



Stage 03: Assessment Consultation

Consultation closes 5.00pm on 29 June 2012

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

The current BSC provisions do not allow BSCCo (ELEXON) to perform non-BSC activities. Ofgem has consulted, and recently published conclusions, on ELEXON diversification.

P284 aims to facilitate implementation of the 'contract model', which is supported by a majority of respondents and is in line with Ofgem's view that formal separation of BSCCo and a 'New ELEXON' would better protect BSC Parties' interests. The changes proposed by P284 would enable, but not require, such separation via a BSC services contract.



Modification Group initially recommends:

Approval of the P284 Proposed 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.

What stage is this document in the process?

01

Initial Written Assessment

02

Definition Procedure

03

Assessment Procedure

04

Report Phase

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About this document:

The purpose of this Assessment Consultation is to obtain views or further evidence from BSC Parties and other interested parties on matters discussed in this document. The P284 Workgroup will discuss the consultation responses before making its recommendations to the Panel on 12 July 2012 via the P284 Assessment Report.

This report details the solution, impacts, costs, benefits and the potential implementation activities associated with this change to the extent the Workgroup has been able to determine them, and sets out the Workgroup's discussions. Draft legal text and the Assessment Consultation response form, which includes all the questions highlighted in this document, are attached.



Issue identified by the Proposer

The current BSC provisions do not allow the Balancing and Settlement Code Company (BSCCo) to perform non-BSC activities.

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.

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

National Grid raised P284 to facilitate implementation of the 'contract model' supported by a majority of respondents to Ofgem's consultation, and in line with Ofgem's view that *"a formal separation between the BSCCo and a 'New Elexon' is better able to protect the interests of BSC Parties"*.

What is the 'Contract Model'

The 'Contract Model' would create a new BSC Agent called the 'BSC Services Manager' and will necessitate the separation of ELEXON and BSCCo. The BSC Services Manager would be obligated, via a contract, to undertake some or all of the BSC functions. The new BSC Agent role would be undertaken by ELEXON along with other non-BSC activities.

For further information on the 'Contract Model' Please see Appendix 1.

Proposed solution

The P284 solution would enable, but not require, BSCCo to outsource some or all of the BSC services to a new BSC Agent called the BSC Services Manager. This would be done via a contract between BSCCo and the service provider (i.e. 'New ELEXON'¹).

P284 is not just an enabling change; it also seeks to protect BSC Parties by ensuring that neither they nor National Grid, as the Shareholder, are exposed to risks and costs arising from ELEXON pursuing or undertaking non-BSC activities.

The P284 solution would be given effect by the legal text provided in Attachment A. In order to make it easier to digest, we have broken down the changes P284 will introduce 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 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 Chief Executive, but the scope and responsibilities of such role remain unchanged.
- 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 the organisation appointed as BSC Services Manager 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 neither the BSC arrangements nor BSC Parties can be exposed to any risks or incur any costs as a result of any activities of the BSC Services Manager service provider that are outside the BSC.

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

Proposer's justification against the Applicable BSC Objectives

The Proposer 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.

The 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 are outside the scope of P284.

While acknowledging that it is outside the scope of P284, the Workgroup noted that it believed that Parties should be consulted on the BSC Services Manager Service Description before it is approved and that the process of developing the BSC Services Manager Contract should be as clear and transparent as possible. Furthermore, that any contract 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 going to be undertaken when establishing a contract including the engagement with industry participants.

The Contract Model

P284 would not itself implement the delivery of the 'contract model', but it is important for Participants responding to this consultation to understand what the contract model is and how it will work. An explanation of the contract model is included in Appendix 1 of this consultation document.

3 Impacts & Costs

As a change to the BSC governance arrangements, P284 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 we do not anticipate that implementation of P284 will impact BSC Parties or other industry participants.

Our view of the likely impacts of P284 are set out below, and as part of this consultation we request that participants identify any impacts the implementation of P284 Proposed would have on them and identify costs and timescales associated with impacts.

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 BSC services to this new BSC Agent.



Would implementation of P284 impact you?

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 amend the governance of BSCCo to enable, but not require, it to outsource BSC services 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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4 Implementation

Implementation Approach

Implementation of P284 should have no impact on BSC Parties or other participants and only very minimal impact on ELEXON (to make the required Code changes). The Workgroup therefore recommends that P284 be implemented 1 Working Day following approval by the Authority.



Do you support the Workgroup's proposed implementation approach?

5 Terms of Reference

The P284 Workgroup's Terms of Reference comprise 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 15 WD 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. The key DCC process milestones are the submission of PQQ in the Qualification Stage in early August 2012, and the submission of response in the Proposal Stage in 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 to enable it to participate effectively in the DCC Award Process, and to ensure that the outcome of P284 is known before the early August PQQ deadline (i.e. not on the day).

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.

A Workgroup member commented that Modification P281 would potentially deliver improvements to the transparency, composition and accountability of the BSCCo Board that would provide Parties with greater confidence in BSCCo Board decisions (under the current arrangements or the contract model). However, the Member noted that the P281 provisions would not have a practical effect until after the anticipated P281 implementation date of December 2012.

What safeguards need to be in place?

