

By email to [energymarket@cma.gsi.gov.uk](mailto:energymarket@cma.gsi.gov.uk)

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4 May 2016

Dear Will,

On 26 April 2016 my colleagues Justin Andrews, Kathryn Coffin and John Lucas met with Tony Curzon Price, Francesca Caputo and Pietro Menis of the CMA. The meeting was to discuss the CMA's questions on ELEXON's response<sup>1</sup> to the CMA's proposed remedy on zonal transmission losses.

During the meeting, we clarified the respective roles of ELEXON and National Grid under the Balancing and Settlement Code (BSC). The CMA asked us to follow this up by providing, outside the meeting, the relevant provisions of the BSC which set out:

- ELEXON's ownership and governance and, in particular, its relationship with National Grid; and
- ELEXON's responsibility for the imbalance settlement systems and processes

We have prepared the appended note which summarises and references these BSC provisions. We trust this is helpful. We also attach a copy of the original CMA summary from our hearing in October 2014 where, in section 10, we clarified the nature of the relationship between ELEXON and National Grid.<sup>2</sup>

If you would like to discuss any aspect of these matters further please contact me on 020 7380 4117 or by email at [adam.richardson@elexon.co.uk](mailto:adam.richardson@elexon.co.uk).

Yours sincerely,

Adam Richardson  
Design Authority, ELEXON

List of appendices: Briefing note for the CMA on ELEXON's governance

List of enclosures: CMA's summary of hearing with ELEXON and the BSC Panel on 30 October 2014

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<sup>1</sup> [https://www.elexon.co.uk/wp-content/uploads/2016/04/CMA\\_Prov\\_Dec\\_ELEXON\\_Response\\_April\\_2106\\_v1.0.pdf](https://www.elexon.co.uk/wp-content/uploads/2016/04/CMA_Prov_Dec_ELEXON_Response_April_2106_v1.0.pdf)

<sup>2</sup> Also available on the CMA's Energy Market Investigation page at: [https://assets.digital.cabinet-office.gov.uk/media/54bf95dde5274a15b300000f/Summary\\_of\\_hearing\\_with\\_Elexon\\_and\\_BSC\\_Panel.pdf](https://assets.digital.cabinet-office.gov.uk/media/54bf95dde5274a15b300000f/Summary_of_hearing_with_Elexon_and_BSC_Panel.pdf)

# BRIEFING NOTE FOR THE CMA ON ELEXON'S GOVERNANCE

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## RELATIONSHIP BETWEEN THE TRANSMISSION LICENCE AND THE BSC

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### Requirement to have a BSC

Condition C3.1 of National Grid's Transmission Licence<sup>3</sup> requires it to have in force a Balancing and Settlement Code (BSC) document which outlines the terms of the electricity balancing and settlement arrangements.

### Requirement to establish a BSCCo

Condition C3.1B of the Transmission Licence requires National Grid to establish a Balancing and Settlement Code Company (BSCCo) to provide and procure facilities, resources and services required for the proper, effective and efficient implementation of the BSC.

The BSC, rather than the licence, contains the actual arrangements for the establishment and ownership of BSCCo.

### Requirement to establish a BSC Panel

Condition C3.1(f) of National Grid's Transmission Licence requires it to establish a panel body, as specified in the BSC, that includes an independent Ofgem-approved Chairman and a voting consumer representative.

The BSC contains the detailed arrangements for the establishment, composition, objectives and proceedings of the Panel.

## CONSTITUTION AND ROLE OF BSCCO UNDER THE BSC

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### Who is BSCCo?

[Annex X-1](#) of the BSC defines 'BSCCo' as 'ELEXON Limited (or any successor to that company acting in the capacity as BSCCo)'. ELEXON, as a company, therefore fulfils the role of BSCCo under the BSC.

### What is BSCCo's role?

Reflecting Condition C3.1B of the Transmission Licence, BSC Section C1.2.1 states that BSCCo's principal role is to provide and procure facilities, resources and services required for the proper, effective and efficient implementation of the BSC.

