group on an ongoing basis (other than where there is a regulatory funding obligation such as under BSC).</li> <li><b>S:</b> Potential investors can make an informed decision to participate or not, as each new opportunity arises over time.</li> <li><b>M:</b> Investors in potential ventures are not limited. New HoldCo will not have any incentive to exclude new participants.</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> BSC Parties are not compelled to invest in ELEXON Mk2 Ltd. at its start-up. And it is felt that those that do will therefore be fully engaged in the new company.</li> <li><b>S:</b> Existing investors can make an informed decision to participate or seek additional investors or not, as each new opportunity arises over time (depending upon the provisions in the Mems and Arts).</li> </ul>	<ul style="list-style-type: none"> <li><b>M:</b> No upfront costs to set up a new company as existing structure (modifications process) already funded by BSC Parties.</li> </ul>





# Issue 40 Findings Report

## 1e Appropriateness - Enables those parties that wish to be part of any new ventures to participate, without compelling those that do not

	Model A	Model B	Model C
Concerns	<ul style="list-style-type: none"> <li><b>S:</b> BSC Parties may have no choice but to invest in (at least the initial) future ventures. This forced funding of the initial set-up of New HoldCo and its initial subsidiaries may result in costs being imposed on BSC Parties and not returned if any commercial contracts bid for are not awarded.</li> <li><b>M:</b> New ventures to be delivered using Special Purpose Vehicles (subsidiaries to New HoldCo). Separate governance and business models will be required for each new venture which could introduce unnecessary complexity and cost.</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> Parties wishing to invest may have to make that decision at time of set-up, as opposed to having an option as new ventures arise. This is because it is likely to be at discretion of the original shareholders (via the ELEXON Mk2 Ltd Board) whether to let anyone else invest.</li> <li><b>M:</b> If new ventures are delivered using ring fenced Special Purpose Vehicles (subsidiaries to ELEXON Mk2 Ltd), this could be seen as unnecessarily complex.</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> All BSC Parties would be obliged to fund new activities once approved for inclusion within the BSC, so no investment discretion exists.</li> </ul>



# Issue 40 Findings Report

## 2a Protection for the BSC Arrangements - Ring-fencing and ensuring transparency of liabilities and costs for any new activities

	Model A	Model B	Model C
Observations	<ul style="list-style-type: none"> <li><b>S:</b> The BSC must contain protections for failure by Hold Co or its subsidiaries to pay inter-company debts to BSC Co.</li> <li><b>M:</b> The checks and balances required to ensure appropriate ring-fencing of costs and liabilities must be captured in the BSC and in the Arts &amp; Memos of New HoldCo and its subsidiaries.</li> <li><b>M/A:</b> Continued high levels of transparency and scrutiny around BSC activities (as prescribed by the BSC).</li> <li><b>M/A:</b> Service Descriptions for BSC and non-BSC work will need to be set out and clearly communicated.</li> </ul>	<ul style="list-style-type: none"> <li><b>M:</b> The checks and balances required to ensure appropriate ring-fencing of costs and liabilities must be captured in the BSC, in the contract between BSC ProcureCo and BSC ServeCo and in the Arts &amp; Memos of both BSC ProcureCo and BSC ServeCo.</li> <li><b>M:</b> An opportunity will exist for ELEXON Mk2 Ltd to spread costs/risks arising across its portfolio of activities whenever the BSC ServeCo contract is re-negotiated</li> <li><b>M/A:</b> Continued high levels of transparency and scrutiny around BSC activities (as prescribed by the BSC).</li> <li><b>M/A:</b> Service Descriptions for BSC and non-BSC work will need to be set out and clearly communicated.</li> </ul>	<ul style="list-style-type: none"> <li><b>M:</b> The checks and balances required to ensure appropriate ring-fencing of costs and liabilities must be captured in the BSC and in the Arts &amp; Memos of ELEXON Ltd as BSCCo.</li> <li><b>M/A:</b> Continued high levels of transparency and scrutiny around BSC activities (as prescribed by the BSC).</li> <li><b>M/A:</b> Service Descriptions for BSC and non-BSC work will need to be set out and clearly communicated.</li> </ul>
Benefits	<ul style="list-style-type: none"> <li><b>S:</b> All new (non-BSC) activities undertaken through limited liability Special Purpose Vehicles.</li> <li><b>S:</b> All ELEXON Group companies will be operationally and financially independent of ELEXON Limited (BSCCo).</li> <li><b>S:</b> Use of BSC assets and resources for non-BSC activities could be charged at arms-length rates with the consent of the BSCCo. Board.</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> Ring-fencing of new venture costs and risks is felt to be less of an issue under arms-length contract between Procure Co and Serve Co with appropriate and transparent SLs, KPIs, etc.</li> <li><b>S:</b> Protects non-shareholders (BSC Parties) from liability for failure of new ventures</li> </ul>	<ul style="list-style-type: none"> <li>None</li> </ul>



