

Appendix 1 – Share Allocation, Transfer and Voting

The proposed solution is to issue shares in Elexon (BSCCo) to BSC Parties, DNOs, New Entrants and the Authority, as well as convert the existing National Grid shares into a single share.

The Authority

A single Class A share in Elexon (BSCCo) would be created and allocated to the Authority at a nominal price of £1. The Class A share will not receive any dividend or any payment beyond that one share's face value (of £1) if the company is sold.

BSC Parties

Allocation

10,000 (ten thousand) Class B shares in Elexon (BSCCo) would be created. These will be allocated initially (and reallocated each year) to BSC Parties only at a nominal face value of £1 per share allocated.

Each BSC Party will be allocated, for a single year duration, one Class B share per 0.01% of BSC funding that they pay each year (reference to year is illustrative – it should be a 12 month period, but could be based on calendar year or financial year or some other period).

Any payment for the transfer of Class B shares to or from BSC Parties will be at the nominal face value of £1 only.

Class B shares may only be 'sold' or 'bought' by BSC Parties based on their annual allocation and may not be held by any other party but a BSC Party or the Nominee Account.

If a party no longer remains a BSC Party then their Class B shares shall be transferred (at the £1 per share face value) to the Nominee Account till the next annual reallocation of Class B shares amongst BSC Parties (based on BSC funding shares).

Reallocation

At one point in each year a reallocation of the Class B shares will take place based on any changes in the BSC funding share allocations in the preceding year.

By way of simple illustration, if we assume, in the first year, there are ten BSC parties, all having exactly the same funding share (of BSC costs) then all ten parties are allocated 1,000 Class B shares each (and be invoiced for £1,000 each). However, in year two Party A's funding share declines, say, to 9.99% and Party B's funding share increases to 10.01% (the other eight parties remain the same). In this simple example Party A will be allocated 999 shares (in year two) and will receive a credit of £1 for the one share it is required to sell back. Party B will be allocated 1,001 shares (in year two) and will be debited £1 for the one additional share they receive for the year in question.

Any credit or debit associated with the transfer of Class B shares (at the nominal £1 price per share) shall be reconciled via the next monthly Elexon bill via a separate line item. For the avoidance of doubt, where a BSC Party has exactly the same funding share from one year to the next then they

shall receive exactly the same number of shares as the year before and the line item on their Elexon invoice will show £0 (zero).

It is proposed that the Class B shares will be issued to BSC Parties based on each 0.01% of the annual funding share(s) of BSC costs (which shall be assessed once a year) that the BSC Party pays.

Where a BSC Party has less than a full 0.01% annual funding share then they would not receive one Class B share. For example, if Party X has a BSC funding share of 9.999% they would only receive 999 shares (not 1,000 as they are just short of 10%). Equally if Party Y has 10.001% they will only receive 1,000 shares (not 1001).

Schedule 2 of the Knight Review of July 2013 lists the annual funding share for FY 2012/13. We appreciate that funding shares for the latest FY will have changed from that shown in the Knight Review, but based on the 2012/13 figures shown in Schedule 2 we would anticipate that 97 (of 99) BSC Parties would receive at least one share in Elexon, and would thus have equal shareholder rights with all other (97) BSC Parties who would also have shares in Elexon.

Those (two, based on 2012/13 data) BSC Parties who would, in this proposed solution, not be allocated funding share based Class B shares in Elexon (BSCCo) - as they do not pay any annual funding share of Elexon (BSCCo) - costs would, however, be able to receive Class B shares (see 'Trading' below) if they wished to do so.

Nominee Account

As a result of the proposed share allocation there will be a rounding 'error' each year of a few Class B shares which are not allocated to BSC Parties. These Class B shares will be held in a Nominee Account (as will any Class B shares returned due to a party no longer being a BSC Party). All shares held in the Nominee Account will be allocated at the next annual review/(re)allocation.

With respect to the Nominee Account there are two pertinent matters that arise. Firstly, how will any money arising from those shares held in the account, such as dividends, be paid out and secondly, how will those shares be voted.

