



Stage 03: Assessment Consultation

Consultation responses due by 12 noon on Thursday 24 May 2012

P281: Change of BSCCo Board of Directors & Chairman

P281 seeks to change the make-up of the Balancing and Settlement Code Company (BSCCo) Board of Directors, to:

- Allow BSC Parties a more active say in the management and oversight of BSCCo; and
- Ensure the appropriate separation of the BSCCo Board from the management of ELEXON Limited, should ELEXON be permitted to diversify its activities.

The Workgroup has developed an Alternative solution to address the issues identified under P281 by introducing provisions that promote corporate governance best practices.



The Workgroup initially recommends approval of the P281 Alternative modification



High Impact:
BSCCo (ELEXON) and BSC Parties.

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 the views of BSC Parties and other interested parties on the P281 Workgroup's assessment of P281. The Workgroup will discuss the consultation responses before submitting its recommendations to the Panel in the P281 Assessment Report on 14 June 2012.

This consultation document details the P281 Proposed and Alternative Modifications developed by the Workgroup and the Workgroup's view of the potential benefits and impacts associated with P281. The response form and the legal text for the P281 Proposed and Alternative Modifications are attached to this document.

Why Change?

There is concern among Parties that the current arrangements around the BSCCo Board do not promote the appointment of a Board which Parties that fund the BSC arrangements can be confident will understand and fully consider the implications of its decisions for the wider industry. There is also a concern that the process of Board appointments are not sufficiently transparent and do not provide for enough input from Parties.

Proposed Solution

Under the P281 Proposed Modification four industry Board members would be elected by Parties that operate as generators or Suppliers, who would be split into constituencies based on how they operate in the market.

Alternative Solution

Under the P281 Alternative candidates for the Board would be selected by a Nomination Committee and would need to be ratified by the Panel. The Alternative is intended to provide a robust and transparent process that is in line with accepted best practice and incorporates Party input and Panel oversight.

Implementation, Impacts & Costs

The Code changes for both the Proposed and Alternative Modification would be implemented ten Working Days following approval by the Authority.

For the Proposed, initial elections would be conducted alongside the next Panel elections at which it is feasible to do so.

For the Alternative, once the Code provisions are in place the Nomination Committee would appoint new Board members in accordance with its Terms of Reference and the P281 Alternative provisions, with regard for the need to preserve continuity, experience and expertise.

We believe that besides increased participation in the process of Board appointments, implementation of either the Proposed or Alternative would have minimal impact on Parties. Industry and ELEXON implementation impacts and costs will be established by this consultation and ELEXON's impact assessment.

The Case for Change

The Workgroup supported the intent of P281 Proposed but was concerned that election by constituencies of Parties would not be an effective process to appoint Board members that are required to act independently.

The Workgroup believed that the Alternative is in line with best practice processes and would deliver the increased transparency and greater opportunity for Party input that are sought by P281.

Recommendations

The Workgroup's initial view is that:

- P281 Proposed should not be approved; and
- P281 Alternative should be approved.

The Balancing and Settlement Code Company

ELEXON Limited fulfils the role of the Balancing and Settlement Code (BSC) Company ('BSCCo').¹

BSC Section C sets out the powers, functions, responsibilities and constitution of BSCCo, whose principle role is to give proper, effective and efficient implementation of the BSC. BSC Section C1.2.2 currently precludes BSCCo from undertaking any business or activity which is not provided for in the BSC.

Current constitution of the BSCCo Board

BSC Section C4 sets out the existing constitution of the BSCCo Board of Directors ('the Board').

Under these provisions, the Board comprises five Directors as follows:

- **The Board Chairman**, who is the BSC Panel Chairman appointed by Ofgem. The Chairman holds office for three years, although they may be reappointed by Ofgem following the expiry of this term of office.
- **Two (non-executive) Industry Directors**, who are Industry Panel Members nominated to the Board by the BSC Panel. The Industry Directors hold office for the two-year term of their Panel Membership, although they may be reappointed by the Panel following the expiry of this term of office.
- **Two (non-executive, non-industry) Directors**, who are nominated by the Chairman after consultation with the Panel. These Directors hold office for two years, although they may be reappointed by the Chairman following the expiry of this term of office.

All five Directors are indemnified by BSCCo for all liabilities incurred in their role as Directors (C4.5), and are entitled to be reimbursed by BSCCo for their reasonable costs and expenses (C4.4). The two non-industry, non-executive Directors are also entitled to receive such additional remuneration and benefits as may be determined by the Chairman after consultation with the Panel (C4.4.2). None of the others are entitled to receive any additional remuneration or benefits in their capacity as Directors (C4.4.3).²

All of the five Directors are able to vote on Board business. BSC Section C4.7 requires that Board proceedings are conducted and governed in accordance with the Articles of Association of BSCCo, which include provisions relating to the appointment and removal of Directors. BSCCo's Articles of Association are based on the Companies Act 1985 Table A Articles,³ and are publicly available through Companies House.

The Board delegates the day-to-day conduct of BSCCo to the Chief Executive (C4.6.4), supported by the BSCCo Executive team. The Chief Executive of BSCCo is not a member of the Board, although they are entitled to attend and speak (but not vote at) Board meetings in accordance with BSC Section C4.6.3. Members of the BSCCo Executive team may also attend Board meetings, but are not Board members and cannot vote. The Chairman is not a member of the Executive team.