BSC Section C3.1 sets out BSCCo's powers, functions and responsibilities in more detail. These include:

- Entering into, managing and enforcing contracts with service providers (as BSC Agents) for the supply of certain core BSC services, as further provided in [BSC Section E](#)
- Providing advice/expertise, facilities, resources and other support<sup>4</sup> to the BSC Panel, Panel Committees and Workgroups, and to support the Modification Procedures set out in [BSC Section F](#)
- Providing BSC Parties with other BSC facilities, services and information, as set out in the BSC or required by the Panel

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<sup>3</sup> You can access a copy of the Transmission Licence through [Ofgem's Electronic Public Register](#).

<sup>4</sup> Including the provision of meeting facilities and the production of working papers, reports and other documents.

- Monitoring any breaches of the BSC by BSC Parties, and taking proceedings against any Party for such a breach where instructed to do so by the Panel

BSC Section C1.2.2 currently precludes BSCCo (and thereby ELEXON) from undertaking any business or activity which is not provided for in the BSC.

ELEXON, as BSCCo, must exercise its powers and discharge its functions and responsibilities with a view to achieving the same objectives as the BSC Panel (BSC Section C1.3).<sup>5</sup>

### What is BSCCo's role in imbalance settlement?

BSC Section E1.1 requires certain BSC services to be outsourced to service providers which the BSC calls BSC Agents. BSC Section E2 sets out BSCCo's role in contracting with these service providers, including the requirements that BSCCo (and therefore ELEXON):

- selects the person to be appointed as each BSC Agent, after following a procurement process overseen by the BSC Panel
- enters into contracts with each person to be appointed as a BSC Agent
- manages and enforces each BSC Agent Contract
- monitors, inspects and supervises the performance of each BSC Agent under its BSC Agent Contract

These BSC Agent services include Settlement Administration, which BSC Section E1.2 requires to be provided by a Settlement Administration Agent (SAA). The SAA is responsible for performing the imbalance settlement calculations that give rise to BSC Parties' imbalance charges (which the BSC calls Trading Charges), under [BSC Section T](#). These include:

- Allocating transmission losses by scaling BSC Parties' Metered Volumes (BSC Section T2)
- Making payments to, and receiving payments from, BSC Parties for actions taken by National Grid in the balancing mechanism – and settling these amounts with National Grid (BSC Section T3)
- Undertaking the imbalance settlement calculations, including determining imbalance prices and each BSC Party's energy imbalance volume and imbalance cashflow (BSC Section T4)
- Determining the Trading Charges payable by each BSC Party (BSC Section T5)

To fulfil this role, the SAA uses data from other BSC Agents such as the:

- Central Registration Agent (who holds all the central registration data needed for Settlement – e.g. which BSC Party is responsible for which Meter(s))
- Central Data Collection Agent (who collects metered data for transmission-connected generators and customers)
- Energy Contract Volume Aggregation Agent (who receives and aggregates information on BSC Parties' energy contracts)
- Supplier Volume Allocation Agent (who receives and allocates Suppliers' metered, or estimated metered, data, and who applies the profiles needed to determine half-hourly energy volumes for non-half-hourly-metered customers)

The SAA provides another BSC Agent, the Funds Administration Agent (FAA), with the resulting Trading Charges payable from/to each BSC Party (BSC Section T5.3). [BSC Section N](#) then requires the FAA to invoice BSC Parties, and process payments for these amounts.

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<sup>5</sup> See our later explanation of the Panel's role for a description of these objectives.

These other BSC Agents also have prescribed roles in the BSC and ELEXON (as BSCCo) manages them in accordance with BSC Section E.

To perform the imbalance settlement calculations, the SAA uses data which National Grid is required to provide to the SAA or other BSC Agents under [BSC Section Q](#).

National Grid, as the Transmission Company / System Operator, is responsible for the real-time balancing (via the balancing mechanism) of the electricity flowing onto and off the Transmission System. This is separate to BSCCo's responsibility (via its BSC Agents) to perform imbalance settlement under the BSC. A Party's imbalance volume is the difference between its contracted volume (the electricity it bought or sold ahead of time) and its actual metered generation or demand volume, and the Party is exposed to an imbalance price for any such difference. The BSC adjusts Parties' contracted volumes to account for any balancing actions taken by National Grid,<sup>6</sup> so that these in themselves do not cause Parties to be in imbalance.