Workgroup members commented that Code provisions 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 Parties or the BSC arrangements to risk and/or without sufficient oversight.

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.

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 a procurement exercise, and therefore questioned whether New ELEXON could be immediately 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 BSC services 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.

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 BSCCo. This is accomplished by introducing the concept of a new BSC Agent, the BSC Services Manager, into the Code.



QUESTION!

Do you believe that it is better to enable or require BSCCo to outsource BSC activities?



QUESTION!

Are there any alternative solutions that the Workgroup has not identified that they should consider?

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 activities specified in the BSC. However, the legal text allows ELEXON to 'unlock the 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 allowed to pursue activities outside the BSC. This solution does not change the vires of the BSCCo, but enables the creation of a new entity to deliver BSC activities whilst allowing it to pursue non-BSC activities; this ensures that neither the BSC arrangements nor BSC Parties can be exposed to any risks or incur any costs as a result of ELEXON providing non-BSC services.

Why is the CEO removed?

The removal of the CEO in the legal text (Section E4.6) had raised some questions by 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 CEO role being removed entirely.

Is the BSC Services Manager a person?

The Workgroup considered 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 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.

7 The Case for Change

Initial views against the Applicable BSC Objectives

The initial majority view of the Workgroup is that the P284 Proposed Modification **would better facilitate achievement** of the Applicable BSC Objectives compared with the existing baseline. The Workgroup's provisional recommendation, subject to consultation responses received and its further considerations, is that P84 should be implemented.

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).



Would the P284 Proposed Modification help to achieve the Applicable BSC Objectives compared with the current baseline?

8 Further Information

More information is available in

Attachment **A**: Legal Text Proposed

Attachment **B**: Assessment Consultation response form

Other documentation relating to P284 can be found on the [P284 page](#) of the ELEXON website. Following the consultation a complete set of responses received will be available on this page.

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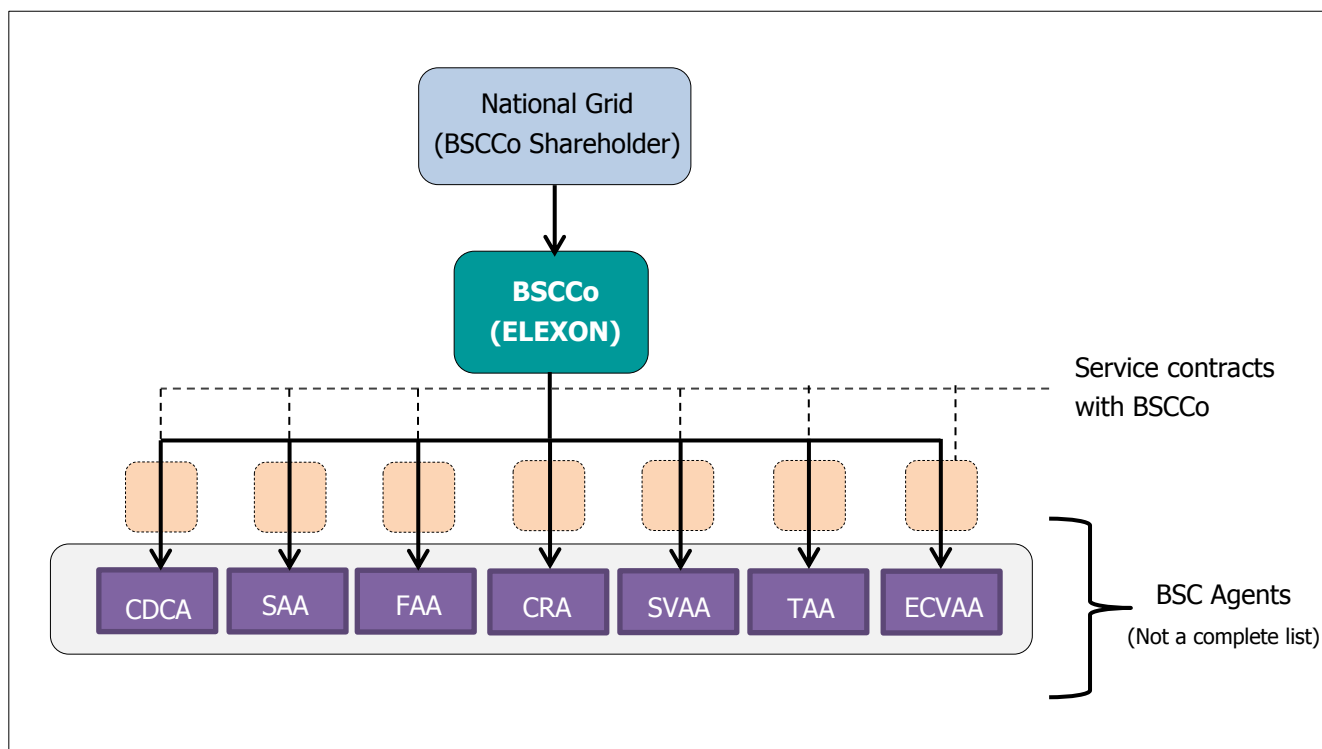
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Appendix 1: What is the 'Contract Model'?

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.