¹ See the definition of 'BSCCo' in BSC Annex X-1.

² The Chairman is remunerated as the BSC Panel Chairman under BSC Section B2.1, rather than as the BSCCo Board Chairman. This remuneration is determined by Ofgem in consultation with the Panel (B2.11).

³ http://www.companieshouse.gov.uk/about/tableA/comm1Aug85CoRegulations1985_P1.pdf

Role of the BSCCo Board

Under the BSC, the Board must fulfil the following requirements:

- Responsibility for the appointment of the BSCCo Chief Executive after consultation with the Panel (C4.6); and
- Responsibility for the approval of BSCCo's Annual Budget following consultation with BSC Parties and other interested parties (C6.4). Note that the Panel, not the Board, approves BSCCo's annual Business Strategy following consultation with BSC Parties and other interested parties (C6.3).

In addition to its specific BSC requirements, the Board has the wider role of directing BSCCo. This role includes responsibility for monitoring BSCCo's performance, scrutiny of BSCCo's finances and ensuring that BSCCo operations are subject to effective cost-control. The manner in which the Board fulfils its role is not prescribed in the BSC. Certain requirements (e.g. regarding quorum at meetings) are included in BSCCo's Articles of Association. However, in general terms the way the Board conducts its business is not prescribed.

Rationale for current Board constitution

Page 174 of '[The New Electricity Trading Arrangements: Ofgem/DTI Conclusions Document](#)' (October 1999) summarises the conclusions of Ofgem and the Department of Trade and Industry (DTI) on the constitution of the BSCCo Board as follows:

"BSC Board

The Chairman and the Panel will select four persons to become non-executive directors of the BSCCo and to form the BSCCo Board. Ofgem/DTI feel that the Board should be smaller in size than the Panel, as a smaller body is better able to exercise the required level of scrutiny and control of the BSCCo. Two of the directors will be drawn from the industry members of the Panel. The remaining two directors could be selected either from within the remaining Panel members or from outside, if particular skills were required on the Board that were not present among the Panel membership. For example, the Chairman might want to have accounting and IT advice available to him on the Board. The Board responsibilities will include the approval of the BSCCo business plan and budget and the monitoring of performance. The fact that the Board will be non-executive, and include representatives of those paying BSCCo fees, should reassure participants that there will be sufficient transparency, scrutiny and control of costs."

P281 issue

The Proposer of P281 (E.ON Energy Solutions Ltd) believes that the current BSCCo Board arrangements can allow the non-industry, non-executive Directors and the Chairman to carry Board decisions against the will of the non-executive Industry Directors. The Proposer argues that this means ELEXON resources can be used, budgets set and expenditure incurred even though such decisions may not be supported by BSC Parties and other affected stakeholders.

ELEXON has expressed its desire to diversify and extend its activities outside the administration of the BSC, to take advantage of its skills and expertise in the development of market arrangements. The Proposer supports ELEXON's aspirations in this regard and has confidence that ELEXON is well placed to make a valuable contribution to these market developments.

The Proposer considers that, should ELEXON be permitted to diversify its activities beyond the BSC, it will become even more important to establish a BSCCo Board that is able to safeguard the interests of BSC Parties (who fund the BSC arrangements) from any potential risk or conflict of interest arising from these other non-BSC commercial activities. The Proposer believes that the reform of the BSCCo Board is thus an essential component of the changes required to enable ELEXON to diversify its activities. The Proposer argues that such reform will help ensure the appropriate separation of the BSCCo Board from the management of ELEXON.

Related changes

E.ON UK raised BSC Standing Issue 40⁴ in March 2011 to explore how ELEXON might 'unlock' its vires to pursue new business development opportunities outside the BSC. The Issue 40 Group identified two workable governance models, but recognised that either of these will require changes to documents outside the BSC. It therefore looked to Ofgem and the Department of Energy and Climate Change (DECC) to provide a clear direction that could deliver a way forward. The Group submitted its report to the BSC Panel in September 2011, and you can download a copy from ELEXON's website [here](#).

Separately to Issue 40, Ofgem commissioned its own report from an independent advisor (Richard Morse) concerning ELEXON's diversification and governance. This report was published in July 2011, and you can download a copy from Ofgem's website [here](#).

Both Issue 40 and the Richard Morse report concluded that, in order to facilitate ELEXON's aspiration, it will be necessary to allow ELEXON to operate independently of the BSC under any of the proposed models. In November 2011, Ofgem therefore issued an open letter consultation seeking views on the potential expansion of ELEXON's role and the organisational options to facilitate this. Ofgem's consultation closes on 6 January 2012, and you can download a copy from its website [here](#). Following its consideration of the consultation responses, Ofgem intends to publish its decision in early 2012.

⁴ 'Review of ELEXON Governance and Funding Arrangements for New Business Opportunities'.

3 Proposed Solution

The P281 Proposed solution is largely based on the solution set out in the P281 proposal form, though the Proposer made clear that they were seeking the group's help in developing the solution and determining its details and specific characteristics. The Proposer was therefore open to suggestions from the group, but clarified that an aspect of P281 Proposed that they considered definite was that the Board must contain a majority of members selected by industry participants based on constituency categorisation.