In respect of the dividend(s) it would be for the Board and the shareholders to determine (i) if a dividend was to be paid in any particular year and (ii) if a dividend was to be paid what that should amount to. This Modification does not require that a dividend be paid, but it would permit one to be paid if that is what the Board and the shareholders vote for. In this way Elexon (BSCCo) is the same as other companies to which the UK Corporate Governance Code applies.

In the case of any monies due to be paid out to Class B shares during a year, all funds allocated to be paid to the shares in the Nominee Account will be reallocated. This will be done by those funds to be paid to the Nominee Account being put back into the 'pot' and reallocated, at that time, based on the Class B shares (but excluding those Class B shares held in the Nominee Account).

In the event of Elexon (BSCCo) being sold/wound down etc., and all value due to be paid to the Nominee Account shares having to be allocated, then the above process will be repeated (and the monies due to the shares in the Nominee Account being disbursed amongst other Class B shares).

Voting

In the case of any vote of shareholders taking place those shares held in the Nominee Account would abstain entirely from all shareholder votes.

Any changes to the documents governing Elexon (BSCCo); i.e. the Articles of Association, Memorandum of Association or Shareholders Agreement; would only be approved if a majority of all Class B, C, D and E shares eligible to vote, support the change and the single Class A share either (i) supports the change or (ii) abstains from voting. It may be appropriate to apply a higher threshold (x%) than simple majority, designed to ensure consensus across industry and to ensure that a bloc of large Parties cannot outvote smaller Parties.

Should the Class A share (held by the Authority) that is eligible to vote does not support the change, then the change shall not be implemented.

For all other matters that require a shareholder vote, this will be achieved (as with other companies) via a resolution at either the Annual General Meeting or (as specified in the Articles/Memorandum of Association) an Extraordinary General Meeting of all the Class B, D and E shares, where the threshold to carry the vote (of the Class B, D and E shares) shall be a simple majority of 50% plus one share. This shall include the appointment of all Directors of the Company and the Chairman.

However, in addition to receiving majority shareholder support from, collectively, the Class B, D and E shares issued to parties for their appointment, the Chairman must also receive the positive support of the single Class A share (or its abstention from voting). If the Class A share eligible to vote does not support the appointment of the Chairman then the appointment shall not be made.

National Grid

In addition to the issuing of other classes of shares, and in recognition of their role as GB System Operator, all the current shares held by the Company (National Grid) in Elexon (BSCCo) will be converted into a single Class C share, in recognition of their existing licence position/shareholding in Elexon (BSCCo).

The single Class C share (with a face value £1) would be issued to, and could only be held by, the GB System Operator. It is proposed that this Class C share would have exactly the same rights and limitations as the single Class A share, except with respect to any vote relating to the appointment of the Elexon (BSCCo) Chairman, where the Class C share would have the same rights as the Class B (and not the Class A) shares; i.e. National Grid would not have a right of veto.

Note: If legally the Authority cannot hold the Class A share then we would propose that the Class A share, as set out here, would be 'transferred' to the GB System Operator (National Grid) and, in this scenario National Grid would have a right of veto with respect to the Elexon (BSCCo) Chairman, which we would expect them to exercise after discussion with the Authority. It may be necessary to 'codify' this particular aspect in the Transmission Licence.

DNOs

In recognition of the role that distribution system operators (i.e. DNOs and IDNOs) have in Elexon

(BSCCo) it is proposed that a special class of shares in Elexon (BSCCo) would be created. These Class D shares would only be able to be held by those parties who Ofgem confirms as being either a DNO or IDNO.

As with Class B shares, these Class D shares would be valued at the same nominal £1 and could only be purchased or sold (from/to the Nominee Account) on the same annual date as the Class B shares. DNOs and IDNOs would have the option, exercisable once every year, to buy or sell their Class D share(s).

Unlike other BSC Parties, who are liable to pay towards Elexon (BSCCo) costs, a DNO or IDNO would not be required to hold Class D share(s).

