Contract Framework Document

Initial BSC Services Manager Contract Principles

Date	31 July 2012
Purpose of paper	For Industry Consultation
Summary	Modification Proposal P284 'Expansion of ELEXON's role via the 'contract model" contemplates the appointment of a BSC Service Manager under the BSC. However, even if the Authority approves P284, the BSCCo Board will require the case to be made for outsourcing before entering into any such arrangement. This document sets out the initial Contract Principles that would be used to underpin the appointment of a BSC Services Manager by the BSCCo Board should P284 be approved. The BSCCo Board welcomes any views on these matters and will amend the document after taking account of consultation responses. The final BSC Services Manager Contract Principles will be used by the BSCCo Board to guide its assessment of the case for outsourcing some or all BSC services to a BSC Service Manager and any subsequent negotiation of appropriate commercial and contractual terms.

1. Background

1.1 ELEXON Ltd is currently the Balancing and Settlement Code Company (BSCCo). This is defined in the BSC. The terms are effectively co-terminus.

1.2 Modification Proposal P284 'Expansion of ELEXON's role via the 'contract model" contemplates the appointment of a BSC Service Manager under the BSC. It is an enabling modification which would allow the BSCCo Board to outsource services presently provided to BSC Parties by ELEXON Ltd under the Balancing and Settlement Code should a sufficient case be made for it to do so.

1.3 However, even if the Authority approves P284, the BSCCo Board will require the case to be made for outsourcing before entering into any such arrangement. If commercial and contractual terms cannot be agreed which satisfy a number of contract principles it is anticipated that the current BSC services would not be outsourced and would continue to be provided by ELEXON Ltd as the Balancing and Settlement Code Company.

1.4 If P284 is approved and a sufficient case subsequently made for outsourcing, it is envisaged that ELEXON Ltd will change its name to BSCCo Ltd (remaining the Balancing and Settlement Code Company as defined by the BSC). A new company, un-related to BSCCo Ltd. would be created under different ownership. For the purposes of this paper this new legal entity is referred to as New ELEXON.

1.5 BSCCo Ltd would be the Balancing and Settlement Code Company as per the current limitations set out in the BSC. Its sole purpose would remain the provision of services under the BSC and the requirement to provide services in an efficient and economic manner, outsourcing those services as appropriate. New ELEXON Ltd could act as the BSC Service Manager and could also undertake additional roles outside the remit of the BSC.

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2. Purpose

2.1 This document sets out the initial contract principles that would be used to underpin the appointment of a BSC Services Manager by the BSCCo Board should P284 be approved.

2.2 The principles have been developed by BSCCo with independent legal support provided by Wragge & Co. They take account of:

- The findings of the Issue 40 'Review of ELEXON Governance and Funding Arrangements for New Business Opportunities' workgroup[1];
- Ofgem's conclusions to its consultation on the potential expansion of ELEXON Ltd's scope and vires[2];
- discussions held with the BSC Panel;
- industry feedback received on Modification P284[3]; and
- industry feedback received on the BSC Services Manager Service Description[4].

2.3 This framework document has been approved by the BSCCo Board for consultation with the BSC Panel and industry.

2.4 The BSCCo Board welcomes any views on these matters and will amend the Contract Framework document after taking account of consultation responses.

2.5 The final BSC Services Manager Contract Principles will be used by the BSCCo Board to guide its assessment of the case for outsourcing some or all BSC services to a BSC Service Manager and any subsequent negotiation of appropriate commercial and contractual terms.

3. Overview of the BSC Services Manger Function

3.1 Under P284 the BSC Service Manager is a BSC Agent. The BSC Panel must establish a BSC Service Description for each BSC Agent setting out the services that the BSC Agent should provide. The BSC Panel has consulted on a prospective BSC Service Description for the BSC Service Manager. Further information is available in Panel Paper 200/07.

3.2 The Panel has noted that the final decision on which of these services may be included in a BSC Service Manager contract will be taken at a later stage as part of any contractual negotiation and would also be subject to Authority approval of Modification P284. At the time of this decision it may be necessary to amend the BSC Service Description to reflect the actual services to be provided, and this would require further BSC Panel approval.