It was also clarified that the BSC defect identified by P281 does not concern the function of the Board, only its constitution (i.e. the Proposer believe that the Board's constitution is not optimised to allow it to fulfil its function) and that is therefore key that P281 is seeking only to change the Board's constitution, not its function.

Board Chairman

Under the Proposed Modification the Board Chairman would be appointed as at present, i.e. and independent Chairman of both the BSCCo Board and BSC Panel who is selected by the Panel, and whose appointment is ratified by the Authority, i.e. as prescribed under the Transmission Licence following Ofgem's Code Governance Review. However, the BSC does not currently reflect this change to the Transmission Licence; the necessary housekeeping change required to align the BSC with the Transmission Licence would therefore be made under both P281 Proposed and Alternative. If neither is approved the housekeeping change would be progressed separately.

Unlike at present, under the Proposed the Board Chairman would not vote unless the Board is split and a casting vote is therefore required.

Board Constitution

Under P281 Proposed the BSCCo Board would consist of the Chairman and four independent, non-executive Directors appointed via a system of industry elections (see below) as follows:

- Large Supplier Board Member;
- Small Supplier Board Member;
- Large Generator Board Member; and
- Small Generator Board Member.

The independent industry-elected Board members ('industry members') would serve three year terms and would all carry equal weight in Board votes.

The industry members would act independently and in the interests of BSCCo and the delivery of the BSC (i.e. in line with P281 not affecting the function of the Board). Though elected by 'constituencies' of particular types of BSC Parties, the industry members would not represent the interests of the constituency that elected them. Rather it is envisaged that the elections process will ensure that the industry members have experience such that they will understand the implication of Board decisions for Parties that fund the BSC arrangements.

The proposal form suggested that existing Panel members would be eligible to be elected as an industry member and that P281 would not place any restriction on a person fulfilling both a Panel and Board role. The Workgroup did however consider that the present situation where two Board members are drawn from the industry Panel members may cause somewhat of a conflict for those Panel members who also act as Board members, or at least impose restrictions on what they can discuss with the Panel, as opposed to the intent of the dual role Panel-Board role which was intended to ensure communication and coordination between the Panel and Board. Despite these concerns the Proposer decided that P281 Proposed would not prohibit membership of both the Panel and Board, though it is inherent in the solution that it allows Panel and Board members more flexibility with respect to whether they wish to attempt to serve on both (e.g. there would not be a requirement for some industry Panel members to become Board members too; industry Panel and Board membership would be completely independent of one another).

The group considered whether the aim of P281 could be more effectively or efficiently achieved by some other constitution of Board membership, for instance:

- Adding one further industry member to the existing Board Structure (i.e. three industry and two independent) with the industry members either elected or drawn from the Panel or a mixture; and
- Introducing the Large/Small Supplier/generator Board members as under P281 Proposed but also retaining the existing two independent members (i.e. six Board members overall, besides the Chairman).

However, the Proposer ultimately decided on the Board constitution as set out above because they believe the present size of the Board is reasonable and that the elections process should deliver the relevant expertise and experience required by the Board (as well as providing assurance to Parties) so there is no need for further, non-elected Board members.

The solution outlined in the proposal called for the Board to be permitted to appoint up to three independent, non-voting experts to support it. However the group agreed that there was nothing preventing the Board from seeking such expertise at present and if such experts would be unable to vote on Board matters there was no benefit to including this restriction (i.e. the Board could enlist further experts as it saw fit so the restriction would be meaningless). The Proposer therefore agreed that this aspect would not be part of the proposed solution.

Remuneration of Board Members

The four industry members of the Board would receive the same remuneration as that currently received by the two non-executive industry (Panel) Board members. The current industry members do not receive a fee for their Board services, only payment for expenses incurred in the course of service on the Board. Since the Proposed solution would dispense with the non-industry Board members the cost associated with the membership of the Board would decrease (i.e. the two additional industry Board members' expenses would be paid, but the current remuneration of two non-industry Board members would cease).

Board Elections

Constituencies

The Proposer determined that the constituencies for industry Board members would be those as set out above (which match those suggested in the P281 proposal). The Proposer believed that these groups would ensure that the views of a variety types and sizes of the BSC Parties that predominantly fund the BSC (i.e. generators and Suppliers, as Trading Parties that are exposed to the net main funding share) are taken into account in the appointment of Board members. Taking the constituency principle as a given, the Workgroup did not suggest any alternative constituency structures that they believed would be more effective. The group accepted the rationale that the views of generators and Suppliers should be prioritised since these are the Parties that primarily fund the BSC arrangements. The Proposer therefore confirmed that any Party/TPG that is neither a Supplier nor a generator would not be able to participate in the elections proposed by P281 Proposed.

Parties would be considered in terms of Trading Party Groups (TPG) for the purposes of determining constituency membership. A TPG can qualify for membership of up to two constituencies based on its activities and market share (i.e. it can be a Large or Small generator and also a Large or Small Supplier) and can vote in elections for any constituency for which it qualifies. However, a Party or TPG can nominate a candidate in only one constituency for which it is qualified for each two year round of elections (i.e. due to the staggering of elections the replacement of all industry Board members spans two years, but this is considered a single 'bloc' of elections for the purposes of Parties' ability to nominate Board members). Any Party/TPG would be able to select the constituency in which it wishes to nominate, and notify ELEXON of its choice (i.e. if it wishes to make a nomination).