DNOs and IDNOs (confirmed as such by Ofgem) would notify the Nominee Account by a set date each year that they wish to exercise their right to Class D shares.

In recognition of the linkage between shareholding and funding, these Class D shares would also come with the responsibility for the year in which each Class D share is held to pay a corresponding proportion of the Elexon (BSCCo) costs for that year.

This contribution to the Elexon (BSCCo) funding costs paid by the Class D shareholder(s) would be deducted from the amount of Elexon (BSCCo) costs to be paid by the other (Class B) Elexon (BSCCo) funding parties.

Class D shares would have all the same rights, such as voting, and responsibilities as Class B shares.

New Entrants

In recognition of the need to accommodate new entrants it is proposed that a special class of shares in Elexon (BSCCo) would be created. These Class E shares would only be able to be held by those parties who Ofgem confirms as being a new entrant.

As with Class B shares, these Class E shares would be valued at £1 and could only be purchased (from the Nominee Account) or sold (to the Nominee Account) on the same annual date(s) as the Class B shares. New entrants would have the option, exercisable once every year, to buy or sell their Class E share(s).

Unlike other BSC Parties, who are liable to pay towards Elexon (BSCCo) costs, no new entrant would be required to hold the Class E share(s).

New entrants (confirmed as such by Ofgem) would notify the Nominee Account by a set date each year that they wish to exercise their right to Class E shares.

In recognition of the linkage between shareholding and funding, these Class E shares would also come with the responsibility for the year in which each share is held to pay a corresponding proportion of the Elexon costs for that year. These contributions to the Elexon funding costs paid by the Class E shareholder(s) would be deducted from the amount of funds to be paid by the other (Class B) Elexon funding parties.

Class E shares would have all the same rights, such as voting, and responsibilities as Class B shares.

Once a Class E new entrant party becomes an Elexon funding party in their own right; that is they are no longer a new entrant by virtue of having a right to hold Class B shares; they would not be able to hold Class E shares. Their Class E share(s) would be sold back, at £1 per share, on the next annual share allocation date, to the Nominee Account and they would be issued with their corresponding Class B share(s) in accordance with the Class B arrangements set out above.

It is recognised that it is possible that a new entrant may, over the course of time, become part of a corporate entity which is liable to pay towards Elexon (BSCCo) costs; i.e. it is a funding party. If a Class E shareholding party at some future date becomes part of a corporate entity which holds Class B share(s) their Class E share(s) would, from that date, be sold at the nominal value (£1) to the Nominee Account and they would, from that same date, no longer be liable going forward for the equivalent share of funding Elexon costs for the rest of the year in question. They would not, from that same date, be able to hold Class E shares in the future.

A question arises as to whether it is appropriate to consider allowing holders of Class D or Class E shares to hold more than a single share (and pay the proportionally higher share of Elexon (BSCCo) funding costs that would arise from their greater shareholding in Elexon). There may, for example, be arguments for them to have a greater shareholding in order that they can vote for the position, say on strategy, that they seek.

However, this needs to be balanced with the need to avoid such a party exercising this right, voting for a course of action that incurs a cost in the medium/long term (that is beyond the next annual share allocation date) and they then sell their shares back (to the Nominee Account) thus avoiding themselves funding those items which they voted for when those costs arise in future years. Such a position would be inequitable, to say the least.

Given this it is proposed that there may only be up to one thousand (1,000) Class D shares and one thousand (1,000) Class E shares allocated by the Nominee Account at any one time and that no one party may hold more than two hundred (200) Class D or two hundred (200) Class E shares respectively.

If we assume for illustrative purposes that Elexon's (BSCCo) funding costs in a particular year is £30M then if one Class D or one Class E share is purchased the holder of that share will be responsible for paying £2,999.70 of Elexon's (BSCCo) costs in the year in question. The amount of funds to be paid by the other (Class B) Elexon (BSCCo) funding parties will drop from £3,000 per 0.001% (to the same £2,999.70 as the Class D or Class E shareholder).