[1] http://www.elexon.co.uk/wp-content/uploads/2012/02/Issue_40_Final_Report.pdf

[2] http://www.ofgem.gov.uk/Licensing/IndCodes/Governance/Documents1/elexon%20expansion%20way%20forward%20letter%20300412.pdf

[3] http://www.elexon.co.uk/wp-content/uploads/2012/05/P284-Assessment-Consultation-Responses-v1.0.pdf

[4] http://www.elexon.co.uk/wp-content/uploads/2012/06/bsc-services-manager-services-description-consultation-responses.pdf

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3.3 The BSC Service Description currently confirms that the BSC Service Manager will be responsible for delivering all those services currently provided by ELEXON Ltd. An overview of these services is set out in Appendix 1 for reference.

3.4 For the avoidance of doubt, it is envisaged that:

- The BSC Service Manager will be responsible for managing and procuring other BSC Agent services on behalf of BSCCo.
- The BSC Service Manager will not be able to provide other BSC Agent activities itself.
- BSCCo will establish appropriate governance and resource that enable it to deliver its corporate obligations and manage the BSC Service Manager.
- BSCCo will also retain responsibility for specific discretions or judgements to be made under the BSC which would otherwise not align with good corporate practice and corporate control were they to be delegated to the BSC Service Manager. For example: the BSC Service Manager cannot be responsible for managing itself or administering payments for its own services.

4. Contract Principles

4.1 The initial appointment of a BSC Services Manager would be via a directed procurement. However, it is not certain that the BSCCo Board would choose to outsource BSC Services were it ultimately given the option to do so via P284. The BSCCo Board has determined that its decision would be underpinned by a set of contract principles which are described below.

4.2 Ofgem has also set out a number of **pre-requisite conditions** that must be fulfilled for any diversification to take place. These are explored in Ofgem's conclusions letter[5]. The contract principles set out by the BSCCo Board take account of these pre-requisite conditions which state that:

a) BSC Parties should benefit from any diversification;

b) The arrangements should not place disproportionate risk on BSC Parties;

c) Standards of service under the BSC should be maintained; and

d) ELEXON's BSC role should not give it any undue competitive advantage in a contestable activity.

4.3 Accordingly, the case for appointing a BSC Service Manager will be assessed against the following principles. They may be expanded upon or developed further as more information becomes available and include:

- **Qualification Criteria** (including the legal position, financial standing and technical capacity of any prospective BSC Service Manager company);

[5] http://www.ofgem.gov.uk/Licensing/IndCodes/Governance/Documents1/elexon%20expansion%20way%20forward%20letter%20300412.pdf

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- **General BSC Agent Contract Principles** (including, but not limited to, BSC Parties being the beneficiaries of contracted services, an appropriate pricing methodology, limitations on liability, intellectual property rights and subcontracting restrictions); and
- **BSC Services Manager Contract Principles** (specific to the appointment of the BSC Service Manager including, but not limited to, benefits delivered to BSC Parties across the contract term, maintenance of existing service standards, ring-fencing from non-BSC liabilities and risks and the ability to re-let the contract in future).

Qualification Criteria

4.4 Under a directed procurement the BSCCo Board would perform the normal checks and balances to underpin an outsourcing decision. This will include:

- **Legal position:** an initial assessment of the prospective BSC Service Manager company status to ensure it is a valid and legally constituted organisation.
- **Financial standing** would be checked to ensure it is sufficiently robust.
- **Technical capacity:** an initial assessment of the ability of the prospective BSC Service Manager to take on and provide the services to ensure it is capable of delivery BSC services.

General BSC Agent Contract Principles

4.5 The development of the outsource arrangements will follow the general BSC Agent contract principles established under Section E of the BSC and presented to the BSC Panel (Panel Paper 127/13). They are set out in Appendix 2 for reference and have been incorporated into the BSC Service Manager Contract Principles set out below.

BSC Services Manager Contract Principles

4.6 The P284 Alternative solution identifies specific matters which should be covered by a set of contract principles. These include:

(a) the principles governing the pricing of services under the contract;

(b) liability and limitations or exclusions of liability for breach of the contract;

(c) the ownership of Intellectual Property Rights;

(d) the grounds for termination of the contract;

(e) the treatment of assets; and

(f) the principles governing the term of the contract.

4.7 This document captures the principles considered by the BSCCo Board. They have been organised under the headings noted in P284 for consistency and ease of reference. It also covers some areas that are not explicitly contemplated by the P284 Alternative solution.