# Issue 40 Findings Report

## 2a Protection for the BSC Arrangements - Ring-fencing and ensuring transparency of liabilities and costs for any new activities

	Model A	Model B	Model C
Concerns	<ul style="list-style-type: none"> <li><b>S:</b> Any BSC funds approved by the BSCCo Board for use in establishing a Special Purpose Vehicle may result in costs being imposed on BSC Parties and not returned if any commercial contracts bid for are not awarded.</li> <li><b>S:</b> Should any inter-company charge from BSCCo to another ELEXON Group subsidiary not be met by that subsidiary company, there is a risk that BSC Parties have funded services to companies which may not be able to meet their liabilities, and therefore the BSCCo may have to accommodate this bad debt by calling for funds from BSC Parties to cover the loss, since the BSC cannot be under-funded.</li> <li><b>S:</b> The BSC Panel may not endorse a strategy which provides for the provision of BSC funds for an the initial set up of an SPV. Alternatively, the BSCCo Board BSC may not release funds for such a venture. This will require New HoldCo to seek alternative funding arrangements for its initial new business venture.</li> <li><b>M:</b> BSC Parties will be compelled to fund the costs associated with establishing New HoldCo.</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> Where ELEXON Mk2 is undertaking multiple roles without Special Purpose Vehicles, the transparency of costs is reduced across the total portfolio of services. On the face of it there may be less transparency for BSC Parties in how ELEXON Mk2 Ltd. pursues its new business opportunities; nevertheless it will be accountable to its shareholders.</li> <li><b>S:</b> There is a risk that no (or too few) organisations will take shares in ELEXON Mk2 Ltd preventing the company from being set up and causing BSC ProcureCo to seek other providers for the BSC ServeCo contract.</li> <li><b>M:</b> BSC Parties will be compelled to fund the costs associated with establishing BSC ProcureCo.</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> BSC Parties potentially exposed to a wider set of risks and liabilities.</li> </ul>



# Issue 40 Findings Report

## 2b Protection for the BSC Arrangements - Avoiding inappropriate cross-subsidy or unfair competitive advantage

	Model A	Model B	Model C
Observations	<ul style="list-style-type: none"> <li><b>S:</b> ELEXON reported on legal advice it had received under legal privilege (and therefore not available to the Group for review). This advice confirmed that the use of BSC funds to establish New HoldCo and for use in an initial venture is not anticompetitive</li> <li><b>M:</b> Company directors have a primary responsibility to act in the interests of the company. The BSCCo Board must act wholly independently of the New HoldCo Board and the Boards of other New HoldCo subsidiaries.</li> <li><b>A:</b> Appropriate management controls and monitoring of resource (e.g. timesheets, resource management etc.) would be utilised to ensure costs are identified and allocated correctly.</li> </ul>	<ul style="list-style-type: none"> <li><b>M:</b> Company directors have a primary responsibility to act in the interests of the company. The BSC ProcureCo Board must act wholly independently of the BSC ServeCo Board.</li> <li><b>A:</b> Appropriate management controls and monitoring of resource (e.g. timesheets, resource management etc.) would be utilised to ensure costs are identified and allocated correctly.</li> </ul>	<ul style="list-style-type: none"> <li><b>A:</b> Appropriate management controls and monitoring of resource (e.g. timesheets, resource management etc.) would be utilised to ensure costs are identified and allocated correctly.</li> </ul>
Benefits	<ul style="list-style-type: none"> <li><b>S:</b> The BSCCo Board must approve the use of BSC resources by an ELEXON affiliate on arms-length commercial terms for cross-charging.</li> <li><b>S:</b> New HoldCo's constitution will prevent it from facilitating the grant of security or otherwise the creation of any encumbrance over BSCCo.</li> <li><b>S:</b> All ELEXON Group companies will have independent and distinct financial accounting and management. They will be operationally and financially independent of ELEXON Limited (BSCCo).</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> Cross-charging is not an issue for BSC under contract model.</li> <li><b>S/P:</b> Establishment of a robust, actively managed BSC Contract by Procure Co will reduce the likelihood of resources being used to inappropriately cross subsidise new business ventures which means ELEXON Mk 2 Ltd is not given an unfair competitive advantage in competing for new work.</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> Existing BSC governance ensures funds are spent appropriately, where needed</li> </ul>