The group considered how membership of a constituency should be determined and what thresholds should be applied to differentiate between Small and Large for the purposes of the P281 provisions, and considered that the criteria applied should consider market share and ideally relate to how Parties funding share contributions are determined. The group considered that either metered energy volumes or generation capacity might be used to distinguish between Large and Small Generators, while differentiation of Large and Small Suppliers could be achieved by considering energy volumes or number of Meters registered to Parties ('MSID count').

The Workgroup discussed the benefits and drawbacks of the various approaches (see table below) and ultimately agreed that it would be better to use energy volumes as criteria for both the generator and Supplier constitutions. The group believed that this approach had the benefit that it is consistent with the basis of the methodology used to calculate funding shares and can be applied for both generator and Supplier constituencies. The Proposer agreed with this rationale and agreed that this approach would be used in the P281 Proposed solution.

	Benefit	Drawback
Generator Volumes	<ul style="list-style-type: none">• Consistent - energy volumes can be considered for both generation and Supply• Matches basis of funding share methodology• Represents actual activity and market impact	<ul style="list-style-type: none">• May be affected by variations e.g. weather• Relatively backward looking (average over time period to minimise effect of variations)• Affected by netting/embedded generation

Generator installed capacity	<ul style="list-style-type: none"> • Generation Capacity (GC) can be used • No problem of netting off where Party/TPG operates as both generator and Supplier • Represents maximum impact generator's activity could have on the market • Relatively stable • Up to date snapshot at point in time of nominations 	<ul style="list-style-type: none"> • Differs from funding share methodology • Does not take into account transfer of volumes between Parties via Metered Volume Reallocation Notification (MVRN) • Can be distorted by large declared GCs which are never realised in practice
Supplier volumes	<ul style="list-style-type: none"> • Consistent - energy volumes can be considered for both generation and Supply • Matches basis of funding share methodology 	<ul style="list-style-type: none"> • May tend to underestimate share of domestic Suppliers (i.e. industrial Suppliers may have large volumes associated with few customers) • May be affected by variations e.g. weather • Relatively backward looking (average over time period to minimise effect of variations) • Affected by netting/embedded generation
Supplier MSID count	<ul style="list-style-type: none"> • Clear • Relatively stable • Up to date snapshot at point in time of nominations 	<ul style="list-style-type: none"> • Differs from funding share methodology • May tend to underestimate share of industrial Suppliers (i.e. large volumes for few MSIDs)

The Workgroup considered the threshold values that might be applied to determine whether a generator or Supplier is considered Large or Small under the P281 solution. The group considered analysis of Party/TPG share of SVA volumes (with volumes in SVA considered to denote a TPG as eligible for Supplier constituency under P281) and CVA volumes (with volumes in CVA considered to denote a TPG as eligible for generator constituency under P281).

The analysis considered the magnitude of TPGs' energy volumes as a percentage of the overall magnitude of SVA or CVA volumes. The group looked at the average percentage share of Parties/TPGs in the group analysed and considered thresholds for Large Supplier/Generator status of 1%, 5% and 10% share of volumes.

	Average	Large (>1%)	Large (>5%)	Large (>10%)
Supply (SVA vols)	3.704%	9	6	5
Generator (CVA vols)	1.89%	16	7	2

The group agreed that a 5% threshold for both Supply and Generator constituencies would capture the right Party/TPGs as Large. The group considered that a 10% threshold

would be too high and would unduly limit qualification as 'Large' while 1% would be too small and would result in organisations being classified as 'Large' where this was clearly not appropriate.

This threshold would be applied upon implementation of P281 Proposed if approved, but under the Proposed solution there is provision for the Panel to review the thresholds as necessary to ensure that they remain relevant and continue to effectively deliver appropriate Large and Small Generator and Supplier constituencies. There is no necessity that the same threshold level is applied for both Suppliers and Generators.

Question 4

Do you agree with the proposed provisions for the industry constituencies and the determination of constituency membership?

Voting in Board elections

The group considered whether voting in elections should be weighted by market share or whether each Party/TPG should get a single vote in any constituency relevant to it. Consideration was given to voting weighted using the measurement criteria applied to determine constituency membership, albeit using some sort of cap to preclude predominance by a single or very few Parties. This would be consistent with the rationale of apportioning weight in Board elections based on Parties' contribution to the funding of the BSC arrangements.

However, the group and Proposer ultimately agreed that a 'one Party/TPG, one vote' system would be more straightforward and equitable, and also consistent with the approach employed in Panel elections.

Frequency of elections

The Workgroup considered that it would not be sensible to hold elections such that the entirety of the Board could be changed all at once, and therefore agreed that the election of industry Board members should be staggered to preclude this possibility.

The group considered that in the interests of preserving continuity of experience and expertise it might be best to stagger elections such that the greatest variety of existing Board members was preserved (i.e. between type and size), i.e. appointment of the Large Supplier and Small Generator members in one election and appointment of the Small Supplier and Large Generator members in the next elections, and so on. However, the group considered that this approach could potentially lead to inconsistency in constituency memberships (i.e. if Large and Small Supplier members are elected in different years an organisation could potentially move between constituencies) and the process could well be unclear and confusing for Parties. The Group therefore agreed that the elections would be staggered such that the election of the Supplier members (Large and Small) takes place in a different year to the election of generator members (Large and Small). The Proposer agreed with this rationale.

