



Stage 04: Draft Mod Report

What stage is this document in the process?

01 Initial Written Assessment

02 Definition Procedure

03 Assessment Procedure

▶ 04 Report Phase

P284: Expansion of Elexon's role via the 'contract model'

The current BSC provisions do not allow BSCCo (ELEXON) to perform anything other than the activities specified in the BSC. As part of a recent Ofgem consultation on ELEXON diversification, Ofgem concluded that if ELEXON were to undertake a wider role, a 'contract model' (whereby 'New ELEXON' would be contracted to BSCCo) would best protect BSC Parties' interests.

P284 seeks to place provisions in the BSC to enable, but not require, the BSCCo Board to establish a BSC services contract with 'New ELEXON' subject to specified steps having been undertaken.



The Panel initially recommends

Rejection of both P284 Proposed and Alternative Modification



High Impact:
BSCCo (ELEXON)



Medium Impact:

Though P284 is an 'enabling' change, which does not itself require the contract model to be put in place, it is likely to be of interest to all BSC Parties and stakeholders

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About this document:

This document is a Draft Modification Report, which ELEXON will present to the Panel on 09 August 2012. The Panel will consider this report, and agree a final view on whether or not this change should be made.



Any questions?

Contact:
Dean Riddell



Dean.riddell@elexon.co.uk



0207 380 4366

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Why Change?

The current BSC provisions do not allow the BSCCo to perform anything other than the specific activities set out in the BSC. In order to allow ELEXON to participate in a broader range of activities and to leverage its skills and experience, a new model is required. The proposed model would formally separate BSCCo from 'New ELEXON' via a contract which would specify the services that 'New ELEXON' will deliver to the BSCCo and BSC Parties.

Solution

The P284 solution would enable, but not require, BSCCo to outsource some or all of the BSC services (currently delivered by ELEXON) to a new BSC Agent called the BSC Services Manager. This would be given effect via a contract between BSCCo and the BSC Services Manager. Building on the practices used for other BSC Agents, a new Service Description would need to be approved by the BSC Panel prior to the appointment of a BSC Services Manager.

Alternative Solution

The Alternative solution is identical to the Proposed except it also requires a contractual framework to be consulted upon, and for both the BSCCo Board and Authority to be satisfied that any contract meets the Authorities' pre-requisite conditions prior to the appointment of any BSC Services Manager.

Impacts & Costs

As a change to how BSCCo's services are delivered, P284 Proposed and Alternative will be of interest to all BSC Parties. However, since it is an 'enabling' change, the implementation of P284 itself will impact BSC Parties. However, if P284 were approved and the BSCCo Board exercised the option to enable a contract, there would be an impact on Parties.

Implementation

Both Proposed and Alternative Modifications will be implemented 1 WD after an Authority decision.

The Case for Change

The Panel unanimously agree that the Proposed Modification does not better facilitate the Applicable Objectives. The Panel noted the potential risks to the delivery of the BSC Service that this enabling change may bring and believed that they had not been presented with either a clear business case justifying the potential risks, or sufficient controls to enable the industry to shape the proposed service.

The majority of the Panel believe the same arguments against the Objectives apply equally to the Alternative solution as to the Proposed. However, a minority of the Panel believe that the Alternative solution would have marginal benefit against objective (d) as enabling the option of a 'contract model' will provide competitive pressures which should deliver cost savings and efficiencies for Parties. The approach also mandated greater industry oversight of the subsequent contractual arrangements.

Recommendations

The Panel's initial recommendation is that both P284 Proposed and Alternative Modifications are rejected.

2 Why Change?

Issue identified by the Proposer

The current BSC provisions do not allow the Balancing and Settlement Code Company (BSCCo) to perform anything other than the specific activities set out in the BSC.

BSC Section C1.2.2 states that:

"BSCCo shall have the powers, functions and responsibilities set out in or assigned to it in the Code, and shall not undertake any business or activity other than as provided for in the Code".

Because Annex X-1 of the Code defines the Balancing and Settlement Code Company (BSCCo) as meaning ELEXON Limited, BSC C1.2.2 therefore also restricts ELEXON as a company from undertaking any activities which are not set out in the Code.

ELEXON's Diversification

As identified in Ofgem's findings, ELEXON has built sector knowledge and expertise through its twelve years of delivering the BSC and this could be used to support activities other than the BSC. An example of this is the role of the Data and Communications Company (DCC).

As part of the Smart Metering Implementation Programme, the Department of Energy and Climate Change (DECC) intend to established the DCC to deliver a central procurement and contract management role for services used by energy suppliers and distributors across the domestic sector; there are strong synergies with ELEXON's current activities.

Recognising this, ELEXON has expressed its interest in participating in the DCC Licence Award process. These aspirations are caveated with the proviso that competing should not impact BSC services or BSCCo budget, and operating such a service would not put at risk delivery of the ongoing BSC service.

The potential benefits that may arise from ELEXON's participation in the DCC Licence Award process were noted by Ofgem when it reviewed ELEXON's current model. Equally the potential for cost savings to BSC Parties from diverse usage of ELEXON's assets and other resources was noted. ELEXON believe that this could potentially benefit the industry and other stakeholders including consumers.

Although the DCC Licence Award is a visible and imminent opportunity, ELEXON have made it clear that the option for ELEXON to undertake a wider role has broader applicability outside of the DCC opportunity. A 'contract model' solution (as proposed under P284) also avoids an alternative mechanism whereby each new opportunity would be subject to a separate BSC Modification. ELEXON have noted that a prompt decision on P284 will determine whether ELEXON can pursue the DCC opportunity, but support the view of BSC Parties that P284 needs to be decided on its merits regardless of the impact on the DCC opportunity.

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Ofgem consultation

Ofgem recently [consulted](#) on allowing ELEXON to diversify its activities and published its [conclusions](#) on 30 April 2012.

Ofgem concluded that *"there may be benefits in facilitating the removal of structural obstacles to ELEXON's diversification"*. Ofgem also stated that should ELEXON diversify, the formal separation of BSCCo and a 'New Elexon' (a contract model) is better able to protect the interests of BSC Parties.

To ensure protection of BSC Parties, and ultimately consumers, Ofgem stated that any diversification must meet 4 pre-requisite conditions:

1. BSC Parties should benefit from any diversification;
2. The arrangements should not place disproportionate risk on BSC Parties;
3. Standards of service under the BSC should be maintained; and
4. Elexon's BSC role should not give it any undue competitive advantage in a contestable activity.