# Issue 40 Findings Report

## 2b Protection for the BSC Arrangements - Avoiding inappropriate cross-subsidy or unfair competitive advantage

	Model A	Model B	Model C
<b>Concerns</b>	<ul style="list-style-type: none"> <li>• <b>S:</b> Should any inter-company charge from BSCCo to another ELEXON Group subsidiary not be met by that subsidiary company, there is a risk that BSC Parties have funded services to companies which may not be able to meet their liabilities, and therefore the BSCCo may have to accommodate this bad debt by calling for funds from BSC Parties to cover the loss, since the BSC cannot be under-funded.</li> <li>• <b>P:</b> There is a risk that BSCCo may accumulate resource with a view to charging this resource out to non-BSC work. This could lead to artificially high BSC operational costs in times when this resource is not actively deployed on non-BSC work at chargeable rates. The risk can be mitigated by firm oversight and active direction of BSCCo by the BSCCo Board and its management team.</li> <li>• <b>P:</b> The use of chargeable BSC resources for non-BSC work would be at the discretion of the BSCCo. Board (in alignment with BSC strategy set by the BSC Panel) and this could include offering BSC resources to organisations outside of ELEXON group. However, there may be a risk of challenge by other competing service companies of an unfair competitive advantage regarding New HoldCo's ability to compete for new work if New Hold Co or one of its subsidiaries purchases BSC resources from BSCCo at discounted rates.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>M:</b> There may be less transparency for BSC Parties in how ELEXON Mk2 Ltd. pursues its new business opportunities; nevertheless it will be accountable to its shareholders.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>S:</b> High risk of cross-subsidy as same organisation undertaking several roles, using BSC Parties' funds</li> <li>• <b>M:</b> Probably leads to differential charging arrangements</li> </ul>