In line with the agreed three year term of industry Board members under P281 Proposed, each constituency industry Board member's position would be subject to re-election at three year intervals. Since upon implementation of P281 all industry Board members would need to be elected in the same year the staggering would be achieved by one set of industry members serving a truncated initial term of two years. This is shown in the table below, and in this illustration the Supplier members serve a short first term. Note that

Panel elections occur every two years, so the staggered three year Board elections process would mean that elections of some sort would occur more frequently than at present.

ELEXON will administrate each election (Board or Panel), will require the participation of Parties in order to be effective and will necessitate the re-establishment of the list of Trading Party Groups. In the ten year period shown in the table only two years would have no elections at all, and after the pattern is established an election-free year would occur only once every six years.

Year	1	2	3	4	5	6	7	8	9	10
Panel Election	X	No elections	X		X		X	No elections	X	
Board Election (Suppliers)	X		X			X			X	
Board Election (Generators)	X			X			X			X

Mid-term replacement of Board members

The provisions to be applied under P281 Proposed in the case of a Board member leaving the Board part-way through their term have not been determined. Potential options are somewhat constrained by the principle of appointment by elections and the need to maintain the election cycle set out above.

It may be pragmatic to allow the Chairman discretion to decide how to address the situation, taking into consideration the remaining Board and the current point in the Board election cycle (i.e. the staggered three year cycle) and the time till the next Panel elections. So the Chairman could determine, depending on the amount of time till the next election and the constitution of the remaining board:

- Not to replace the Board member before the next relevant constituency election;
- To appoint an interim Board member (i.e. without an election) to serve until the next relevant constituency election; or
- To hold an ad hoc constituency election at the same time as a scheduled election (Board or Panel) to appoint a Board member under the next scheduled relevant constituency election.

Question 5

Do you have any views on the approach to the replacement of a Board member who has not completed their full three year term on the Board (i.e. mid-term appointment)?

Implementation

If approved, the Proposed Modification would be implemented such that the initial Supplier and Generator Board elections would be conducted at the same time and aligned with the next feasible Panel Election following implementation. The Code changes to implement the Proposed Modification would be implemented ten Working Days following approval by the Authority.

The minimum feasible interval between implementation of P281 Proposed and the initial Board elections will be determined by the results of the P281 Assessment Procedure industry consultation and by ELEXON's internal impact assessment of P281.

In order to implement the First term of either Supplier or Generator members would be a two year term, allowing the subsequent introduction of the three year staggered pattern of Supplier and Generator Board member terms and elections. Following the P281 consultation the Workgroup will consider which of the initial constituency industry Board member terms are only two years long.

Question 6

Do you agree with the proposed implementation approach for P281 Proposed?

Do you have any comments, such as:

- Views on the minimum feasible period between implementation in the Code and the start of the initial industry Board elections?
- Views on which industry constituency Board members should have an initial shortened term of two years, i.e. Supplier or Generator?

Impacts and Costs

The central (ELEXON) and industry impacts and costs associated with implementation of P281 Proposed will be determined following the results of the industry consultation and ELEXON's assessment.

Our initial view is that implementation of P281 Proposed will have minimal impact on Parties and other industry participants. Going forward, Parties will need to notify ELEXON of their votes in Panel elections (if they qualify for a voting constituency and wish to vote) and of any nominations of Board candidates, though these activities are not mandatory.

ELEXON will administrate the new arrangements and the Panel may review the constituency threshold from time to time (or delegate this task to another group).

The Code changes that the Workgroup believes will deliver the Proposed solution in the BSC are set out in the attached draft legal text (Attachment A).

Question 7

Would implementation of P281 Proposed impact you?

Please describe any impacts directly related to implementation and provide an estimate of associated costs and timescales if possible.

4 Alternative Solution

The Workgroup developed a P281 Alternative solution to deliver the aims of P281 and address the identified BSC defect by introducing provisions that promote established best practices in corporate governance.

The Workgroup considered that the key principles of P281 were increasing the influence of BSC Parties on the constitution of the Board and increasing the Board's transparency and accountability to Parties. The Workgroup felt it would be beneficial to disregard the restrictions implicit in the Proposed solution, that Board members are elected by Parties and that industry Board members must constitute all, or the majority, of the Board.

The Workgroup considers that the Alternative solution addresses industry concerns without restricting the Board's ability to flexibly identify and recruit to the Board individuals that it considers will supply expertise that will enable the Board to fulfil its functions.

The Workgroup believes that the Alternative solution aligns with the relevant corporate governance guidelines and the accepted principles and best practice with respect to Board structure and recruitment.

Question 8

Do you believe that there are any alternative solutions that the Workgroup has not identified that they should consider?

Board Constitution

As drafted, under the Alternative solution the size of the Board would be limited to four members (and the Chairman). The Workgroup considered that it was sensible for the Code to limit the number of Board members to preclude the possibility of the Board becoming inappropriately large and thus less effective.

An alternate approach would be for the Board and the Nomination Committee to determine the number of Board members comprising the Board based on the Board's functions and requirements, existing Board composition and the available nominees. This approach would more closely align with best practice, which puts the onus on the board to manage its own size. The UK Corporate Governance Code states that the 'board should be of sufficient size that the requirements of the business can be met and that changes to the board's composition and that of its committees can be managed without undue disruption, and should not be so large as to be unwieldy'.