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(A) Principles Governing the Pricing of Services Under the Contract

4.8 A decision to outsource must only be made where it is cost effective to do so. In particular the pricing provisions of an outsourced arrangement should seek to deliver:

- **Pricing Methodologies:** BSCCo will ensure that appropriate principles and methods of pricing of goods and services are in place for the BSC Service Manager contract. The pricing structure should be as simple as possible; however, we anticipate that services will be provided under a mixture of fixed-price, variable-price and cost pass-through elements.
- **Incentives and Service Credits:** The contract will provide appropriate incentives and service credits that encourage the right behaviours and help drive efficiencies.
- **Benefits Realisation:** BSC Parties have indicated they expect to see commensurate and on-going cost savings within a reasonable period. BSCCo will look to safeguard the existing budget projections and seek to deliver savings against like for like costs over the life of the BSC Service Manager contract. Provisions will be sought that would ensure BSC Parties will benefit where the BSC Service Manager takes on new areas of business which would enable it to achieve synergies and allow a reduction in the price associated with certain costs of operation (e.g. corporate service costs) across its suite of contracts.
- **Recovery of Set-Up Costs:** Any material costs incurred by BSCCo in supporting the set-up New ELEXON[6] should be recouped from New ELEXON over time and fed back to Parties via BSC charges.

(B) Liability and Limitations or Exclusions of Liability for Breach of the Contract

4.9 A decision to outsource must only be made where no undue risk is borne by BSCCo. The liability provisions of an outsourced arrangement must encompass:

- **Limitations on Liability:** Liability limitations and associated indemnities to be consistent with other BSC Agents. BSCCo will ensure that liability and limitations and exclusions of liability for breach of contract are set at levels which are fair, reasonable and appropriate.
- **Existing Liabilities:** Careful consideration will be given to the treatment of existing liabilities which may crystallise as a result of choosing to outsource services. These include pension liabilities which are explored further in Appendix 3.
- **New Liabilities:** We do not feel it is right or appropriate that BSC Parties are subject to undue additional liabilities arising from outsourcing work to a BSC Service Manager. In particular the contract should ensure that BSC Parties are not unduly exposed to additional risks or liabilities arising from non-BSC business ventures undertaken by the BSC Service Manager.
- **Force Majeure Provisions:** The BSC Service Manager contract will set out a "Force Majeure" provision which will deal with the issue of the contracting party's liability for breach resulting from circumstances beyond its reasonable control.

[6] If P284 is approved and a sufficient case subsequently made for outsourcing, it is envisaged that ELEXON Ltd will change its name to BSCCo Ltd (remaining the BSCCo as defined by the BSC). A new company, un-related to BSCCo Ltd. would be created under different ownership. For the purposes of this paper, this new legal entity is referred to as New ELEXON Ltd.

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- **Additional Indemnities/Guarantees:** Additional agreements may be needed to be entered into by BSCCo or the BSC Service Manager and these may require the approval or other bodies/companies. For example - agreements with National Grid / Pension Trustees regarding pension liabilities (see Appendix 3).

(C) Ownership of Intellectual Property Rights

4.10 Any outsourcing arrangement will be based on the current policy applied in BSC Agent contracts. It would include:

- **Intellectual Property Rights:** BSCCo will, where possible and/or commercially viable, seek to own all IPR in materials produced by the BSC Service Manager pursuant to the contract or used by the BSC Agent in the creation of such materials.
- **Use of BSCCo Intellectual Property by Third Parties:** Use of IP for non-BSC work is to be allowed under licence agreements at usual market rates.

(D) Grounds for Termination of the Contract

4.11 The BSC Service Manager contract will include the normal protections (including termination rights) associated with an outsourcing arrangement. It will encompass:

- **Service Protections:** The BSC Service Manager will be required to perform in line with applicable law and any regulatory requirements and good industry practice. Appropriate performance standards, Key Performance Indicators, step-in and termination triggers will be put in place. We anticipate these including a mechanism to allow for early warning and an opportunity to remedy breaches ahead of termination. Grounds for termination will include persistent or material breach of the contract or insolvency of either party to the contact.
- **Maintained Service Standards:** The contract will require the existing levels of service to be maintained and will include incentives to drive improvements in performance over the life of the contract where possible.
- **Contingency Arrangements:** The BSC Service Manager contract will also capture the contingency arrangements required for continuity of service in the event of a service failure or insolvency of the BSC Service Manager. We will establish handover provisions that permit a relatively straightforward handover of services such that the service will operate to the benefit of BSC Parties with little disruption in the event of a BSC Service Manager business failure. These are common elements of outsourced services contracts and we will ensure the provisions are appropriate for the BSC. It has been noted that a termination of the contract would most likely result in TUPE transfers of employees back to BSCCo or a replacement service provider.