# Issue 40 Findings Report

## 2c Protection for the BSC Arrangements - Ensuring that existing core BSC business services are maintained

	Model A	Model B	Model C
Observations	<ul style="list-style-type: none"> <li><b>A:</b> BSCCo's ownership would necessarily be secure (i.e. it cannot be sold).</li> <li><b>A:</b> Stimulates innovation and efficiency in contestable services (e.g. BSC Agents) as is currently the case.</li> </ul>	<ul style="list-style-type: none"> <li><b>M:</b> BSC ProcureCo's ownership would necessarily be secure (i.e. it cannot be sold). It is anticipated that ownership would be on a single share per BSC Party basis.</li> <li><b>A:</b> Stimulates innovation and efficiency in contestable services (e.g. BSC Agents) as is currently the case</li> <li><b>M:</b> It is important to capture all appropriate services and service levels in the BSC ServeCo contract when it is agreed and recognise that this would need to be amended and/or re-negotiated following any change arising from a Modification or a Change Proposal.</li> </ul>	<ul style="list-style-type: none"> <li><b>A:</b> BSCCo's ownership would necessarily be secure (i.e. it cannot be sold).</li> <li><b>A:</b> Stimulates innovation and efficiency in contestable services (e.g. BSC Agents) as is currently the case</li> </ul>
Benefits	<ul style="list-style-type: none"> <li><b>S:</b> <b>BSCCo Board must be satisfied that any activities do not compromise ability to discharge its BSC obligations</b></li> <li><b>S:</b> <b>No risk of financial failure of BSC service company.</b></li> <li><b>S:</b> <b>ELEXON reported on legal advice it had received under legal privilege (and therefore not available to the Group for review). This advice confirmed that there is no impact on BSCCo if New HoldCo fails as BSCCo is its subsidiary.</b></li> <li><b>A:</b> Retains existing oversight of BSC activities</li> <li><b>A:</b> Retains competitive procurement for key operational BSC services (BSC Agents)</li> </ul>	<ul style="list-style-type: none"> <li><b>M:</b> Can also stimulate innovation and efficiency BSC ServeCo services (BSC Administration, Change Management, Helpdesk, Meeting Management, Outsourced Service Management).</li> <li><b>P:</b> The costs of running Serve Co may reduce over time due to commercial drivers within the BSC ServeCo contract.</li> <li><b>P:</b> Customer satisfaction becomes a more important factor since the Service Co would seek to ensure they were re-selected upon re-tendering based on normal commercial values of performance, reliability, reputation and cost.</li> <li><b>A:</b> BSC Parties retain existing oversight of BSC activities via Procure Co.</li> <li><b>A:</b> Procure Co retains competitive procurement for key operational BSC services (BSC Agents)</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> <b>No risk of financial failure of BSC service company</b></li> <li><b>A:</b> Retains existing oversight of BSC activities</li> <li><b>A:</b> Retains competitive procurement for key operational BSC services (BSC Agents)</li> </ul>



# Issue 40 Findings Report

## 2c Protection for the BSC Arrangements - Ensuring that existing core BSC business services are maintained

	Model A	Model B	Model C
Concerns	<ul style="list-style-type: none"> <li><b>M:</b> There is a slightly increased risk of disruption to BSC activities arising from financial failure of any of the subsidiary corporate vehicles, since any appointed administrator would need to satisfy themselves of the relationships between the different parties in the structure.</li> <li><b>M/A:</b> There may be a small risk that quality BSCCo resources are diverted to new activities (via arms length commercial agreements made between HoldCo subsidiaries at the discretion of the BSCCo Board) as a result of New HoldCo taking on new roles.</li> </ul>	<ul style="list-style-type: none"> <li><b>M:</b> There is a slightly increased risk of disruption to BSC activities arising from financial failure of ServeCo. However, it is envisaged that an administrator would step in to ensure that ServeCo would continue to ensure a managed transition to a new service provider.</li> <li><b>M/A:</b> There may be a small risk that the management of ELEXON Mk2 Ltd become distracted and resource diluted as a result of taking on additional roles and activities. This might be mitigated (in part) by the use of Special Purpose Vehicles.</li> <li><b>P:</b> Contestability of BSC services may introduce instability. The stability and ongoing investment potential will depend upon the length of the BSC ServeCo contract.</li> <li><b>P:</b> The nature of the contract between ProcureCo and ServeCo may limit or remove the ability of ServeCo to pass-through costs. This would drive towards budget solutions, potentially undermining service quality. This would be mitigated by pro-active and robust contract management. It will rely on level of prescription in contract (which will come at a commercial price). It could be achieved by having a charging methodology for demand led work.</li> </ul>	<ul style="list-style-type: none"> <li><b>M/A:</b> There may be a small risk that the management of BSCCo. become distracted and resource diluted as a result of taking on additional roles and activities.</li> </ul>

**NOTE:** The Group made a general comment in respect of all Models. It recognised the importance of the BSCCo (or BSC ProcureCo) Board being able to drive BSCCo (or BSC ProcureCo) according to the needs of its stakeholders (BSC Parties). The Group also believed that members of the BSCCo (or BSC ProcureCo) Board should be different/independent of the New HoldCo (or BSC ServeCo) Boards to avoid any conflict of interest. Further, the Group felt that the composition of the BSCCo (or BSC ProcureCo) Board should be changed to ensure that BSC Parties have greater control over the BSCCo Board and associated funding while still drawing on appropriate expertise from outside the industry in decision making.