The BSC requires National Grid to provide BSC Agents, including the SAA, with data on the actions it takes in the balancing mechanism (BSC Section Q6.2). The SAA then uses this data in its determination of imbalance prices and imbalance volumes under BSC Section T.

[BSC Annex X-1](#) defines 'BSC Systems' as meaning:

- The computer systems and the processes used by each of the BSC Agents and required in connection with the services provided by the BSC Agents under BSC Section E
- So far as used in Settlement, any other computer systems and processes operated or procured by BSCCo

The systems and processes that the SAA and other BSC Agents use to perform imbalance settlement are therefore BSC Systems, for which BSCCo is ultimately responsible under BSC Section E.

## Who owns BSCCo?

[BSC Section C](#) sets out BSCCo's governance arrangements, including its relationship with National Grid. As described in BSC Section C2.2, BSCCo (and therefore ELEXON) is a wholly-owned subsidiary of the Transmission Company.<sup>7</sup> National Grid is therefore the BSCCo (ELEXON) Shareholder.

## What rights and responsibilities does National Grid have as BSCCo Shareholder?

National Grid's shareholder rights are completely constrained by the BSC.

In particular, it:

- cannot change BSCCo's Memorandum and Articles of Association (BSC Section C2.1 / C2.3)<sup>8</sup>
- cannot transfer ownership of BSCCo unless directed to do so by Ofgem, with such transfer being at par value (BSC Section C2.2)
- has no right to deal in BSCCo shares or authorise the issue of any further securities (BSC Section C2.2)
- cannot consolidate the financial results of BSCCo into National Grid's group accounts (BSC Section C2.3.4)
- has no liability or obligation to provide BSCCo with finance or financial support (BSC Section C2.4)

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<sup>6</sup> E.g. any Bids or Offers that National Grid accepts from BSC Parties to vary their generation/demand.

<sup>7</sup> BSC Annex X-1 defines 'Transmission Company' as 'National Grid Electricity Transmission plc'.

<sup>8</sup> These are treated as forming part of the BSC and so can only be amended by a Code Modification (i.e. a modification to the BSC itself). We can provide the CMA, on request, with copies of our Memorandum and Articles of Association.

- is prohibited from having any director of National Grid as a director of BSCCo<sup>9</sup>
- has no overarching obligation to be the 'provider of last resort' if BSCCo fails to deliver its BSC obligations (see below)
- has no overarching ability to direct BSCCo's activities (see below)
- is bound to use its voting and other rights solely to give effect to the BSC (see below)
- has no right to receive any assets or resources, or any amounts available for distribution, upon the winding up of BSCCo (BSC Section C2.5)<sup>10</sup>

The BSC provides that Ofgem may direct National Grid to undertake particular tasks that would otherwise be performed by BSCCo, should BSCCo fail to deliver certain BSC obligations. These are known as 'step-in' provisions. Any such Ofgem directions must be issued under Condition C3 of the Transmission Licence.

The scope of these step-in provisions is limited to the following activities and circumstances only:

- Admitting a new Party to the BSC, if BSCCo fails to implement Ofgem's instruction to do so (BSC Section A2.3)
- Assuming responsibility for the BSC Modification Procedures if, in Ofgem's opinion, the BSC Panel and/or BSCCo is materially failing to comply with BSC Section F despite being given notice by Ofgem to do so (BSC Section F1.7)
- Publishing data or providing Ofgem with information, if BSCCo fails to meet a BSC obligation to do so (BSC Section C3.7)

National Grid has no other right under its licence or the BSC to direct or undertake BSCCo's (and therefore ELEXON's) activities.

In April 2013, the BSC Panel and BSCCo Board jointly commissioned Bill Knight OBE<sup>11</sup> to carry out an independent review of ELEXON's governance. The Knight Report was published in 2013.<sup>12</sup> This report concluded, on page 27, that 'National Grid's rights as shareholder are so constrained by the BSC as to be de-natured'.