(E) Treatment of Assets

4.12 In order to mitigate the risk of any financial failure of the BSC Service Manager, a decision to outsource should only be made where BSCCo retains appropriate operational assets used for delivering the BSC. In particular, this should encompass:

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- **Contracts:** The contracts for each BSC Agent and any other operational service contracts required for delivering the BSC will remain with BSCCo. Other contracts (e.g. catering and facilities contracts) will be novated to the BSC Service Manager.

- **Assets:** Assets will remain with BSCCo or move with the contracts with which they are concerned. The BSCCo Board will ensure that value is determined and recognised for such transferring assets.

- **Use of Assets:** BSCCo will allow the BSC Service Manager to use BSCCo assets for the delivery of BSC services.

- **Lease and Premises:** BSCCo currently holds the lease for the 4th and 5th Floors at 350 Euston Road. The options for BSCCo to disengage from this lease are limited and likely to be costly. It is therefore appropriate for BSCCo to retain the lease but to allow the BSC Service Manager to operate from the existing ELEXON offices via a sub-letting arrangement. This will require the consent of the Landlord (which is not to be unreasonably withheld).

(F) Principles Governing the Term of the Contract

4.13 Duration is linked to many elements of the contract and we envisage that this will be a key area of negotiation. Many BSC Panel members have concurred with Ofgem's conclusions that a duration of 5-8 years is preferable. Other BSC Panel members have indicated that the Board should explore whether any additional benefits might accrue from longer contract/extension provisions. The initial BSC Service Manager contract should be for an appropriate term, taking a balanced account of:

- **Stability:** The initial contract should be for an appropriate term to mitigate any adverse impact on service quality or staff retention associated with the disruption and uncertainty which could arise from starting of a procurement exercise only a very short time into the initial appointment of a new firm.

- **Payback:** A longer term contract (up to 8 years) will allow a longer period for any costs incurred in establishing the arrangement costs to be recovered or offset by efficiencies.

- **Incentives:** The contract should contain incentives on increasing efficiency and service quality over time. A shorter contract term with options to extend might form part of this package.

- **Consistency Through a Period of Change:** There are many areas of change within the energy industry which may impact the BSC over the next decade. A longer term (e.g. up to eight years) may be appropriate in order to take it beyond the expected smart metering roll-out.

Other BSC Services Manager Contract Principles

- **Beneficiaries of Contracted Services:** The BSC Service Manager contract shall contain terms which give effect to the principle that the BSC Parties should have the benefit of the main obligations of the contract.

- **Transparency:** BSCCo will seek to ensure that it has the appropriate capacity to provide relevant information to Parties concerning the performance of BSC Agents and the terms of the contract.

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- **Simplicity:** The contract must be comprehensive and robust, yet, wherever possible it should be as simple as possible in order to minimise costs incurred by BSCCo in managing the relationship. This should include straightforward governance and change management structures and a workable mechanism for cost management.
- **Separation of Services:** When a single person provides more than one service, all processes and systems employed by that person in each capacity where possible and commercially viable are to be completely capable of being separated from each other.
- **Subcontracting Restrictions:** BSCCo will restrict the BSC Service Manager from sub-contracting some or all of its obligations under the contract without first obtaining the written consent of BSCCo.
- **Contract Able to be Re-let:** The contract should be designed to avoid the incumbent becoming entrenched and should allow BSCCo to re-tender the outsourced services to the wider market. The BSC Service Manager's operations should be easily transferable (either back in-house or to a new provider) such that the incumbent does not have any undue competitive advantage in any future contestable procurement.

5. Consultation Questions

QUESTION 1
Are there any specific discretions, judgements or services currently provided by ELEXON Ltd that you feel it would be inappropriate for BSCCo to subcontract to a service management company? If yes, please list these together with your rationale for each area.

QUESTION 2
Are the principles set out in section 4 appropriate for use in underpinning a decision whether to appointment a BSC Service Manager? If no, please explain why.

QUESTION 3
Do you believe the principles set out in section 4 are consistent with Ofgem's conclusions and prerequisite conditions as published in its letter of 30 April 2012[7]? If not, please explain your rationale.

[7] http://www.ofgem.gov.uk/Licensing/IndCodes/Governance/Documents1/elexon%20expansion%20way%20forward%20letter%20300412.pdf

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QUESTION 4
Are there any additional principles which you believe the BSCCo Board should use to underpin any outsourcing decision? If yes, please list these areas together with a rationale for each additional area.