National Grid raised P284 to facilitate implementation of the 'contract model' that was concluded from Ofgem's consultation. The Modification itself is an enabling change. If approved it would not instantly put in place a contract between BSCCo and 'New ELEXON', nor would it require that such a contract ever exist.

P284 provides the option for the contract model to be developed and deployed should the BSCCo Board believe it right to do so. The model builds on the arrangements used for other BSC Agents and would require the creation of, and agreement to, a new Service Description. Any contract developed as a result of the implementation of P284 would still have to meet Ofgem's 4 pre-requisite conditions.

The Modification itself is an enabling change. If approved it does not of itself separate BSCCo and 'New ELEXON'. Nor does it mandate that a contract is established.

Proposed solution

The P284 solution would enable, but not require, BSCCo to outsource some or all of the BSC services currently delivered by ELEXON to a new BSC Agent called the BSC Services Manager. These BSC services would be delivered through a contract between BSCCo and the BSC Services Manager (i.e. a new corporate entity that for ease of understanding has been termed 'New ELEXON'¹).

The ownership and accountabilities of BSCCo remains unchanged. The change is to give BSCCo the option of how they discharge the BSCCo services that are specified in the BSC.

P284, by allowing the separation of New ELEXON from BSCCo and introducing the contract, seeks to protect BSC Parties by ensuring that neither they nor National Grid, as the Shareholder, are exposed to risks and costs arising from New ELEXON pursuing or undertaking non-BSC activities.

The P284 Proposed Solution would be given effect by the legal text provided in Attachment A. In order to make it easier to digest the changes introduced by P284 may be summarised as follows:

- BSCCo may delegate some or all of its powers, functions and responsibilities under the BSC to a BSC Agent (the 'BSC Services Manager').
- Additionally the BSC Clearer will similarly be enabled to discharge powers, functions and responsibilities via the BSC Services Manager.
- It specifies that any BSC Services Manager will be a BSC Agent.
- It specifies broadly the rights which may be transferred to the BSC Services Manager for it to perform its role and the effect in BSC terms of the discharge of its functions.
- It sets out the process for a new Service Description to be approved prior to the appointment of any initial BSC Services Manager.
- Provisions relating to the Chief Executive of BSCCo will be amended so that the BSCCo Board may choose whether to appoint a BSCCo Chief Executive, but where it does so the scope and responsibilities of the role will remain unchanged.

¹ The Proposer uses the term 'New ELEXON' to represent the company which would carry out BSC activities under service contract with BSCCo.

- In order to preserve independence it specifies that no organisation can perform both the role of BSC Services Manager and any other BSC Agent, and that no BSC Party can perform the role of BSC Services Manager.
- Existing definitions of "Affiliate", "BSC Agent" and "BSCCo" will be amended, and new definitions for "BSC Services Manager" and "Relevant Affiliate" will be added to Section X.

The aim of these changes is to ensure that if an organisation is appointed as BSC Services Manager, it can perform any of the activities currently performed by BSCCo while:

1. maintaining the provisions in the BSC that safeguard the delivery of the Code arrangements; and
2. ensuring that neither the BSC arrangements nor BSC Parties can be exposed to any risks or incur any costs as a result of any activities that New ELEXON may elect to undertake that are outside of the services they are providing to BSCCo under the BSC Services Manager contract.

Service Description

The Proposed solution (as outlined above) not only makes the relevant Code changes to allow BSCCo to outsource to a BSC Services Manager, it also requires that a BSC Services Manager Service Description is created and approved by the BSC Panel before any contract is signed. This arrangement mirrors that employed for other BSC Agents.

The intention of this is to provide safeguards to BSC Parties that the BSC Services Manager would continue to provide the same "as is" service that Parties currently receive from ELEXON. As such, if a BSC Services Manager was appointed, there would be no detrimental impact in service provided to BSC Parties.

Therefore whilst P284 allows the option for the BSCCo Board to contract out some or all of the services currently delivered by BSCCo, it places a clear requirement that, before such an option can be exercised, the BSC Panel must approve the Service Description for the new BSC Services Manager.

Proposer's justification against the Applicable BSC Objectives

Currently the BSCCo is a monopoly provider of BSC services under what amounts to an "evergreen contract". It is argued that enabling the option to outsource some or all of the BSC Services to a BSC Agent (via a contract) would allow BSCCo the flexibility to expose the BSC Services to periodic benchmarking and/or competitive tender. It is generally accepted that outsourcing offers potential significant benefits, including cost reduction. In the context of the BSC it is BSC Parties who would be the beneficiaries of these potential benefits.

In addition, BSC Parties effectively indemnify BSCCo against all costs incurred including, any claims for damages or any other claim of a financial nature and releases BSCCo from any liability in respect of any breach of any provision of the Code. In short, BSC Parties incur the full risk and costs of the delivery of the BSC arrangements. It is argued that the option to outsource some or all of the BSC Services to a BSC Agent, if exercised, would ensure that the services and service standards are documented and understood by BSC, Parties that appropriate risk and cost allocation mechanisms linked to performance are put in place with the BSC Service Manager.

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The Proposer therefore believes that P284 will better facilitate the achievement of Applicable BSC Objective (d) because, in their view:

- It will ensure clear BSCCo accountability for the BSC arrangements following diversification of 'New ELEXON'; and
- If the contract arrangements are outsourced, and the provisions of BSC services are exposed to periodic competitive tender, this may deliver cost savings and benefits to BSC Parties.

Scope of P284

The Proposer clarifies in the Modification Proposal that P284 is an enabling change, and would only amend the Code to enable the contract model to be introduced. They highlight that as such, the terms of any contract between the BSCCo and the BSC Services Manager are outside the scope of P284.

The P284 Group discussed the scope of this Modification, and whilst acknowledging that it is outside the scope of P284, requested that Parties be consulted on a BSC Services Manager Service Description before it is approved and that the process of developing the BSC Services Manager Contract should be clear and transparent. Furthermore, they reiterated that any contract between BSCCo and the BSC Services Manager should reflect the BSC Services Manager Service Description.

As such the Workgroup encourages the BSCCo Board to provide information to industry participants and/or present information to the BSC Panel on the process that is proposed for establishing a contract and specifically what engagement there would be with industry participants.

The Contract Model

As noted above, P284 is an enabling change that seeks to provide the option of outsourcing to a BSC Agent, should pre-requisite approvals be granted. P284 would not itself implement the delivery of the 'contract model', but it is important for all interested participants to understand what the contract model is and how it would work. An explanation of the contract model is included in Appendix 1 of this document.