# Issue 40 Findings Report

## 3a Achievability - Enables ELEXON to apply its expertise in new areas in the near/mid-term including enabling ELEXON to participate in the competitive process for award of the DCC licence.

	Model A	Model B	Model C
Observation	<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li>None</li> </ul>
Benefits	<ul style="list-style-type: none"> <li><b>S:</b> Implementable in relatively short timescales (e.g. 3-6 months minimum). This is based on the transfer of the single National Grid share in ELEXON Ltd to New HoldCo</li> </ul>	<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> Could be implemented relatively swiftly.</li> </ul>
Concerns	<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> Is not achievable within timescales envisaged by DECC – effectively excluding ELEXON from the DCC bidding process. A phased implementation could allow ELEXON Ltd. to bid for the DCC, but as this is currently precluded by the code any way a code modification would still be required. The Group has not assessed such a transition arrangement.</li> <li><b>M:</b> Significant change to the BSC, requiring extensive analysis, development and consultation.</li> <li><b>M:</b> Protracted timescales (2 yrs minimum, based on ESIS experience).</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> Requires an enabling BSC modification for every opportunity going forwards.</li> </ul>





# Issue 40 Findings Report

## 3b Achievability - Is legally robust with clearly articulated rights, obligations and liabilities.

	Model A	Model B	Model C
Observations	<ul style="list-style-type: none"> <li><b>S:</b> Implementation of Model A will require the Authority to direct National Grid to transfer its ownership of ELEXON to the New HoldCo.</li> <li><b>S:</b> A Modification to the BSC will be required to effect the restructure and include the proposed protections for BSC Parties relating to New Hold Co.</li> <li><b>M:</b> There would be a process to attract members to New HoldCo, however establishment of New HoldCo could be realised as soon as a single first member is found.</li> <li><b>M:</b> It is felt unlikely that there would be any changes to the Transmission Licence and it is anticipated that any that were required would be minimal.</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> A direction from the Authority would be needed to effect the change of ownership in ELEXON under Model B.</li> <li><b>S:</b> National Grid has also indicated that some Transmission Licence changes may be required, for example, in relation to references to the secretarial body.</li> <li><b>S:</b> A Modification to the BSC will be required to create and define the ownership, role, governance and funding arrangements for the new BSC ProcureCo.</li> <li><b>S:</b> It would be necessary to create an appropriate commercial services agreement for the delivery of BSC services and potentially to procure and negotiate a contract with an organisation to fulfil the role of BSC ServeCo.</li> <li><b>M:</b> It may also be necessary to novate existing BSC Agent contracts from ELEXON Limited to ProcureCo.</li> <li><b>M:</b> Establishment of ELEXON Mk2 would require some process to enable the offer and purchase of shares.</li> </ul>	<ul style="list-style-type: none"> <li><b>M:</b> Requires a Modification to the BSC to implement.</li> </ul>
Benefits	<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li>None</li> </ul>



# Issue 40 Findings Report

## 3b Achievability - Is legally robust with clearly articulated rights, obligations and liabilities.

	Model A	Model B	Model C
Concerns	<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> Requires an enabling BSC modification for every opportunity going forwards, potentially re-casting BSC Parties rights, obligations and liabilities on each occasion.</li> <li><b>S:</b> National Grid has indicated that the broader scope of the BSCCo under this model is likely to require changes and/or additions to the existing Applicable BSC Objectives to accommodate ELEXON's 'other' activities and that it would also be necessary to consider the extent to which the Transmission Licence could accommodate non-core activities for National Grid Electricity Transmission</li> </ul>



# Issue 40 Findings Report

## 3c Achievability - Enables an appropriate balance between implementation costs and the realisation of any efficiency savings for BSC Parties.

