













| BSC Modification Proposal Form | | At what stage is this document in the process? |
|---|--|---|
| <h1>P365</h1> <h2>Enabling ELEXON to tender for the Retail Energy Code (REC)</h2> | | <div>01 Modification</div> <div>02 Workgroup Report</div> <div>03 Draft Modification Report</div> <div>04 Final Modification Report</div> |
| <p>Purpose of Modification:</p> <p>To enable ELEXON to participate in the process to appoint the Retail Energy Code (REC) administrator which is expected to occur in the near future.</p> | | |
|  | <p>The Proposer recommends that this Modification should be:</p> <ul style="list-style-type: none"> sent directly into the Report Phase <p>This approach is proposed because much of the “ground work” necessary to enable the appropriate provisions to be introduced into the BSC were developed under Approved Modification P330 ‘Allowing ELEXON to tender for the Uniform Network Code Gas Performance Assurance Framework Administrator (PAFA) role’. Such provisions include the arrangements to ensure that ELEXON would be ring-fenced from any enduring operational costs and risks associated with performing the role of the gas PAFA, by creating a separate subsidiary specifically for that purpose. P330 was approved by the Authority on 25 May 2016.</p> <p>This Modification will be presented by the Proposer to the BSC Panel on 8 February 2018. The Panel will consider the Proposer’s recommendation and determine how best to progress the Modification.</p> | |
|  | <p>High Impact:</p> <p>N/A</p> | |
|  | <p>Medium Impact:</p> <p>This Modification Proposal will impact the Trading Parties that fund BSC Costs. Trading Parties will initially fund ELEXON’s bid costs. In the event that ELEXON is unsuccessful, bid costs will not be repaid to Trading Parties.</p> <p>However, if successful, ELEXON’s bid costs will be repaid. Furthermore, securing the REC administrator role will enable certain existing ELEXON overheads to be defrayed, reducing the ongoing charges paid by Trading Parties.</p> | |
|  | <p>Low Impact:</p> <p>N/A</p> | |

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| Timetable | |  Any questions? |
| The Proposer recommends the following timetable: | | Contact: <i>Jemma Williams</i> |
| Workgroup Report presented to Panel | 8 Feb 18 |  <i>jemma.williams@elexon.co.uk</i> |
| Report Phase Consultation | 14 Feb 18 – 27 Feb 18 (10WDs) |  020 7380 4359 |
| Draft Modification Report presented to Panel | 8 Mar 18 | Proposer: <i>James Evans</i> |
| Final Modification Report submitted to Authority | 15 Mar 18 |  <i>Jevans@justenergy.com</i> |
| | |  01908 302 447 |
| | | Proposer's representative: <i>Jennifer Smith</i> |
| | |  <i>jsmith@hudsonenergy.co.uk</i> |
| | |  01908 300 329 |

Summary

What is the issue?

Ofgem has indicated that in the near future a competitive award process will be undertaken to appoint a body to administer a new REC.

Section C of the BSC currently precludes ELEXON from undertaking any business or activity which is not prescribed and provided for in the BSC. These restrictions preclude ELEXON from participating in any REC administrator appointment process.

If not addressed these restrictions will:

- Limit the pool of experienced code administrators that are able to participate in the competitive process;
- Limit the full range of commercial/operating models from being evaluated;
- Increase the potential for further fragmentation in the provision of code administration services; and
- Limit the opportunity for ELEXON to further defray its costs to Trading Parties (it is noted that this final point is subject to successfully securing the REC administrator role).

What is the proposed solution?

Although ELEXON has taken on non-BSC roles in recent years, namely the administration of the Warm Homes Discount Scheme and as Settlement Services Provider for the Electricity Market Reform (EMR), participation in both of these government schemes resulted from 'directions' from the Secretary of State, rather than via a Modification process. It should be noted that subsequent to the direction, the operation of the Warm Home Discount Scheme was secured through competitive tender. However, the ability for ELEXON to seek to become the Gas PAFA was the subject of Modification Proposal P330 'Allowing ELEXON to tender for the Uniform Network Code Gas Performance Assurance Administrator (PAFA) role' which was approved by Ofgem on 2 June 2016.