### What is the governance of BSCCo?

The BSC states that the person who is the Panel Chairman shall be the chairman of the BSCCo (ELEXON) Board (BSC Section C4.1).<sup>13</sup>

The Board's Nomination Committee determines the remaining size and composition of the BSCCo Board, within the following constraints set out in BSC Section C4.1:

- a majority of Directors (excluding the chairman) must have relevant electricity industry experience
- at least two Directors must be, in the Nomination Committee's reasonable opinion, suitably independent from the electricity industry

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<sup>9</sup> See our later explanation of the BSCCo Board. Article 23 of BSCCo's Articles of Association states that 'No person who is a director of the Transmission Company or any subsidiary of the Transmission Company shall be appointed as a director and the office of a director shall be vacated by any director who becomes a director of the Transmission Company or any subsidiary of the Transmission Company'.

<sup>10</sup> Any amounts available for distribution are delivered to BSC Parties.

<sup>11</sup> Bill spent 34 years as a city solicitor. During the course of his career he has been a senior partner at international law firm Simmons & Simmons, President of the City of London Law Society, Gambling Commissioner, Deputy Chairman of Council at Lloyd's of London, Director of the Financial Reporting Council and Chairman of the Financial Reporting Review Panel. Bill was awarded the OBE in 2012 for services to financial regulation.

<sup>12</sup> You can find a copy on the [BSC Panel](#) page of the BSC Website.

<sup>13</sup> See our later explanation of the Panel's composition for details of the chairman appointment process.

The BSC constrains National Grid's right to appoint or remove BSCCo Directors, including its right to remove Directors under Section 168 of the Companies Act 2006.<sup>14</sup> National Grid may only appoint or remove any Director so as to give effect to the provisions of the BSC, or at any direction of the BSC Panel consistent with the provisions of the BSC (BSC Section C2.3).<sup>15</sup>

The BSC Panel approves the Nomination Committee's terms of reference and the Panel may appoint a Panel Member to act as an advisor to the Nomination Committee (BSC Section C4.1).

BSC Section C4.7 requires the Board to conduct its proceedings in accordance with BSCCo's Articles of Association.

The Board, after consultation with the BSC Panel, appoints the Chief Executive of BSCCo (ELEXON). The Board delegates the day-to-day running of BSCCo to the Chief Executive; neither the Chief Executive nor any other members of ELEXON's Executive team are Directors of the Board (BSC Section C4.6). Therefore, with the exception of the Chairman, BSCCo Board members are Non-Executive Directors.

### Who approves BSCCo's business strategy?

For each BSC Year<sup>16</sup>, BSCCo must prepare (and consult BSC Parties on) a Business Strategy setting out the principal BSC activities which it expects to carry out during the next three BSC Years.

The BSC Panel approves the BSCCo Business Strategy (BSC Section C6). In practice, the Panel's own strategy and strategic work programme for the BSC are an important input to the BSCCo Business Strategy.

### Who funds BSCCo?

The BSC does not permit BSCCo to make a profit or a loss in any BSC Year (BSC Section C5.1).

The BSCCo Board sets an Annual Budget which, in its view, is required to deliver the Business Strategy approved by the BSC Panel (BSC Section C6).

BSC Trading Parties provide the funding to deliver this Annual Budget in accordance with [BSC Section D](#), and BSCCo returns any surplus funds to these Trading Parties at the end of the year. These Trading Parties include all licensed electricity generators and Suppliers, who are required by their licences to comply with the BSC. National Grid in its role as the Transmission Company, although a BSC Party, is not a Trading Party (see BSC Section A1.3) and therefore does not contribute to BSCCo's funding costs.

BSC Section D6.6 contains emergency funding arrangements. These state that, if BSCCo is unable to pay any of its costs, it can (with the BSC Panel's approval) give notice to BSC Trading Parties of the need for a cash call. Trading Parties are then required to meet the cash call requirements on the specified date.

BSC Section C6.5 also allows BSCCo (after discussion with the BSC Panel and consultation with BSC Parties) to revise its Annual Budget during a year to include further expenditure.