4 Alternative Solution

As part of their deliberations on P284 the Workgroup have developed an Alternative Modification. Whilst still allowing the option to establish the new delivery model outlined in the Proposed solution, the Alternative solution introduces two additional safeguards for BSC Parties:

- a contractual framework consultation; and
- Authority oversight and approval.

These additional pre-requisite safeguards are intended to provide BSC Parties with extra assurances that any contract signed by BSCCo and the BSC Services Manager will not put BSC Parties at risk.

Further information on how the Group developed this Alternative can be found in section 9 of this document.

Contractual Framework

In addition to the provisions described in the Proposed Modification, before an initial Service Manager is appointed:

- A contractual framework will be developed by the BSCCo Board and consulted upon with BSC Parties and the BSC Panel.
- The contractual framework will include key contractual areas and principles. For example; BSC Agent Contracts would remain owned and maintained by BSCCo.
- These key principles must be of sufficient detail to allow Parties to make an informed decision as to whether or not the contract would provide sufficient safeguards.
- The contractual framework will be issued for consultation to Parties and the BSC Panel and any views considered by the BSCCo Board. The BSC Panel should also provide any necessary advice to the BSC Board on the drafting of the contract framework.

Authority oversight

As part of the Ofgem conclusions letter issued on 30 April 2012, four pre-requisite conditions were set out. These conditions are:

1. BSC Parties should benefit from any diversification;
2. The arrangements should not place disproportionate risk on BSC Parties;
3. Standards of service under the BSC should be maintained; and
4. ELEXON's BSC role should not give it any undue competitive advantage in a contestable activity.

Under the P284 Alternative solution, before an initial BSC Services Manager is appointed both the BSCCo Board and the Authority must be satisfied that the contract meets these pre-requisite criteria.

Both provisions of 'contractual framework' and 'Authority oversight' as outlined above will only apply to the initial BSC Services Manager contract. Any future procurement or contract change would be subject to the same process as any other BSC Agent.

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Enabling and Pre-requisite Conditions

As stated in previous sections of this report, P284 is seeking to introduce the option for BSCCo to outsource to a BSC Services Manager. Implementing P284 would not of itself introduce a contract or require any contract.

Similarly if P284 is approved, it would require that certain pre-requisite conditions must be met. It does not in itself meet the pre-requisite conditions. It states what must be done after P284 is implemented; it does not complete the actions that is states must be done.

P284 Alternative seeks only to enable the discussion and development of a BSC Services Manager contract and to establish the control framework within which it could be progressed. The details of the controls themselves would need to be agreed should the Modification be approved.

This arises since there is a natural sequencing for the production of these controls:

Control	Consulted	Approved by
Modification	BSC Parties and BSC Panel	Ofgem
Service Description	BSC Parties	BSC Panel
Contract Principles	BSC Parties and BSC Panel	BSCCo Board
Contract		BSCCo Board
4 point criterion assessment	Ofgem and BSCCo Board	Ofgem

Note only some of the above conditions are additional steps introduced by the Alternative solution.

Both P284 solutions require that the Panel approve a BSC Services Manager Service Description before a contract is signed. Despite being a critical document in any future contractual discussions, this Service Description cannot be completed and agreed by the BSC Panel unless P284 is implemented. The reason for this is that without P284 the role of BSC Services Manager does not exist. Until P284 introduces the concept of a BSC Services Manager into the BSC the Panel will not be able to approve a Service Description (a Code Subsidiary Document) for a BSC Agent not in the Code. To help address this issue ELEXON have produced, issued and consulted on a draft Service Description as a separate exercise to this Modification.

Equally, without having the option in the BSC to outsource some or all of the BSC services to the BSC Services Manager, key contractual principles as specified in the Alternate cannot be drafted and consulted on as there would not be an entity to which the principles would apply. The same is true for the pre-requisite of the Authority being satisfied that their 4 point criteria has been met. Without P284 creating the role of BSC Services Manager no contract can be drafted and therefore the Authority cannot be satisfied that a contract meets is criteria.

If the Service Description needed to be approved, contract principles consulted upon and a final contract endorsed by the Authority prior to P284 being approved, this would risk nugatory work were P284 rejected and could add significantly to the time required to process the Modification. Approval of P284 does not remove the need to undertake these tasks; rather it allows them to be undertaken in a sequenced manner.

There has been a great deal of debate at the Modification Group, and discussion at the Panel, regarding the pre-requisite conditions that should be included in the Modification and how these relate to the total package of work that is necessary to exercise the

contract option. Some have requested that further work should be done to flesh out the pre-requisite documentation (Service Description/Contractual framework) before P284 is approved. However, detailed control documentation cannot be drafted until P284 is put in place for the reasons stated above. Thus whilst a 'complete package' of ELEXON diversification work would provide maximum clarity, in the absence of P284 work cannot be undertaken without direction from the BSC Panel for BSCCo to do so.

Why not include the additional controls in the Proposed Modification?

The Proposer was asked by the P284 Workgroup whether or not they wished to include the Alternative provisions in the Proposed Modification. Whilst supportive of the principles, the Proposer was unsure if or how you could put such provisions into the Code. They did not wish to overcomplicate their Proposed solution with obligations, however sensible, which they felt may not be workable or binding.

5 Impacts & Costs

As a change to the BSC governance arrangements, P284 Proposed and Alternative will be of interest to all BSC Parties and stakeholders. However, since it is an 'enabling' change to the BSC which does not in itself require a BSC Services Manager Contract to be put in place, there is no immediate impact on BSC Parties. Some Parties have however expressed caution that introducing the option introduces the possibility of change and therefore a risk. Parties therefore have an interest in the controls that will be used if the option is exercised. Others see introducing the option to outsource services as exerting additional commercial pressures on ELEXON which are not currently available.

Our view of the likely impacts of P284 Proposed and Alternative are set out below.

Estimated implementation costs are £240 equating to one man day effort.

Likely impacts

Impact on BSC Agent/service provider contractual arrangements

P284 will create the concept of the BSC Services Manager (a new BSC Agent) and a BSC Services Manager Contract. In doing so it will enable, but not require, BSCCo to outsource some or all of the BSC services currently delivered by ELEXON to this new BSC Agent.