The proposed solution to this Modification Proposal repeats the implementation approach developed during the assessment of P330 and the arguments set out in Ofgem's decision letter¹ (see Attachment 1) where the detailed rationale behind their decision to approve P330 is set out (also summarised in Section 7 of this Modification Proposal).

The proposed solution to this Modification will require changes to the following BSC sections:

- Section C: BSCCo and its Subsidiaries, Annex C-1: Permissible Activities; and
- Section X: Definitions and Interpretation, Annex X-1: General Glossary.

It is proposed to use BSC legal text² developed under P330, but modified to reflect the REC administrator role, in this Modification Proposal (see Attachment 2).

At high level, the changes to Annex C-1 will:

- Establish REC administration as a Permissible Activity and the establishment of the appropriate legal entity (REC Administrative Services Co (RECASCo));

¹ <https://www.elexon.co.uk/wp-content/uploads/2015/12/P330D.pdf>

² <https://www.elexon.co.uk/mod-proposal/p330/>

- Detail the arrangements under which BSCCo may provide a loan or grant credit to RECASCo for the purposes of bidding for the REC administration role, together with the requirement for cost to be ring-fenced;
- The arrangements for the repayment of any loan and what will happen in the event that RECASCo is unsuccessful in its bid; and
- Confirm the shareholder arrangements with RECASCo and its relationship with BSCCo.

At high level, the changes to Annex-X1 will include, but not be limited to, the following definitions:

- Aggregate RECAS Tender Costs;
- RECAS Tender;
- RECAS Tender Costs;
- RECAS Tender Recovery Period;
- RECASCo;
- RECASCo Board;
- RECASCo Shareholder; and
- RECAS Role.

1 Governance

Justification for proposed progression

This Modification should **not** be considered suitable for treatment as Urgent, Fast Track or Self-Governance.

It is proposed to recommend to the Panel that the Modification Proposal proceeds directly to the Report Phase. The reasons for this proposed approach are:

- The BSC changes required to implement this proposal repeat those introduced under P330;
- The governance and operating model introduced for the PAFA role will be reused. These arrangements ensure that ELEXON is ring-fenced from any enduring costs and risks associated with performing the REC administrator role by creating a separate subsidiary specifically for that purpose. This approach repeats the tried and tested model established for the delivery of EMR services and subsequently repeated for P330;
- P330 was fully assessed and consulted upon before the Authority directed that P330 should be implemented. It is inefficient use of industry's time/resources (as well as ELEXON's), to repeat the P330 process to simply enable the scope of Permissible Activities to be extended such that BSCCo may participate in the process to appoint a REC administrator;
- This is an enabling Modification Proposal. The decision on whether or not to make a proposal to become the REC administrator is a matter for the ELEXON Board. Furthermore, the ELEXON Board would not be compelled to enter into any arrangement to provide REC administrative services if they were not convinced that it would be in the best interests of ELEXON and BSC Parties;
- In submitting this proposal directly to the Report Phase, industry will still have the opportunity to comment, through the Report Phase consultation, on the merits of the proposal. If industry believes there are arguments as to why this proposal is materially different to P330, or that new material has since come to light which was not captured during the assessment of P330, the Report Phase consultation enables those reasons and new arguments to be surfaced and considered.

Requested Next Steps

This Modification should be:

- sent directly into the Report Phase

2 Why Change?

What is the issue?

The BSC was established pursuant to Standard Condition C3 of National Grid's Electricity Transmission Licence. The BSC sets out the powers, functions and constitution of BSCCo and ELEXON is the BSCCo. ELEXON is a non-profit-making limited liability company established to facilitate the effective delivery, implementation and operation of the electricity balancing and settlement arrangements.

Section C of the BSC currently precludes ELEXON from undertaking any business or activity which is not provided for in the BSC itself. Although ELEXON has taken on non-BSC roles in recent years, namely administration of the Warm Home Discount scheme and as EMR Settlement Service Provider (EMRS), both of these resulted from directions by the Secretary of State, rather than via a Modification.

ELEXON and its not-for-profit operating model is highly regarded as is its end-to-end operating model. ELEXON's focus is on service excellence, independence and delivering what is best for the industry.