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<sup>14</sup> Article 26 of BSCCo's Articles of Association states that 'Any member or members holding a majority in nominal amount of the issued ordinary share capital which confers the right to attend and vote at general meetings may at any time appoint any person to be a director, whether as an additional director or to fill a vacancy, and may remove from office any director howsoever appointed *provided that no such appointment or removal shall take effect unless it has first been approved in accordance with the Code [i.e. the BSC]*'.

<sup>15</sup> National Grid could use BSC Section C2.3 to give effect to the disqualification provisions for Directors set out in BSCCo's Articles of Association (e.g. on grounds of mental incapacity, non-attendance or bankruptcy). BSC Section B6.2 allows the BSC Panel to vote to remove any BSCCo Director (other than the Chairman) if their appointment has not been conducted in accordance with the BSC. There are no other BSC provisions that permit anyone other than the BSCCo Board to appoint or remove Directors.

<sup>16</sup> Defined in [BSC Annex X-1](#) as being 1 April – 31 March.

## COMPOSITION AND ROLE OF THE PANEL UNDER THE BSC

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[BSC Section B](#) sets out the role and composition of the BSC Panel.

### Who sits on the Panel?

In accordance with BSC Section B1.1, the Panel's membership comprises:

- an independent Chairman nominated by the BSC Panel (in consultation with the BSCCo Board) and approved by Ofgem<sup>17</sup>
- up to five Panel Members elected by BSC Trading Parties
- up to two Panel Members appointed by Citizens Advice and Citizens Advice Scotland
- a Panel Member appointed by the Transmission Company (National Grid)
- up to two independent Panel Members appointed by the Panel Chairman
- a further industry member appointed by the Panel Chairman, if the Chairman believes this would help reflect (within the composition of the Panel) the interests of licence-exempt generators or suppliers of electricity

An Ofgem representative and a Distribution System Operators representative are also entitled to attend and speak at any BSC Panel Meeting (BSC Section B2.12 / B2.13). They are not Panel Members and do not vote. However, Ofgem has powers to input into, and in some cases veto, certain Panel decisions on the progression of Modification Proposals.<sup>18</sup>

The Chief Executive of BSCCo is entitled to attend and speak at any Panel Meeting, but is not a Panel Member and does not vote (BSC Section B2.14).

### What are the Panel's objectives?

The Panel must conduct its business with a view to achieving the objectives set out in BSC Section B1.2. These include ensuring that:

- the BSC is given effect fully, promptly, economically and efficiently
- the BSC is given effect without undue discrimination between BSC Parties or types of Party
- there is transparency and openness in the conduct of the Panel and BSCCo
- the BSC is given effect in a manner that will facilitate achievement of the objectives set out in Condition C3(3)(a) to (c) of the Transmission Licence, namely:
  - the efficient discharge of National Grid's responsibilities under its licence
  - the efficient, economic and co-ordinated operation of the Transmission System by National Grid
  - promoting effective competition

Once appointed, all Panel Members must act impartially in accordance with these objectives (BSC Section B2.8).

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<sup>17</sup> As noted above, on their appointment as the Panel Chairman, this person also becomes chairman of the BSCCo Board.

<sup>18</sup> See our later explanation of the roles of BSCCo, the Panel, National Grid and Ofgem in the BSC change process.



## What are the Panel's powers and functions?

These are set out in BSC Section B3.1 and include:

- overseeing the change processes set out in BSC Section F, including the progression of Modification Proposals
- determining values for certain BSC parameters
- taking steps to ensure compliance by BSC Parties with the BSC, including (in extremis, and with Ofgem's approval where appropriate) suspending a Party's rights to operate under the BSC or expelling it from the BSC
- establishing arrangements for the resolution of Trading Disputes relating to errors in the data and/or processes used for imbalance settlement, or in the application of the rules for imbalance settlement
- setting the terms of reference for, and considering the results from, the annual operational BSC Audit of:
  - the processes used for imbalance settlement
  - the processes used to determine the amounts payable by BSC Trading Parties to fund BSCCo
- approving the annual BSCCo Business Strategy

## ROLES OF BSCCO, THE PANEL, NATIONAL GRID AND OFGEM IN THE BSC CHANGE PROCESS

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[BSC Section F](#) sets out the procedures by which the BSC can be modified.