QUESTION 5
Any other comments?

Appendices:

Appendix 1 – ELEXON's Current Role and Activities
Appendix 2 – BSC Agent Contract Principles
Appendix 3 – National Grid Pension Scheme and Section 75 Debt

Attachment:

Attachment 1 – Consultation Response Form

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Appendix 1 – ELEXON's Current Role and Activities

ELEXON Ltd currently fulfils the role of the Balancing and Settlement Code Company (BSCCo) as defined under the Balancing and Settlement Code (BSC). The BSC contains the rules and governance arrangements for electricity balancing and settlement in Great Britain, and ELEXON is responsible for ensuring its proper, effective and efficient implementation.

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

- Governance and Committee Support
- Procurement, Service Management and Operational Delivery
- Changes to the Systems and Processes of Settlement
- Assurance that the BSC Arrangements Work

Governance and Committee Support

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

Procurement, Service Management and Operational Delivery

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

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

Changes to the Systems and Processes of Settlement

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

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

Assurance that the BSC Arrangements Work

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

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

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Appendix 2 – BSC Agent Contract Principles

The following Contract Principles were presented to the BSC Panel in May 2007. They are drafted in recognition that it is important for BSCCo to ensure that proper, reasonable and appropriate terms of agreement are entered into which can deliver the services required by industry at best value for money and to appropriate standards. Equally it is important in order for BSCCo to have sufficient flexibility within the Contract Principles to effectively negotiate the best terms on behalf of the industry and achieve value for money.

BSCCo will enter into contracts that will apply for the benefit of all or certain Parties – BSC Section E 2.3.3(a).

BSCCo will enter into BSC Agent Contracts for itself and as agent and trustee for the BSC Parties (and each of them). The Contracts (Rights of Third Parties) Act 1999 will thereby be permitted to operate to the benefit of the BSC Parties. This gives effect to the requirement in Section E 2.4.1(a) of the Code that each BSC Agent Contract shall contain terms which give effect to the principle that the BSC Parties should have the benefit of the main obligations of the BSC Agent contract.

Principles and methods of pricing of services under the contract – BSC Section E 2.3.3(b).

BSCCo will ensure that appropriate principles and methods of pricing of goods and services are in place for each BSC Agent contract. This will enable effective challenge and negotiation with service providers over the costs of delivering BSC Agent services and will help in the assessment of the best value options for delivering those services. Examples of principles and methods that will be used are: visibility of cost drivers; milestone payments (where appropriate) for actual work completed; clear pricing methodologies; breakdown of costs for various activities; price benchmarking (where appropriate) during the course of the contract; and discussion with BSC Agents about alternative delivery and pricing options prior to entry in contracts.

Liability and limitations and exclusions of liability for breach of contract – BSC Section E 2.3.3(c).

BSCCo will ensure that liability and limitations and exclusions of liability for breach of contract are set at levels which are fair, reasonable and appropriate. In doing so, among the matters which BSCCo will consider, is the associated risk to BSCCo and BSC Parties arising from potential breaches of contract. Liability limitations will be calculated and quantified wherever possible (e.g. by conducting a risk assessment) and will be appropriate to the circumstances of each BSC Agent Contract.

Extent to which the BSC Agents may be relieved from liability for breach resulting from circumstances beyond its reasonable control – BSC Section E 2.3.3(d).

Each BSC Agent contract will set out a "Force Majeure" provision which will deal with the issue of a contracting party's liability for breach resulting from circumstances beyond its reasonable control. In particular, the events which fall within this concept will be identified. The Force Majeure provision will not permit the BSC Agent to claim relief if the Force Majeure event is attributable to its own wilful act. The contract will also identify the actions which a BSC Agent must take in relation to an event of Force Majeure.

Extent to which the terms of the contract and information concerning BSC Agents may be freely disclosed to BSC Parties – BSC Section E 2.3.3(e).

BSCCo will seek to ensure that it has the appropriate capacity to provide relevant information to Parties concerning the performance of BSC Agents and the terms of the contract. In agreeing appropriate contractual terms, BSCCo

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will take into account considerations of commercial sensitivity (including of information which may relate to the business or activities of third persons).

Ownership of Intellectual Property Rights (IPR) in materials produced by the BSC Agent pursuant to the contract – BSC Section E 2.3.3(f).