Impact on BSC Parties and Party Agents

As a change to the BSC governance arrangements, P284 will be of interest to all BSC Parties and stakeholders. It is an 'enabling' change to the BSC which does not in itself require a BSC Services Manager Contract to be put in place.

Impact on Transmission Company

P284 has no impact on National Grid in its roles as the Transmission Company or BSCCo Shareholder.

Impact on ELEXON

P284 will enable, but not require, BSCCo to outsource some or all of the BSC services currently delivered by ELEXON via a BSC Services Manager Contract.

The actual decision on whether to outsource BSC services, the exact terms of any BSC Services Manager Contract, and any consequential impact on 'New' ELEXON's structure and corporate governance are outside the scope of P284.

Impact on BSC

Section C 'BSCCo and its Subsidiaries'	Changes will be needed to permit, but not require, BSCCo to outsource BSC services via a BSC Services Manager Contract.
Section E 'BSC Agents'	Changes will be needed to introduce the concept of the BSC Services Manager (as a new BSC Agent) and a BSC Services Manager Contract.
Annex X-1 'General Glossary'	Some new defined terms, and some changes to existing defined terms, will be required.

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6 Implementation

Implementation Approach

Implementation of P284 itself should have no direct impact on BSC Parties or other participants and only very minimal impact on ELEXON (i.e. making and communicating the required Code changes). The Workgroup therefore recommended that both P284 Proposed and Alternative be implemented 1 Working Day following approval by the Authority.

7 Terms of Reference

The P284 Workgroup's Terms of Reference comprised the standard Terms of Reference for the [Governance Standing Modification Group](#) (GSMG), supplemented with the specific areas set out below.

P284 Workgroup Terms of Reference

Walk through the Proposer's solution.

Agree whether the Proposer's suggested legal text delivers their intended solution and, if not, agree any changes to the legal text which are needed to better deliver the Proposer's solution.

Assess whether the Proposer's solution (the 'Proposed Modification') better facilitates the achievement of the Applicable BSC Objectives compared with the current BSC provisions.

Assess whether there is any Alternative Modification within the scope of P284 which would better facilitate the Applicable BSC Objectives compared with the Proposed Modification.

Agree a recommended Implementation Date for the Proposed Modification and any Alternative Modification.

Conduct a consultation on the above before submitting final recommendations to the Panel.

Consider the following areas specified by the Panel:

- What safeguards do the Industry need to be in place before the BSC Service Managers contract is signed;
- Consider why the legal drafting suggests removing the provisions relating to the Chief Executive of BSCCo and whether this is appropriate.
- Consider whether the reference in E4.2 to the 'BSC Services Manager' as a person appointed by BSCCo is appropriate.
- How does P284 actually achieves the 'unlocking' of BSCCo/ELEXON's vires?
- The relative merits of enabling or requiring the introduction of the contract model.

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P284 Background and DCC Interaction

Under the BSC Modification process changes to the Proposed solution can only be made if agreed by the Proposer. The Proposer explained that they were open to the Workgroup considering and developing the solution, using the suggested legal text as a straw man. They reiterated that P284 is an enabling change for the contract model and as such other potential models for ELEXON's diversification are out of scope of P284; as is the actual contract between BSCCo and the BSC Services manager.

National Grid, as the Proposer, also noted that this Modification should not add to or amend National Grid's role, obligations or activities, and that National Grid's Licence obligations and relationships with BSC Parties and BSCCo would remain the same under the provisions proposed by P284. Contracts with BSC Agent Service Providers will continue to be between BSCCo and the Service Providers, though New ELEXON would provide expertise in establishing the contracts as part of its role (e.g. procurement, contract negotiation).

The Group discussed the DCC Licence Award process and timescales, noting that this is a significant driver in ELEXON's aspirations to diversify. Using the information provided in DECC's documentation, the key DCC process milestones are the submission of the Pre-Qualification Questionnaire (PQQ) in early August 2012, and the submission of response in the Proposal Stage in late October 2012. It is critical for ELEXON (or New ELEXON, as the case may be) to have certainty around the provisions and outcome of P284 if it is to participate effectively in the DCC Award Process. To do this requires that the outcome of P284 is known promptly, ideally before the early August PQQ deadline, but certainly prior to the October Proposal deadline. Furthermore participation is dependent on all aspects of vires being amended and not just the approval of the Modification. These activities must be completed in sufficient time to allow any proposed delivery vehicle / arrangement to be established.

The Workgroup acknowledged that these timescales are a consideration for P284; to the extent that the ability to participate in the DCC award process will have significant impact on the potential benefits of P284. However, the Workgroup agreed that it was of paramount importance to ensure that any provisions introduced by P284 do not jeopardise BSC obligations or the protection of the BSC arrangements and BSC Parties. The Workgroup's assessment of P284 would absolutely not be compromised to meet DCC timescales at the expense of introducing risk to the security of the BSC or BSC Parties.

Board transparency

The Group questioned the transparency of the process of the BSCCo Board developing a contract for the provision of BSC services in parallel with the assessment and progression of P284. In order to get a better understanding of what the BSCCo Board intends to do, the Group requested that the Chairman of BSCCo Board present an overview of the process, including the proposed engagement with industry participants, to the BSC Panel.

Pending Modification P281 'Change of BSCCo Board of Directors & Chairman', would potentially deliver improvements to the transparency, composition and accountability of the BSCCo Board and that could provide Parties with greater confidence in BSCCo Board decisions (both under the current arrangements and the contract model). However, the Member noted that, if approved, the P281 provisions would not take effect until after the proposed implementation date of P281 which is December 2012.

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What safeguards need to be in place?

Workgroup members commented that the BSC controls introduced to enable introduction of the contract model must be sufficiently rigorous and detailed to ensure that there is no possibility that a company (i.e. 'New ELEXON') can be set up that Parties have no control over (via BSC obligations transferred through a service contract) and which can engage in other business that has the potential to expose BSC Parties or the BSC arrangements to risk.

The Workgroup acknowledged that the details of a contract between BSCCo and New ELEXON as the BSC Services Manager is outside the scope of P284, but agreed that such a contract should not take effect without an agreed Service Description setting out the obligations and activities of the BSC Services Manager role being agreed by BSC Parties.

The creation and approval of such a Service Description is outside the scope of P284, but the Workgroup believed that provisions introduced by P284 must specify that the contract is based on a finalised and approved Service Description. The Proposer considered that this was a sensible measure, and agreed to incorporate it into the P284 Proposed solution.