Arrangements under which Board/Nomination Committee determine the size of the Board would allow flexibility to respond to different demands. There may be scope for provisions that allow more flexibility but still impose a maximum limit on the number of Board members.

Question 9

Do you believe that under the Alternative the number of Board members should be limited to four (in addition to the chairman)?

If not, please give your views on whether the Board should be given complete flexibility to determine the appropriate size; some other maximum limit should be imposed (and if so, what it should be); or an alternate approach not yet considered.

The Workgroup considered that the current structure of some industry Panel members acting as industry Board members may place a constraint on the dual Panel/Board members, but did not believe it was necessary to prohibit people from acting as both a Panel member and a Board member. Inherently, the Alternative would deliver a separate Panel and Board, though a person filling either role could put themselves forward for consideration for the other role. In the latter circumstance the individual, the nomination committee and Parties can all decide for themselves whether the person's existing role is a positive or negative factor.

Under the current arrangements all members of the Board are non-executive directors. The Workgroup has not discussed whether this should be changed under the Alternative solution, and the legal text preserves the status quo of no executive directors. However, best practice suggests that a board should contain a mix of both executive and non-executive directors - the UK Corporate Governance Code states that a 'board should include an appropriate combination of executive and non-executive directors (and, in particular, independent non-executive directors) such that no individual or small group of individuals can dominate the board's decision taking.'

The Workgroup may therefore give consideration to including executive directors on the Board under the Alternative. As part of such consideration the Workgroup may also discuss whether it would be appropriate to limit the number of executive directors compared relative to the number of non-executive directors (e.g. by specifying that there must always be a majority of non-executive directors, or by imposing a maximum limit on the number of executive directors). Consideration of inclusion of executive directors would need to take into account the current prohibition of the Chief Executive of BSCCo being a director. To inform such considerations participants' views in this area are sought.

Question 10

Do you believe that the Alternative should contain provision for executive directors on the Board, and do you have any views on the approach such provision should take?

As under P281 Proposed, the Alternative solution includes a housekeeping change to amend the BSC to reflect the change to the Transmission Licence which requires that the independent Chairman of both the BSCCo Board and BSC Panel is selected by the Panel for ratification by the Authority. If neither the Proposed nor Alternative Modification is approved the housekeeping change would be progressed separately.

Board Voting

Under the Alternative the Board members and Chairman would all have the same voting rights, as under the present arrangements (currently the Chairman has an equal vote on the Board but only a casting vote on the Panel), i.e. under the Alternative the Chairman would not be restricted to only a casting vote on the Board, as they would be under the Proposed). It is normal in Board arrangements for the Chairman to have the same voting right as the other Board members.

Nomination Committee

Under the Alternative the Board would form a Nomination Committee which would be responsible for selecting candidates for membership of the Board. This committee would comprise the Chairman, one or more Board members and any additional support considered necessary by the Board, which could include input from Panel members as advisors.

The Nomination Committee's powers and functions would be set out in its Terms of Reference, which would be published in the interests of transparency⁵. The means of recruitment for the Board and selection of candidates would be at the discretion of the Nomination Committee. The committee would determine job descriptions for particular roles, setting out necessary skills and experience (which could include industry experience, but this would depend on relevance to the particular role).

The Terms of Reference will be substantially based on the [ICSA standard](#), supplemented with specific details relating to the balance of industry/non-industry members which will be prescribed in the BSC as part of P281 Alternative. The Terms of Reference therefore should not change much over time, although they will need to be adapted occasionally to keep up to date with best practice. The Panel would be consulted on any material changes and the changes would be published on the BSC website. The Panel's role would be to ensure the Terms of Reference follow the specific BSC requirements.

The Nominations Committee could select candidates via advertisement, through the use of head-hunters or following submission of an individual to the Nomination Committee by a BSC Party. The Workgroup noted that the use of an open advertisement or head hunters is in line with corporate governance best practice, and considered that providing for BSC Parties to nominate potential candidates would deliver the kind of industry involvement sought by P281.

Panel Ratification and BSC Party input

The Panel has the power to veto candidates' appointment to the Board. No other party (i.e. BSC Party or other person/organisation) other than the Panel can veto a candidate, but any BSC Party may inform the Panel of reasons why it believes an appointment should not be ratified.

The BSC requires that an Annual BSC Meeting is held in July each BSC Year (BSC Section B 6.2). The full BSC Panel, each Director of BSCCo and the Chief Executive of BSCCo are all required to attend this meeting. Under the Alternative, any candidate for appointment to the Board would be formally put forward for ratification. Either at the meeting or before any Party would be able to ask the Panel to veto an appointment and provide supporting rationale for this request. If the Panel agrees with such a request, or as a result of its own considerations, the Panel may veto any candidate (i.e. decline to ratify their appointment). The Panel would be able to question the Board and nomination committee about candidates and its selection process. The intent of this process is to give Parties and the Panel transparency and an opportunity to have input into the composition of the Board.

⁵ Most companies have similar Nomination Committee Terms of Reference; standard Terms of Reference prepared by ICSA are available, which most companies use as a basis: <http://www.icsa.org.uk/assets/files/pdfs/guidance/071013.pdf>.