Results from ELEXON's own Stakeholder Engagement surveys and Ofgem's 2017 survey of code administrators, reinforce how highly ELEXON, its operating model and the expertise of its staff, is regarded by industry.

Section C of the BSC currently precludes ELEXON from undertaking any business or activity which is not provided for in the BSC itself. As a result, industry is unable to secure any potential benefit by applying its not-for-profit operating model and expertise that may arise as a result of ELEXON's participation in the competitive process for the appointment of the REC administrator role.

Potential benefits include:

- Sharing ELEXON's existing fixed costs across the REC would allow costs to BSC Parties to be defrayed;
- Enable ELEXON's extensive experience and best practice in the operation of key BSC processes that are expected to be required under the REC, to be applied. These include:
 - Accession processes;
 - Operational support and guidance to new market entrants;
 - Application of appropriate compliance and assurance tools and techniques;
 - A fully transparent budgeting process;
 - Dispute processes and management;
 - Technical and secretarial support to the REC Panel and its sub-groups/committees; and
 - Develop and foster joint working arrangements with the related code bodies.
- Participating in the process to appoint the REC administrator will also enable parties to evaluate the competitiveness of ELEXON's services;
- Improves the likelihood that there will be sufficient responses to ensure a competitive process; and
- The energy industry is moving towards a dual fuel market with dual arrangements. Having ELEXON administer the REC is a further step in that direction and would allow synergies to be realised and in particular, to drive the central services consolidation agenda.

3 Code Specific Matters

Technical Skillsets

The BSC Panel recommends that as well as the usual Report Phase Consultation, a targeted communication is sent to the members of the P330 Workgroup and other known parties that have a particular interest in BSC governance matters.

Reference Documents

P330 'Allowing ELEXON to tender for the Uniform Network Code Gas Performance Assurance Administrator (PAFA) role' – legal text.

P330 'Allowing ELEXON to tender for the Uniform Network Code Gas Performance Assurance Administrator (PAFA) role' – Ofgem decision letter dated 25 May 2016.

4 Solution

Proposed Solution

The Proposer suggests that the solution for this Modification Proposal repeats the implementation approach developed during the assessment of P330 and the arguments set out in Ofgem's decision letter³ (see Attachment 1) where the rationale behind their decision to approve P330 is set out (also summarised in Section 7 below).

The proposed solution to this Modification will require changes to the following BSC sections:

- Section C: BSCCo and its Subsidiaries, Annex C-1: Permissible Activities; and
- Section X: Definitions and Interpretation, Annex X-1: General Glossary.

It is proposed to use the P330 BSC legal text⁴ in this Modification Proposal (see Attachment 2).

At high level, the changes to Annex C-1 will:

- Establish REC administration as a Permissible Activity and the establishment of the appropriate legal entity (RECASCo);
- Detail the arrangements under which BSCCo may provide a loan or grant credit to RECASCo for the purposes of bidding for the RECAS Role, together with the requirement for cost to be ring-fenced;
- The arrangements for the repayment of any loan and what will happen in the event that RECASCo is unsuccessful in its bid; and
- Confirm the shareholder arrangements with RECASCo and its relationship with BSCCo.

At high level, the changes to Annex-X1 will include, but not limited to, the following definitions:

- Aggregate RECAS Tender Costs;
- RECAS Tender;

³ <https://www.elexon.co.uk/wp-content/uploads/2015/12/P330D.pdf>

⁴ <https://www.elexon.co.uk/mod-proposal/p330/>

- RECAS Tender Costs;
- RECAS Tender Recovery Period;
- RECASCo;
- RECASCo Board;
- RECASCo Shareholder; and
- RECAS Role.

5 Impacts & Other Considerations

Impacts

This enabling Modification primarily impacts Trading Parties as they will be required to fund any costs of participation in the REC administrator appointment process. However, if ELEXON is successful, such costs will be repaid and additionally, Trading Parties will benefit from reduced BSC charges as a proportion of ELEXON's existing central overheads will be defrayed.

Does this modification impact a Significant Code Review (SCR) or other significant industry change projects, if so, how?

No, this Modification is not linked to any live SCR. The Proposer requests that this Modification be exempt from the SCR Process.