A Workgroup member queried whether the introduction of a contract for a service provider to deliver the BSC Services Manager role would necessitate an open procurement exercise, and therefore questioned whether New ELEXON could be directly installed as BSC Services Manager. This point was considered under Issue 40, and the Ofgem representative confirmed that Ofgem had taken legal advice and the conclusion was that procurement is not obligatory because the contract relates to neither a utility nor a public service.

Optional or Mandatory outsourcing?

Under the P284 Proposed solution, it is optional for BSCCo to outsource some or all of BSC services currently delivered by ELEXON to a service provider (BSC Services Manager). A Workgroup member suggested an alternative would be to make it mandatory for BSCCo to outsource some or all of its services to the BSC Services Manager. The rationale for this alternative is that if it is considered that there are benefits associated with outsourcing then it should be mandatory for BSCCo to outsource to guarantee that the benefits will be realised. It was also felt that this would remove the necessity for further modifications work should opportunities other than the DCC arise in the future.

The Workgroup considered this suggestion, but noted that this approach would remove flexibility from the solution and would remove the possibility of BSCCo performing BSC services itself (i.e. bringing them back 'in-house') even if this was the best option in future. The Workgroup also believed that obligating BSCCo to outsource would create the risk of a situation arising where a monopoly service provider (as the only organisation willing and/or able to fulfil the BSC Services Manager role) could impose unreasonable demands on BSCCo, potentially to the detriment of the BSC arrangements and/or the BSC Parties that fund the arrangements.

The Workgroup therefore agreed that mandatory outsourcing should not be pursued as a P284 Alternative, but felt it was prudent to seek industry views on this matter as part of the Assessment Procedure industry consultation.

Legal Text

The Workgroup considered the suggested legal text drafting attached to the P284 Modification Proposal in order to confirm that it delivers the P284 Proposed solution and identify any other issues.

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The Workgroup noted that the aim of the legal text is to enable BSCCo to outsource some or all of the BSC services currently delivered by ELEXON. This is accomplished by introducing the concept of a new BSC Agent, the BSC Services Manager, into the Code.

The Workgroup noted that the suggested legal text would be updated to reflect the Workgroup's agreement that the BSC Services Manager contract must be based on an approved Service Description relating to the role.

How does the Text unlock the vires?

BSCCo would still only be able to undertake all BSCCo activities specified in the BSC. However, the legal text allows 'unlocking of ELEXON's vires' by creating the role of the BSC Services Manager and allowing BSCCo to outsource its obligations to this new BSC Agent. Whilst the obligations and restrictions on BSCCo would remain the same, the company who delivers the BSC Services Manager role (i.e. New ELEXON) would be free to pursue activities outside the BSC. Using this mechanism any risks or costs incurred as a result of ELEXON providing non-BSC services do not transfer to BSCCo and hence BSC Parties.

Why is the CEO removed?

The removal of the BSCCo CEO in the legal text (Section E4.6) had raised some questions from both the Panel and the Group. The Workgroup noted that the rationale for the suggested removal in the draft legal text was that a much smaller BSCCo might not automatically need a Chief Executive, but there was nothing in the BSC to stop the appointment of a CEO. However, the Workgroup considered that if a BSCCo Chief Executive was appointed it would be appropriate for such appointment to continue to be governed by requirements in the Code. The Workgroup therefore agreed that the legal text should be updated to reflect that the BSC Board may choose whether to appoint a BSCCo Chief Executive, rather than the BSCCo CEO role being removed entirely.

Is the BSC Services Manager a person?

The Workgroup established that the reference in E4.2.1 to the 'BSC Services Manager' as a person appointed by BSCCo was a normal approach to legal drafting of this nature and did not require a person, rather than an organisation, to fulfil the role. The Workgroup therefore agreed that the wording should be retained.

Extension and Renewal

E4.3.1(a) of the suggested legal text specifies that *'BSCCo may, subject to and in accordance with this paragraph 4, at the expiry or termination of any BSC Services Manager Contract, extend or renew the contract or conduct a procurement to select and appoint a successor BSC Services Manager'*.

The Workgroup believed that there was a potential issue around the implied timing of processes due to the phrase 'at the expiry or termination', because action should always be taken before actual termination of the contract. The Workgroup also believed that, as worded, the paragraph implies that the contract could be extended or renewed without any other action by BSCCo (e.g. putting the contract out to tender or at least investigating options other than the current incumbent of the BSC Services Manager role). The Workgroup did not believe this to be appropriate because it would not promote the realisation of benefits associated with outsourcing under the contract model such as efficiency and improvements driven by competition between incumbent and prospective service providers.

Initial views against the Applicable BSC Objectives

The initial majority view of the Workgroup was that the P284 Proposed Modification **would better facilitate achievement** of the Applicable BSC Objectives compared with the existing baseline.

The Workgroup unanimously agreed that the only Objective relevant to P284 is Objective (d), which relates to the promotion of efficiency in the implementation and administration of the BSC arrangements.

The **majority** of the Workgroup identified the following **benefits against Objective (d)**, though some members felt the benefits to be marginal:

- Delivery of clear accountability of BSCCo;
- Potential future cost savings and benefits to Parties if provisions of BSC services is outsourced and subject to periodic competitive tender;
- Outsourcing under the contract model could increase efficiency while maintaining protection of the BSC Arrangements; and
- Increased flexibility in the delivery of the BSC arrangements.

The **minority** of the Workgroup identified either **no benefit or detrimental impact against Objective (d)**:

- The current standard of service delivered under the current arrangements is satisfactory. Any identified benefits are uncertain to be achieved and there are a number of risks associated with the change. As such the risks associated with the proposal outweigh the benefits against Objective (d); and
- Competition between possible service providers has the potential to improve efficiency, but ELEXON is the only competitor at present, and division of resources between BSCCo and New ELEXON may not be beneficial - therefore overall neutral or slightly detrimental to achievement of Objective (d).

The P284 Workgroup discussed responses to the P284 consultation in order to reach their recommendation and a view on whether or not any alternative modifications were required. The discussions of the Group are summarised below.

Safeguards and industry protection – The Alternative

The Group noted that the majority of concerns raised by industry respondents involved ensuring that BSC Parties were protected from risks arising from the diversification of ELEXON. This included ensuring that Parties did not fund or subsidise any additional (non BSC) work that the new BSC Services Manager might undertake, and that the roles and functions of BSCCo would continue to be delivered to a sufficient quality.