Mid-term replacement of Board members

In the event of a Board member leaving before the end of their agreed term the Nomination Committee would make an appointment as necessary in accordance with its terms of reference. The appointee would then serve on the Board until the next Annual BSC Meeting, when they would be put forward for formal ratification. As drafted, under the Alternative solution Board members' terms would be up to two years in length, in line with the current provisions. The Workgroup will give further consideration to whether this remains appropriate under the arrangements proposed by the Alternative.

Remuneration

Remuneration of Board members appointed under the Alternative would be in line with the remuneration of the independent (non-industry) members that currently serve on the Board. There would therefore be no change in principle in the remuneration of independent Board members, but there would be an increase in the cost of the BSC Board because all members would be considered as independent members and remunerated accordingly.

Implementation

The Code changes to implement the Alternative Modification would be implemented ten Working Days following approval by the Authority. Following implementation, the Nominations Committee would begin the process of appointing new Board members in accordance with its Terms of Reference and the P281 Alternative provisions and with regard for the need to preserve some continuity, experience and expertise on the Board.

Question 11

Do you agree with the proposed implementation approach for P281 Alternative?

Impacts and Costs

The central (ELEXON) and industry impacts and costs associated with implementation of P281 Alternative will be determined following the results of the industry consultation and ELEXON's assessment.

Our initial view is that implementation of P281 Alternative will have minimal impact on Parties and other industry participants. Going forward, Parties will be able to

The Board will be responsible for the Nominations Committee and members of the Panel may be called upon to advise the Nominations Committee from time to time.

The Code changes that the Workgroup believes will deliver the Alternative solution in the BSC are set out in the attached draft legal text (Attachment B).

Question 12

Would implementation of P281 Alternative impact you?

Please describe any impacts directly related to implementation and provide an estimate of associated costs and timescales if possible.

Workgroup Discussions

The Workgroup considered that whether or not the arguments and specific details of the Proposed solution were accepted, there appeared to be an appetite among industry participants for some kind of change in the constitution of the Board and the manner in which Board members are selected and appointed. The driver behind this appetite was the findings of Issue 40 and the potential changes in the respective roles and activities of BSCCo and ELEXON.

The Workgroup noted that the BSCCo Board is responsible for ensuring the BSC is delivered efficiently (by ELEXON). The Ofgem representative suggested that P281 Proposed seems to envisage the Board as more of an operational contract manager, which is not really the role of a Board and that in general having the right experience to be a Board member does not necessarily equate to having the right experience to run a company day to day. However, the Workgroup did note that with respect to the BSC there is some (partly intentional) 'blurring' of the responsibilities of the BSCCo Board and the BSC Panel.

A driver behind P281 was to ensure that the majority of the Board understand the priorities and activities of industry stakeholders, and the impacts of decisions upon them. A Workgroup member felt that a source of concern in this area might relate to ELEXON's original investigation into whether it might be possible for it to pursue potential business outside the BSC, and a perception that this was permitted by the Board despite industry Board members' concerns. However, the Workgroup noted that it has been stated publicly that all the Board's decisions in the last year have been unanimous; while particular incidences of Board disagreement could have significance, such situations are clearly not prevalent.

The Workgroup considered whether as stakeholders in the BSC, and compared with National Grid as the actual BSC shareholder, BSC Parties are the nearest thing to BSCCo shareholders in a conventional sense. If this premise was accepted it could be considered that P281 is simply trying to mirror the ultimate control of the Board by, and responsibility to, shareholders that exists in other organisations. However, in such a conventional structure it is still usual for a Board Committee to nominate candidates for appointment to the Board before shareholders are given the opportunity to vote to ratify an appointment.

The Workgroup considered that P281 Proposed would provide funding Parties with a clear and transparent mechanism to influence membership of the BSCCo Board and remove Board members whose performance they believe is unsatisfactory. It appears Parties do not believe they have any avenue to have input in these areas presently.

The Workgroup considered whether it would be better for Board members to be selected centrally with provision made to give Parties the ability to veto appointments, or at least put in place a means for them to raise concerns for consideration. This would obviate the potential drawbacks and complications associated with the P281 Proposed Modification. The challenge would then be how the appointments could be made, and/or a shortlist of candidates produced, such that industry concerns around transparency and accountability are addressed.

Enabling the input of industry participants to a Board nominations committee could address the P281 defect. The Workgroup considered that this could be effective, particularly if an effective means can be found to enable the Board to be questioned and

held to account and, ultimately, provide for the removal of underperforming Board members.

Based on these considerations the Workgroup developed the P281 Alternative solution set out in this document by considering the issues raised by P281 and established corporate governance best practice.

Transparency and Accountability

The Workgroup discussed a number of measures that they considered might improve the Board's transparency and accountability to Parties. This would increase Parties' confidence that the Board is cognisant of the impacts and risks of its decisions for Parties, and that it gives appropriate weight to these factors in its considerations.

Potential methods of improving Board transparency and accountability might include the inclusion of greater detail in the Chairman's report to the Panel on Board matters; submission of Parties' questions to the Chairman prior to Panel meetings with the Chairman and Board undertaking to respond to reasonable enquiries; and encouraging Parties to question the Chairman at the Annual BSC Meeting.