BSCCo will, where possible and/or commercially viable, seek to own all IPR in materials produced by the BSC Agent pursuant to the contract or used by the BSC Agent in the creation of such materials. Where this is not possible (for example, where 'off the shelf' software is used) BSCCo will seek to acquire an appropriate licence giving it the necessary rights to use the materials or software and, where appropriate, to grant sub-licences of the materials and/or the software.

Where a single person acts in the capacity of more than one BSC Agent, the extent to which the processes and systems employed by that person in each capacity are to be separated or capable of separation from each other – BSC Section E 2.3.3(g).

When a single person acts in the capacity of more than one BSC Agent, all processes and systems employed by that person in each capacity where possible and commercially viable are to be completely capable of being separated from each other. This is to ensure that BSCCo is not overly reliant on one BSC Agent providing multiple BSC Agent roles.

Extent (if any) to which the contract should restrict the ability of the BSC Agent to sub-contract the performance of its obligations – BSC Section E 2.3.3(h).

BSCCo will restrict its BSC Agents from sub-contracting some or all of their obligations under their contract without first obtaining the written consent of BSCCo. BSCCo will require visibility of any such proposed sub-contracting; including the identity of the proposed subcontractor and of the specific activities the BSC Agent intends to sub-contract. BSCCo will also require that the BSC Agent enters into a contract with its sub-contractor which contains the same obligations and requirements as required by the BSC Agent's contract with BSCCo. The entry into a sub-contract will not relieve the BSC Agent from its obligations to perform its contract with BSCCo.

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Appendix 3 – National Grid Pension Scheme and Section 75 Debt

Creation of Section 75 Debt

Under pension legislation, when a company such as the BSCCo, as a member of a group pension scheme such as the ESPS, transfers the bulk of its people to a new employer, and effectively leaves the scheme, there is a S.75 Event and a Section 75 debt is created. This section of the 1995 Pensions Act is aimed at protecting the position of the employers that remain in the scheme from pension liabilities in respect of employees of the employer that is leaving the scheme.

The legislation provides that the whole pension liabilities through and beyond retirement of employees in respect of their service with the old employer are valued, and a debt is created which the Pension Scheme trustees can ask to be paid. In the case of the BSCCo and its eligible employees, this could be a substantial amount. (Estimates of between £10-20m have been mentioned by National Grid and we are currently working to get an estimate of our own.)

Pension Shortfall

The S75 debt issue is quite different from any pension fund shortfall (or surplus) that arises from the investment performance of the pension fund, and which forms part of normal business costs. The BSCCo is, for example, currently paying about £600,000 a year towards an existing pension deficit, along with other employers in the scheme. This situation could change (up or down) at the next fund valuation point.

ESPS Membership

At present, just over 30 ELEXON staff are members of the National Grid section of the ESPS. Membership of the ESPS is not growing. All new ELEXON Ltd / BSCCo staff join a different funded scheme where these issues do not arise.

Existing Liability

It needs to be emphasised that this S75 debt is a liability that has been incurred and is due to be paid whatever happens because it is a liability that arises from BSCCo's previous activity as an employer. What is different in this situation is that it becomes potentially payable immediately, rather than in stages going forward.

Flexible Apportionment Arrangement

In situations such as a contracting out it is normal for arrangements to be made to postpone the payment of the debt through something described in the legislation as a flexible apportionment arrangement, whereby the Pension Trustees accept that the ongoing liability is assumed by the new employer. This usually depends upon the new employer having as good a 'covenant' as the old employer, but in this situation that is not the case, not only because New ELEXON would be a small and new company with no track record financially, but because the Pension Trustees are also looking at an exceptionally good covenant under the existing situation, because they are able to call upon the balance sheets of all the BSC parties collectively.

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Guaranteeing future ESPS Liabilities

It's been made clear by National Grid that it is very unlikely that New ELEXON would be accepted as an employer under the scheme unless the BSCCo gave an unconditional guarantee for any pension liabilities, not just for past liabilities but also for future ones. Again, this is effectively the situation which would ensue if no change was made and the outsourcing did not happen, so on the face of it, whilst clearly there will be a reaction to the idea of giving a guarantee, in cash terms it is very possible that there is no actual difference.

Any changing pension arrangements may have a destabilising effect on employees that currently participate in this scheme. This could potentially be alleviated if BSCCo gave an unconditional guarantee as outlined above.

If the outsourcing occurred but no guarantee were given then the Trustees could call down the Section 75 debt and that would be payable by the Parties immediately. While one can think of situations where a company might welcome the crystallisation of an unquantified liability such as this, it seems unlikely that the bulk of BSC Parties would find it welcome.

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