The Group echoed the concerns raised in the responses and stated that whilst it was broadly supportive of ELEXON doing more and diversifying, they wanted to safeguard Parties from any financial risk. Especially if “new ELEXON” went ‘belly up’. The Group agreed they did not have any issues with the Modification itself; rather it was what could happen once the Modification was in place which was the concern.

In order to mitigate such concerns the Panel had asked the group to consider what safeguards should be put in place to ensure any contract signed with the BSC Services Manager provides the protection and security required by the industry. Previously the Group had agreed to mandate the development of a Service Description before the BSC Services Manager is appointed. Having reviewed the consultation responses the Group considered whether any additional safeguards should be put in place. They concluded that two further controls should be added:

1. A contractual framework should be produced and consulted upon; and
2. The Authority should review the initial contract and confirm that it met the 4 criteria detailed in its open letter.

Contractual Framework

The Group believed that it was essential for the industry to see elements of the contract so that they could gain a better understanding of how it would work and how it would protect BSC Parties. It was noted that it would not be possible to share all of the contract details, but that the principles of the contract should be made available.

The Group discussed how best to make this happen and agreed that a contractual framework should be shared with the industry. The contractual framework would include Heads of Terms (key principles) on which the contract would be based (e.g. BSC Agent Contracts would remain owned and maintained by BSCCo). These key principles should be of sufficient detail to allow Parties to make an informed decision as to whether or not the contract would provide sufficient safeguards. The Group suggested that such a framework should include things like:

- How services are to be maintained;
- What incentive is there for improvement/efficiency
- How could the BSC Service Manager be removed if it performed unsatisfactorily
- What would happen if the role were ever bought back into BSCCo

The Group debated if the Panel should be consulted on the contractual framework, or if they should have approval of it. The point was raised that to have the Board’s contractual

framework agreed by a third Party was not normal business practice and that it may create added complexity when trying to put a contract together. The Group however felt that this circumstance was not an ordinary business situation, and as such there was no reason why the Panel should not approve the contractual framework. It was noted by a Group member that the situation would be similar to that of the BSC Panel signing off the BSCCo Strategy and thereafter the BSCCo Board establishing the supporting budget. Another Group member commented that if the Panel and Parties had oversight of the contract framework, along with Ofgem, this should provide enough information and comfort on the contract.

The Group debated the issue and concluded that if the Authority were to have an overview of the contract, and that the Authority could confirm it met the 4 criteria set out in its open letter (see below), then it should be sufficient that the Panel are consulted. The Group also noted that the Panel should provide any necessary advice and support to the Board on the contractual framework.

Authority Confirmation

Whilst the Group were discussing what they would like to see in a contract framework, that would provide security to the industry, the 4 Ofgem pre-requisite conditions (as stated in the conclusions letter issued on 30 April 2012) were raised.

The Group believed that if the contract met the 4 criteria, and that both the BSCCo Board and the Authority were satisfied that this was the case, then that should provide the assurance the industry are looking for.

The Group agreed that both Authority confirmation and a contractual framework consultation should form part of the P284 solution.

A question was raised as to why the BSC Services Manager should be treated any differently from other BSC Agents and if such provisions were necessary. On consideration, the Group agreed that it should be treated differently in its initial incarnation as it had the potential to have a large impact on the industry and all implications of this new BSC Agent should be thought through. The Group also cited examples from across the industry where they felt contracts had been rushed into (such as the creation of Xoserve) and as a consequence believed that we should learn lessons from these rather than risking the mistakes. The Group therefore agreed that although stricter requirements were needed at the initial set up of the BSC Services Manager, once it was in place it should be treated the same as any other BSC Agent.

Other options considered

The Group had previously discussed a potential Alternative solution which would have made outsourcing some or all of BSCCo function mandatory rather than optional. When the Group discussed this at the first meeting, the majority felt that it was not a sensible thing to do as it removed the flexibility of BSCCo bringing such functions back 'in house'. It might also create the situation where a monopoly service provider could impose unreasonable demands on BSCCo. Ultimately the Group did not believe this solution should be progressed, but decided to ask a question on this potential alternative as part of the consultation. Responses to the consultation supported the Groups views with the large majority supporting enabling over requiring a contract for the reasons already stated.

Implementation Approach

The Group debated whether or not 1 working day was sufficient enough time for implementation. Group members believed that it would require more time than just 1 day to put in place the necessary safeguards before a contract was signed.

The Group debated whether or not 1 working day was sufficient enough time for implementation. Some group members believed that it would require more time than just 1 working day to put in place the necessary safeguards before a contract was signed.

The Group were reminded that whilst this was a valid concern, the P284 solution would ensure that such safeguards were in place before a contract is signed. P284 is an enabling change and the go-live date of P284 is not the go-live date of any new contract. P284 enables a contract to be created, but both the Proposed or Alternative solution contain criteria that must be met prior to any contract being let and therefore 1 working day was a reasonable implementation timeframe.

Views against the Applicable Objectives

The Group found it challenging to assess the Modification against the Applicable BSC Objectives given that it is enabling change which may never take place. The Group acknowledged the argument that there was benefit in merely having the option, but reiterated that they would have liked to have seen the full package of work required for progressing ELEXONs diversification.

There were 3 main viewpoints expressed by the Group.

The first set of viewpoints were made by the minority in favour of P284 Proposed and Alternative. They noted the Proposers arguments that enabling the option to outsource some or all of the BSC Services to a BSC Agent (via a contract) would allow BSCCo the flexibility to expose the BSC Services to periodic benchmarking and/or competitive tender; this is likely to deliver cost savings and other benefits to BSC Parties.

They also noted that, BSC Parties effectively indemnify BSCCo against any claims for damages or any other claim of a financial nature and releases BSCCo from any liability in respect of any breach of any provision of the Code, howsoever caused. The current BSC funding arrangements require that the costs associated with any breach or rectification of any BSCCo failings are met by BSC funding Parties. In short, BSC Parties incur the full risk and costs of the delivery of the BSC arrangements. It is argued that enabling the option to outsource some or all of the BSC Services to a BSC Agent would ensure that the services and service standards are properly documented and understood by BSC Parties and that the risks and costs associated with BSCCo service failure could be transferred to the BSC Service Manager.

The minority of the Group therefore believed that both P284 Proposed and Alternative would better facilitate the achievement of Applicable BSC Objective (d) as:

- It would deliver clear accountability of BSCCo and delivery of the BSC services;
- Potential future cost savings and benefits to Parties if provisions of BSC services is outsourced and subject to periodic competitive tender;
- Outsourcing under the contract model could increase efficiency while maintaining protection of the BSC Arrangements; and
- Increased flexibility in the delivery of the BSC arrangements.