Consumer Impacts

Day to day operation of balancing and settlement will be unaffected so there will be no direct cost on consumers. However, exclusion of ELEXON from the competitive procurement process may limit the pool of experienced code administrators that are able to participate in the process thereby limiting the full range of commercial/operating models to be considered and evaluated. This has the potential to increase costs that will be passed through to consumers either as a result of further fragmentation in the provision of code administration services or, a failure to achieve the best value due to the limited pool of respondents.

Environmental Impacts

Day to day operation of balancing and settlement will be unaffected and so there will be no direct impact on the environment.

6 Relevant Objectives

| Impact of the Modification on the Relevant Objectives: | |
|---|-------------------|
| Relevant Objective | Identified impact |
| a) The efficient discharge by the Transmission Company of the obligations imposed upon it by the Transmission Licence | Neutral |
| (b) The efficient, economic and co-ordinated operation of the National Electricity Transmission System | Neutral |
| (c) Promoting effective competition in the generation and supply of electricity and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity | Neutral |
| (d) Promoting efficiency in the implementation of the balancing and settlement arrangements | Positive |
| (e) Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency [for the Co-operation of Energy Regulators] | Neutral |
| (f) Implementing and administering the arrangements for the operation of contracts for difference and arrangements that facilitate the operation of a capacity market pursuant to EMR legislation | Neutral |
| (g) Compliance with the Transmission Losses Principle | Neutral |

Objective (d)

The Proposer believes that this Modification Proposal P365 will better facilitate Applicable BSC Objective (d) as:

- Sharing the fixed costs of ELEXON across the REC service allows costs to the BSC Parties to be defrayed; and
- Participating in the process for the appointment of the REC administrator role may provide a view to BSC Parties of the competitiveness of ELEXON in delivering their existing obligations and be used to consider efficiencies.

These were the same reasons cited by the Proposer of P330.

Because of the parallels between this Modification Proposal and P330, it is worth highlighting the reasons for Ofgem's decision to approval P330. In their decision letter,⁵ Ofgem stated that they had previously considered the case for allowing ELEXON to diversify its activities.

⁵ <https://www.elexon.co.uk/wp-content/uploads/2015/12/P330D.pdf>

In accepting BSC Modification P284⁶ in September 2012, Ofgem set out their view that whilst there might be benefits of diversification, robust arrangements had to be put in place to mitigate any additional risk to the BSC and BSC Parties. Ofgem considered that the following criteria would have to be met:

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

In accepting P284 Ofgem allowed for these criteria to be met by establishing, subject to a decision of the BSCCo Board, a 'contract model', whereby ELEXON would become distinct from, and provide services under contract to, the BSCCo. However, Ofgem also suggested that there might be other, more proportionate, means of meeting the criteria where the extent of risk was more limited. Ofgem also stated that it would be appropriate for the BSC Board and BSC Parties more generally to give further consideration to a more limited diversification under the existing structure.

Ofgem stated that they agreed with the BSC Panel that P330 should be assessed against relevant **objective d) only**, and that there will be a neutral impact upon the other BSC objectives. Ofgem considered that the first three of the criteria set out above were captured under relevant objective d), whereas the fourth extends beyond the BSC objectives and is suitably considered as part of Ofgem's wider statutory duties.

Regarding this final point and Ofgem's wider statutory duties they stated that whilst the benefits of ELEXON's participation in the gas PAFA tender may not directly be of consideration for the BSC Objectives, Ofgem considers that the existence of additional bidders should improve the extent and quality of the competition for that contract and is therefore consistent with Ofgem's wider statutory duties.

⁶ <https://www.elexon.co.uk/mod-proposal/p284/>

7 Implementation Approach

As this Modification Proposal is a 'Code only' it is proposed that that the BSC changes are implemented 5 Working Days following determination by the Authority.

8 Legal Text

Text Commentary

The legal text required to give effect to this Modification Proposal is attached – see Appendix 1.

9 Recommendations

Proposer's Recommendation to the BSC Panel

The BSC Panel is invited to:

- Agree that P365 should not be progressed as a Self-Governance Modification Proposal; and
- Agree that P365 be sent directly into the Report Phase.