In accordance with BSC Sections F1.1 and F1.2:

- The BSC Panel is responsible for the operation of these Modification Procedures
- BSCCo (ELEXON) is responsible for supporting the Modification Procedures by:
  - implementing Approved Modifications
  - providing assistance to Parties in drafting Modification Proposals, in understanding the BSC and Modification Procedures, and in accessing Modification documentation
  - providing advice/expertise, facilities, resources and other support to the Panel and Modification Workgroups<sup>19</sup>
- National Grid is responsible for serving BSCCo with a notice (under National Grid's Transmission Licence) to modify the BSC, where Ofgem or the BSC Panel (under its Self-Governance arrangements) approves a Modification Proposal

The further provisions of Section F set out more detailed roles and responsibilities, including those summarised below.

The BSC Panel:

- Can raise Modification Proposals, but only in the limited circumstances set out in BSC Section F2.1.1(d)
- Must make a recommendation to Ofgem, following an urgency recommendation from National Grid, BSCCo or the Proposer of the Modification Proposal, as to whether a Modification Proposal should be treated as urgent (BSC Section F2.9)

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<sup>19</sup> See our earlier summary of BSCCo's role for further details on what this support includes.



- Is responsible for determining a non-urgent Modification Proposal's progression route and timetable, including setting the terms of reference for any Workgroup (BSC Section F2.2)
- Can approve or reject Modification Proposals itself where these meet the Self-Governance Criteria (BSC Sections F6 / F7), and otherwise must provide a recommendation to Ofgem who makes the final decision (BSC Section F2.7)

#### BSCCo:

- Can recommend that the Panel raises Modification Proposals, but only in the limited circumstances set out in BSC Section F2.1.1(d)(i)-(iv)
- Can recommend to the BSC Panel that any Modification Proposal is treated as urgent (BSC Section F2.9)
- Is responsible for commissioning impact assessments and any required external analysis (BSC Section F2.6.6)
- Is responsible for preparing a project brief for the implementation of the Modification Proposal (BSC Section F2.6.6)
- Is responsible for commissioning the drafting of the legal text to modify the BSC (BSC Section F2.6 / F2.7)

#### National Grid:

- Has the right, as a BSC Party, to raise Modification Proposals (BSC Section F2.1)
- Must raise Modification Proposals where directed by Ofgem following a Significant Code Review (BSC Section F5.3)
- Can recommend to the BSC Panel that any Modification Proposal is treated as urgent (BSC Section F2.9)
- Must prepare, at the request of the Panel or BSCCo, an analysis and impact assessment of any Modification Proposal (BSC Section F2.8)
- Cannot, as the Transmission Company Panel Member, vote in any Panel determination regarding Modification Proposals (BSC Section B4.4.5)
- Must assume responsibility for the BSC Modification Procedures if, in Ofgem's opinion, the BSC Panel and/or BSCCo is materially failing to comply with BSC Section F despite being given notice by Ofgem to do so (BSC Section F1.7)<sup>20</sup>

#### Ofgem:

- Can raise Modification Proposals, but only in the limited circumstances set out in BSC Section F2.1.1(g)
- Can direct National Grid to raise a Modification Proposal resulting from a Significant Code Review (BSC Section F5.3)
- Can direct the progression and implementation timetable for any Ofgem-raised Modification Proposal, or for any Modification Proposal that it directs National Grid to raise (BSC Section F8)
- Can veto certain Panel decisions on the progression of any other Modification Proposals, including instructing the Panel to set a different priority and/or progression timetable for any Modification Proposal (BSC Section F1.4.3)
- Instructs the BSC Panel, following a Panel recommendation, on whether or not a Modification Proposal is to be treated as urgent (BSC Section F2.9)

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<sup>20</sup> See our earlier explanation of the scope of this power.

- Approves the process and timetable to be followed for any Urgent Modification Proposal (BSC Section F2.9)
- Can 'send back' a Modification Proposal to the Panel for further work if it considers that it is unable to make a decision (BSC Section F2.7A)

**Kathryn Coffin**

**Design Authority, ELEXON**