	Model A	Model B	Model C
Observations	<ul style="list-style-type: none"> <li>• <b>S:</b> There is a need to solve initial transitional funding issue. But a solution to this has been suggested through the BSC Business Plan process and can be agreed swiftly under existing BSC governance.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>M:</b> No transitional funding issues as only willing investors would fund the new business opportunities.</li> </ul>	<ul style="list-style-type: none"> <li>• None</li> </ul>
Benefits	<ul style="list-style-type: none"> <li>• <b>M:</b> Implementation cost is estimated to be lower than Model B.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>P:</b> The costs of running Serve Co may reduce over time due to commercial drivers within the BSC ServeCo contract.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>M:</b> Implementation expected to cost less than Model A or Model B.</li> </ul>
Concerns	<ul style="list-style-type: none"> <li>• None.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>M:</b> Extensive and costly input/engagement required from BSC Parties for setting up BSC ProcureCo and establishing the BSC ServeCo contract</li> <li>• <b>M:</b> Overall implementation is expected to cost more than Model A or Model C.</li> <li>• <b>M:</b> Requires the creation of BSC ProcureCo resource to set up the BSC ServeCo contract. This is likely to call on existing BSCCo resource and divert expert ELEXON resource away from core services onto development of the BSC ServeCo contract and service lines.</li> </ul>	<ul style="list-style-type: none"> <li>• <b>S:</b> Cost associated with each Modification required to enable opportunities going forwards.</li> </ul>



# Issue 40 Findings Report

## 4 Regulation - Ensures an appropriate regulatory framework for any regulated activities that ELEXON may undertake

	Model A	Model B	Model C
Observation	<ul style="list-style-type: none"> <li>• None</li> </ul>	<ul style="list-style-type: none"> <li>• <b>M:</b> Regulatory considerations are unlikely to be the same for the MRA (registration and data requirements) as for the BSC (real-time operational service underpinning meter to bank processes for wholesale/retail electricity arrangements).</li> </ul>	<ul style="list-style-type: none"> <li>• None</li> </ul>
Benefits	<ul style="list-style-type: none"> <li>• <b>S:</b> Allows for separate entities to be established for all regulated activities.</li> <li>• <b>S:</b> Allows for separate boards and governance for separate regulated entities as appropriate.</li> <li>• <b>S:</b> Separation provides transparency for regulator and users of regulated services.</li> <li>• <b>S:</b> Clean legal and regulatory framework (e.g. avoids situation where one set of regulated arrangements are polluted by the inclusion of activities/provisions relating to another unrelated set).</li> </ul>	<ul style="list-style-type: none"> <li>• <b>S:</b> Allows for separate entities to be established for all regulated activities.</li> <li>• <b>S:</b> Allows for separate boards and governance for separate regulated entities as appropriate.</li> <li>• <b>S:</b> Separation provides transparency for regulator and users of regulated services.</li> <li>• <b>S:</b> Clean legal and regulatory framework (e.g. avoids situation where one set of regulated arrangements are polluted by the inclusion of activities/provisions relating to another unrelated set).</li> </ul>	<ul style="list-style-type: none"> <li>• None</li> </ul>



# Issue 40 Findings Report

4 Regulation - Ensures an appropriate regulatory framework for any regulated activities that ELEXON may undertake			
	Model A	Model B	Model C
Concerns	<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li><b>P:</b> The regulator may have concerns a small group of shareholders, will dominate the BSC arrangements through ownership of ELEXON Mk2 Ltd. A significant issue that was addressed in the NETA reforms.</li> </ul>	<ul style="list-style-type: none"> <li><b>S:</b> Would "pollute" BSC with non-BSC requirements</li> <li><b>S:</b> Likely over time to lead to increasing complexity in BSC, to deal with relationship between core BSC scope and new activities.</li> <li><b>S:</b> Regulatory framework would not be 'clean' – e.g. DCC Licence role being undertaken within BSC established under Transmission Licence.</li> <li><b>S:</b> NG may not tolerate expansion of BSC (which is a Transmission Licence obligation).</li> </ul>