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The second viewpoint was from those Group members who were not in favour of P284 Proposed or Alternative. They believed that that there was either no benefit or detrimental impact against Objective (d) as:

- The current standard of service delivered under the current arrangements is satisfactory. Any identified benefits are uncertain to be achieved and there are a number of risks associated with the change. As such the risks associated with the proposal outweigh the benefits against Objective (d); and
- Competition between possible service providers has the potential to improve efficiency, but ELEXON is the only competitor at present, and division of resources between BSCCo and New ELEXON may not be beneficial - therefore overall neutral or slightly detrimental to achievement of Objective (d)

A minority of the Group also believed that P284 Proposed would have a detrimental impact against Objective (c):

- If the company undertaking the role of BSC Services Manager also undertook work in another field which later became part of the BSC. The BSC Services Manager would have either an unfair advantage in any procurement of the new function under the BSC, or could make unreasonable demands on BSC if they were the only party able to undertake the role.

The third viewpoint was regarding P284 Alternative. Some Group members felt that since the Modification was only enabling the option to outsource to a BSC Services Manager it was neutral against the objectives, since merely enabling wouldn't actually have a benefit unless the option was used. However, they felt that should the option to outsource be exercised then the pre-requisite conditions as set out in the P284 Alternative would provide the industry with the security they need and would provide marginal benefits under objective (d).

These views were reflected in the Group's decision that the Alternative was better than the Proposed. The Group believe that the additional safeguards and transparency placed into the Alternative solution reduces the risks of an unfavourable initial contract being created and better ensures BSC Parties do not face undue risk. However, it should be noted that some Workgroup Members characterised this as a choice between two options both of which do not better facilitate the applicable objectives. Therefore, it was felt that the Alternative was the "least worst" of the two solutions developed.

Timetable and Scope

The Panel acknowledged concerns raised by some Assessment consultation respondents and some P284 Group members that progression of P284 had not allowed sufficient time for full consideration of all the aspects – a situation that had been exacerbated by the absence of the supporting control documentation which would be developed if the Modification were approved.

The Panel had initially agreed an expedited P284 timetable to align with the DCC Licence Award timetable. A Panel member noted that there may be a delay in the DCC Licence Award process and as such consideration should be given to allowing the Workgroup more time to review documentation and further develop the BSC Services Manager's Service Description and the contract framework/principles.

The P284 Chair highlighted that some Group members had requested longer to review P284 documentation and noted that a number of emails between Group members and ELEXON had been shared with the Panel in which attempts had been made to address concerns and maximise the available time for assessing the nuances of the Modification. The bulk of comments on progression timescales had related to the process surrounding the creation and agreement of the new Service Description. It was noted that P284, if approved, would introduce a requirement for a Service Description to be created before BSC services could be outsourced by BSCCo, but that its creation is not part of P284 and was not part of the P284 Group's remit. It was noted that ELEXON is undertaking development of the Service Description as a separate process with separate industry engagement and this is subject to separate Panel control outside of the Modification process. The P284 Chair noted that if the Panel wanted further industry consultation on the Service Description, or for a specific workshop to be set up to review the Service Description, then the Panel could do so as they were in control of the new Service Description process.

While noting it is outside the scope of P284, the Panel remained concerned that more time should be spent developing the Service Description and contractual framework. The Panel queried whether the work could be completed satisfactorily within the DCC process timescales and, if not, whether this called into question the potential benefit of P284. ELEXON explained that P284 was not tied to the DCC specifically but concerns the general principle of whether BSCCo having the ability to outsource BSC services in future might be beneficial. A fuller explanation was given by ELEXON's Smart Programme Director of the published timescales for the DCC Licence Award. The non-publication of a draft PQQ (previously suggested by DECC) and the fact that the DCC Prohibition Order still needs approval by both houses, led ELEXON to conclude that there had already been a slippage of around 1 month in the published DCC Award timetable. This apart, the need to determine the Modification expeditiously and sufficiently in advance of the response deadline was repeated.

The Panel agreed that given the concerns around the limited time allocated for assessment and the uncertainty around the exact DCC Licence Award timetable, the Draft Modification Report should now be submitted for consideration at the regular Panel meeting on 9 August, rather than an earlier ad-hoc meeting as previously agreed.

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What's the benefit?

The Panel considered the P284 Group's arguments against the Applicable BSC Objectives and the rationale for these arguments. A Panel member noted that they considered the majority of BSCCo's budget was already subject to competitive tender in the form of Service Provider contracts, and questioned what potential benefit there would be in outsourcing the BSC Services via a contract, as they perceived that financial savings could only come from reducing staffing and that risked compromising the BSC service. ELEXON responded that they strongly believed allowing ELEXON to partake in activities such as the DCC and other industry initiatives, where synergies with their current skills could be employed, could provide benefits to both the industry as a whole and ultimately the consumer. Placing the BSC services in a competitive environment via a contract would naturally drive performance and efficiencies of the BSC Services resulting in benefits to Parties.

Further to this, another Panel member stated that they did not believe the Assessment Report contained any substantive analysis or quantification of the possible benefits, and without this they did not feel that they were in a position to support the Modification.

A Panel member stated that they believed that the Panel had sufficient information to consider P284 and make a recommendation, and that they did not believe significant further information could be delivered on the potential benefits and detriments of enabling possible future outsourcing as part of P284.

This Panel member could not see benefits against the Objectives and had concerns around the contractual model. A Panel member questioned whether the contract model would be difficult to deliver due to the increased complexity in defining service levels and ensuring that any contract captured the ever changing remit of services in the BSC. They also raised a concern that having a contract model in place might distance the Panel from the running of the BSC, putting a potential barrier between the Panel and the BSC Services Manager.

Another Panel member stated their surprise that after receiving industry support as part of the Ofgem consultation and Issue 40, there now appeared to be concerns over the 'contract model'.

Overall, the majority of the Panel agreed that without a clear understanding of the potential benefit to BSC Parties they could not support P284.

Views against the Objectives

Proposed vs. current arrangements

The Panel unanimously agreed that the Proposed Modification did not better facilitate any of the Applicable BSC Objective as there was not a robust enough business case to convince of any benefit to BSC Parties. Equally any identified benefits are uncertain to be achieved and there are a number of risks associated with the change. As such the risks associated with the proposal outweigh the benefits against Objective (d).