The ultimate means of delivering Board accountability was through the ability of stakeholders to remove Board members in whom they did not have confidence. As the BSC shareholder, there is provision for National Grid to remove Board members, but the group believed that there was little incentive or opportunity for National Grid to monitor the Board closely, particularly with respect to the needs and concerns of Parties, and it was difficult to envisage circumstances in which National Grid would exercise its power to remove directors.

The Workgroup did not believe that any changes in this area should be progressed under P281, but noted that consideration might be given to whether improvements could be made outside P281. However, if greater transparency and accountability of the Board is achieved via P281, Parties may be better able to identify and substantiate concerns, which could enable them to approach the Panel, National Grid and/or Ofgem and thereby influence National Grid to consider removing Board members if necessary.

Initial views on P281 Proposed

These are the initial views of the Workgroup on the benefits and drawbacks of the P281 Proposed solution. Workgroup members gave general views for consultation. Following the consultation the Workgroup will agree its formal views against the Applicable BSC Objectives for inclusion in the P281 Assessment Report that will be submitted to the Panel.

The majority of the Workgroup believed that overall the implementation of P281 would not deliver an improvement over the existing Code baseline.

Question 1

Do you believe P281 Proposed would help to achieve the Applicable BSC Objectives compared with the current baseline?

Benefits:

The Proposer reiterated the views set out in the Modification proposal. They emphasised that they believe that drawing Board members from organisations with experience of the energy industry and the BSC arrangements was important given the role of the BSCCo

Board in the context of the BSC. As a consequence industry participants would feel more confident in the BSC arrangements and more in control of their own future.

A member supported the suggestion that industry participants would feel more in control, promoting confidence.

A member felt that the increased industry input meant the Proposed is better than the baseline, though they had concerns with regard to the independence of elected Board members.

Members supported the general views expressed with respect to the benefits of increased industry input and confidence under P281 Proposed.

A member observed that there appeared to be tension between the Board's competence and its accountability; though it has drawbacks P281 Proposed would improve accountability.

Drawbacks:

A member was concerned by the possible implications of moving from independent Board members to Board members required to act independently but elected on a constituency basis. They also noted that Board elections would add complexity to the BSC arrangements.

Though they believed overall the Proposed is better than the baseline, a member felt that there would be no truly independent Board members under the Proposed because the constituency system has an inherent risk that members will represent their constituency.

A member believed a key drawback is the risk to the credibility of Board members elected by constituency.

Another member echoed the concern around the risk to credibility and also suggested that there was a risk of limiting the pool of available expertise if industry experience is a prerequisite. They also noted that there are difficulties around constructing the necessary constituencies.

The Transmission Company Representative stated that at present the Board is impartial, though Board arrangements are not perfect, but P281 Proposed would introduce a risk to Board independence and impartiality. Even in the context of representative elections P281 Proposed was flawed because if there is to be representation of Parties views, the views of *all* Parties should be represented.

Initial views on P281 Alternative

As for the Proposed Modification, the Workgroup gave initial views on the benefits and drawbacks of the P281 Alternative solution. Following the consultation the Workgroup will agree formal views against the Applicable BSC Objectives.

The majority of the Workgroup believed that implementation of the Alternative solution would deliver an improvement compared with the existing Code baseline (and that P281 Alternative is also better than P281 Proposed).

Question 2

Do you believe P281 Alternative would help to achieve the Applicable BSC Objectives compared with the current baseline?

Question 3

Do you believe P281 Alternative would help to achieve of the Applicable BSC Objectives compared with the Proposed Modification?

Benefits:

The Workgroup believes that P281 Alternative would give industry participants confidence in the constitution of the BSCCo Board and in the process of making appointments to the Board.

The P281 Alternative would promote established best practices in corporate governance. The Workgroup felt the Alternative would deliver Board accountability, a superior Board structure and an improved Board selection process while maintaining the independent ethos of the BSC and allowing all types of Party to have input into the Board appointment process (i.e. not just generators and Suppliers).

Drawbacks:

The Workgroup felt that the Alternative would be beneficial overall, but noted that the changes would add complexity to the BSC (though the Workgroup felt the benefits warrant the additional complexity). Workgroup members did express concern that the nomination committee might not be sufficiently transparent, and emphasised that the arrangements and process must be open and incorporate industry input.

Ofgem's current views on potential ELEXON expansion

On 30 April, Ofgem published a [letter setting out its current views on potential expansion of ELEXON's role](#) (following Ofgem's November 2011 consultation). The Workgroup will discuss this letter in detail when it meets following the industry consultation, but it does not appear that it contains anything relevant to P281 that has not already been taken into account by the Workgroup.

There is some mention of possible Panel functions under potential models of ELEXON expansion but these do not appear directly relevant to P281, though they may illustrate the underlying issues. The Workgroup invites views on whether participants believe the letter implies any P281 interactions/dependencies, or contains anything relevant to P281 that has not been taken into account.

Question 13

Do you believe that Ofgem's letter on potential ELEXON expansion contains anything relevant to P281 that has not been taken into account?

6 Further Information

More information is available in:

Attachment **A**: Legal Text Proposed

Attachment **B**: Legal Text Alternative

P281 documentation will be available on the [P281 page](#) of the ELEXON website.

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Assessment Consultation

3 May 2012

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