# Issue 40 Findings Report

## Appendix VIII - Issue 40 Meeting Participation

Member	Organisation	01/06	27/06	11/07	26/07	28/07	01/09	06/09
Bharat Shah	Chairman	✓	✓	✓	✓	✓	✓	✓
Colette Baldwin	Proposer	✓	✓	✓	✓	☎	✓	☎
Andy Colley	SSE	✓	✓	✓	✓	☎	✓	☎
Bob Brown	Cornwall Energy	X	✓	✓	✓	X	✓	☎
Chris Welby	Good Energy	✓	X	✓	✓	☎	✓	✉
Colin Prestwich	Smartest Energy	✓	✓	✓	✓	X	X	X
Eric Graham	TMA	✓	X	X	X	X	X	X
James Evans	Utilisoft Ltd	X	X	X	X	X	X	X
John Stewart	npower	✓	✓	✓	✓	☎	✓	☎
Kevin Woollard	British Gas	✓	✓	✓	X	X	X	X
Lisa Waters	Waters Wye Associates	✓	X	✓	✓	X	X	✉
Man Kwong Liu	IBM for Scottish Power	✓	✓	X	✓	☎	✓	☎
Peter Bolitho	E.ON	X	X	✓	X	X	X	X
Richard Hall	Consumer Focus	✓	X	✓	X	X	X	X
Sarah Willis	EDF Energy	✓	✓	✓	✓	X	✓	☎
Shafqat Ali	National Grid	✓	✓	✓	✓	☎	X	☎
Stuart Cotten	Drax Power	✓	✓	✓	X	X	✓	✉
Attendee	Organisation							
Laone Roscorla	Cornwall Energy	✓	X	X	X	X	X	X
Adam Richardson	ELEXON	✓	✓	✓	✓	✓	✓	✓
Gareth Forrester	ELEXON	✓	✓	✓	✓	✓	✓	✓
David Osborne	ELEXON	X	✓	✓	X	X	X	X
Jon Dixon	Ofgem	X	✓	✓	✓	X	X	X

- ✓ attended meeting
- ☎ attended via teleconference
- X did not attend meeting
- ✉ did not attend meeting but approved findings report via correspondence

## Standing Issue

### Review of Elexon Governance and Funding Arrangements for New Business Opportunities

**Issue: 40**

*(mandatory  
by BSCco)*

Submission Date: 29 March 2011

Description of the Issue: **BSCCo is unable to pursue new business development opportunities as it is precluded from doing so under Section C 1.2.2 of the code.**

The Governance Standing Group is asked to consider options for an appropriate governance framework to address the above Issue, including amongst other things;

- 1) The extent to which Elexon should be permitted to pursue new business development opportunities,
- 2) The process for setting budgets, authorising expenditure and ensuring effective accountability to BSC parties,
- 3) Funding arrangements and the extent to which costs and risks should be allocated to BSC Parties that benefit from new business developments,
- 4) How surplus income generated from new business development opportunities are used including (a) consideration of repayments to parties required to/choosing to fund such activities and/or (b) reductions to BSCCo charges,
- 5) The separate accounting and ring fencing of new business activities from existing BSC activities, and whether new organisation or ownership structures are required,
- 6) The respective roles of the Board and BSC Panel, the Transmission Company and Trading Parties for each of the points 1) to 5),
- 7) An appropriate regulatory regime.

Crafting a new governance regime that meets the need of a range of stakeholders is not a straight forward task. It is therefore important that the diversity of stakeholder views is reflected in the membership of the Standing Group and we would ask the Panel to facilitate this. Active engagement by Ofgem in consideration of the Issue will also be vitality important given changes to the Transmission licence and the regulatory regime within which Elexon operates, may be required alongside changes to the BSC.

It is envisaged that the Standing Group would consider and develop a number of viable governance proposals which could form the basis for one or more future modifications. As part of this process consideration should be given to the Elexon 'strawman' governance proposal, first presented at the February 2011 BSC Panel, alongside other viable options.

Given this Issue primarily focuses on Elexon and the future role and aspirations of that business it is proposed that chair of the Standing Group considering this Issue should not be an Elexon employee or an existing contractor working for Elexon. Nor should the chair be an Industry Panel Member or an employee of a BSC Party or Party Agent.

Details of the Proposer

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