The Panel also felt that the safeguards introduced were not sufficient to provide suitable protection to the industry should P284 Proposed be implemented.

Alternative vs. current arrangements

The majority of the Panel agreed that the Alternative Modification did not better facilitate any of the Applicable Objectives for the same reasons as the proposed.

A minority of the Panel believed that P284 Alternative had marginal benefit against Objective (d) because:

- It offers flexibility and potential cost savings and benefits to Parties if provisions of BSC services can be outsourced and are subject to periodic competitive tender – an argument in support of efficiency;
- The controls in P284 Alternative provide adequate protection of the BSC Arrangements.

The majority of Panel members, who were not eligible to vote (as they were attending the meeting via teleconference), supported the majority view of the Panel that neither the Proposed nor Alternative was better than the Applicable BSC Objectives for the reasons stated above.

A Panel member attending via teleconference did support the minority view that the Alternative Modification was better than the Applicable BSC Objectives.

Those Panel members attending via teleconference unanimously agreed that the Proposed Modification did not better facilitate the Applicable BSC Objectives.

11 Panel Final Views

TBC following Report Phase Consultation

12 Recommendations

TBC following Report Phase Consultation

13 Further Information

More information is available in:

Attachment **A**: Proposed Legal Text

Attachment **B**: Alternative Legal Text Alternative

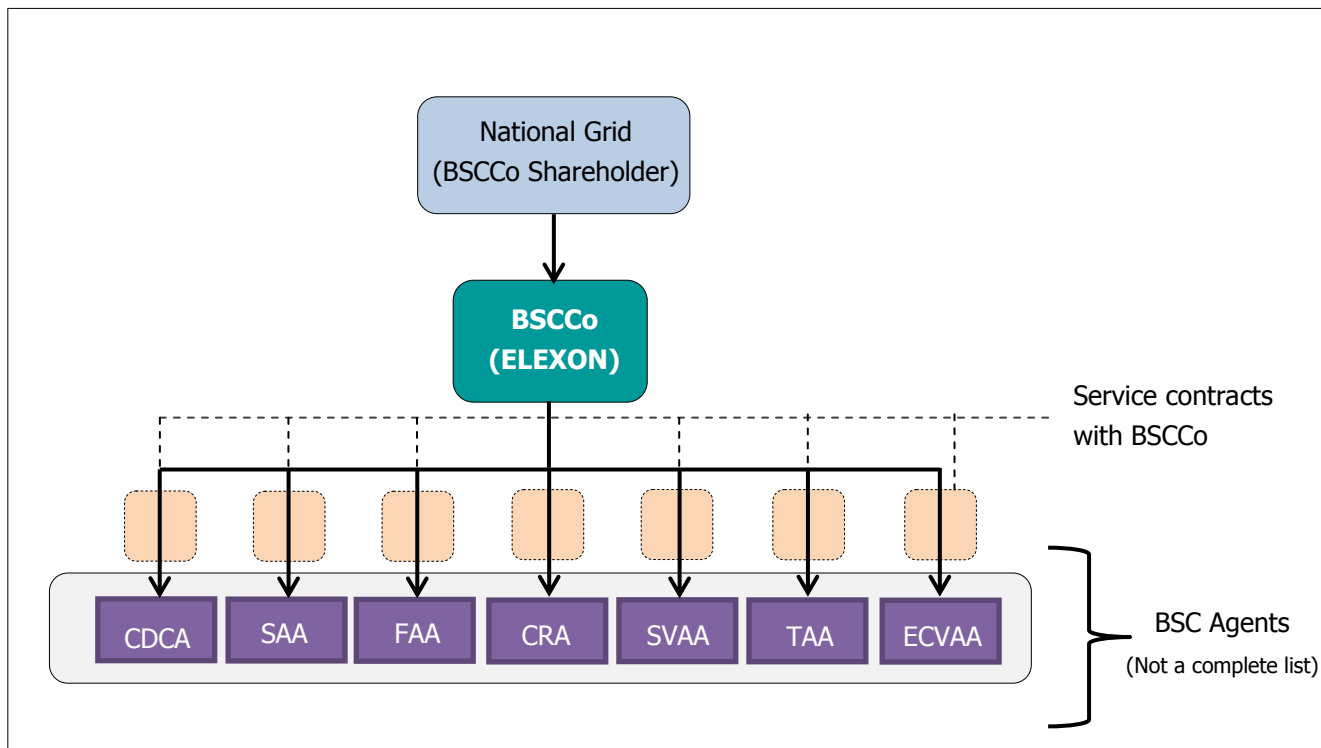
A complete version of the Report Phase consultation received, the P284 Assessment Report, and all other related document are available on the [P284 page](#) of the ELEXON website.

Appendix 1: What is the 'Contract Model'?

Existing Structure

BSCCo is a wholly owned subsidiary of the National Grid plc, and are tasked with delivering the obligations and functions contained within the BSC. Not all functions of the BSC are delivered 'in house' by BSCCo and some services are delivered by separate companies, known as BSC Agents. BSCCo own and maintain the contracts between BSCCo and the BSC Agent.

Current Code provisions state that the BSCCo cannot undertake non-BSC activity. Section X of the Code defines ELEXON to be the BSCCo. This means that ELEXON cannot undertake non-BSC activity.



The Contract Model

Under the contract model (illustrated below) a new BSC Agent called the 'BSC Services Manager' would be created. The BSC Services Manager would be obligated to perform some or all of the functions required of BSCCo. It is envisaged that the BSC Services Manager role would be provided by a new service provider, which in this appendix and throughout this document is referred to as 'New ELEXON'.

The obligations to complete BSCCo functions would be placed on New ELEXON via a service contract between New ELEXON and BSCCo (in the same way that BSC obligations are placed on other BSC Agents service providers via their service contracts) based on a BSC Services Manager Service Description.

As a contracted Service Provider, New ELEXON would be able to pursue and perform activities outside the BSC (which it is subject to solely due to its contract with BSCCo). The intention is for the necessary staff to transfer from ELEON to New ELEXON to deliver he required obligations. Transfer of ELEXON staff to New ELEXON would not be done under

any process introduced by P284 or otherwise codified but would proceed as a matter of course under normal law outside the BSC.

BSCCo would be able to appoint another service provider instead of New ELEXON or could choose not to appoint a service provider and discharge its BSC obligations itself, as it sees fit.