If all 1,000 Class D and 1,000 Class E shares are purchased then the holders of all Class B, Class D and Class E shares will be responsible for £2,500 of Elexon's (BSCCo) costs in the year in question for each B or D or E share they hold.

If multiple DNO or IDNO parties wish to hold Class D (or new entrants for Class E) shares then there would be a two stage process at the start of the annual allocation process. DNO and IDNO Parties

(and new entrants) would inform the Nominee Account that they wished to exercise their right to hold Class D (Class E) shares and how many they wished to hold.

In stage one the Nominee Account would first allocate a single share (Class D or Class E respectively) to every party (DNO/ IDNO or new entrant) that exercised their option. In stage two the remaining shares, out of the 1,000 in total Class D (Class E) shares, would be allocated on a pro rata basis (using the total of shares requested divided by the shares remaining) up to the maximum 200 Class D (or Class E) shares per party.

In this way all DNO, IDNO and new entrants would, if they wished, be able to buy at least one share in Elexon (and have an equal right with all other Class D or Class E shareholders respectively to purchase more shares, on a pro-rata basis).

For the avoidance of doubt the trading of Class D or Class E shares directly between parties would not be permitted. All trades, as with Class B shares, would be to/from the Nominee Account.

Trading of Class B shares and flattening the role of the largest six parties.

The trading of Class B shares directly between parties would not be permitted. All trades could only be completed via the Nominee Account.

BSC Parties who wish to release (from their initial allocation based on their funding share) or receive (over and above their funding share allocation) Class B shares would notify the Nominee Account by a set date each year that they wish to do so.

However, in a similar way to the situation with Class D and Class E shares, a holder of Class B shares who did receive additional Class B shares (at the nominal £1 value) would also receive the corresponding obligation to pay the equivalent share of the Elexon (BSCCo) funding costs, for the year in question only, for those additional Class B shares.

Any BSC Party which released some (or all) of their Class B share(s) would be relieved of the corresponding obligation to pay a share of Elexon (BSCCo) costs, for the year in question only, for those Class B shares actually received by other parties.

For the avoidance of doubt, Class B shares could only be held by those parties entitled to hold Class B shares (namely BSC Parties - funding and non funding).

Requests by BSC Parties to receive additional Class B shares would be logged with the Nominee Account in a short time window between the funding share allocation being known to the party (and thus the share allocation to be made) and the formal allocation for the Class B shares for the year in question.

BSC Parties who wish to receive Class B shares (over and above their funding share allocation) would have to specify the number of shares they wished to receive. This would be in a similar short time window between the funding share allocation being known to the party (and thus the share allocation to be made) and the formal allocation for the Class B shares for the year in question.

For the avoidance of doubt the Class B shares could only be held for the one year in question (and not 'part year' – except where a holder was no longer a BSC Party, in which case their Class B share would revert to the Nominee Account).

BSC Parties who wished to release Class B shares would, in the same short window period, advise the Nominee Account that they wished to release some (or all) of their shares. They would specify the number of shares they were offering to release.

If there were more requests to receive Class B shares than there were Class B shares made available for release then the shares would be allocated to the receivers on a pro-rata basis. Equally, if there were more Class B shares released than there were requests to receive them then these would be allocated from those seeking to release on a pro-rata basis.

For the avoidance of doubt, no party would be required to receive more than the number of Class B shares they specified they wished to receive, even if more shares were available for release. Equally, no party would be required to release more than the set number of Class B shares they specified they wished to release even if more shares were requested to be received.

Those Class B shares offered for release but not received by other parties would be 'returned' (i.e. not be reallocated by the Nominee Account) to the initial party that offered them for release (who would, therefore, be responsible for the associated Elexon (BSCCo) funding costs for the year in question for those 'returned' Class B shares).

As the trading of the Class B shares always takes place via the Nominee Account there is full anonymity of the 'counterparty' and no party (receiver / 'buyer' or releaser / 'seller') is placed in either a privileged or beholden position to either the 'buyer' or 'seller' respectively as they do not trade directly with a particular party.

In order to both facilitate the trade in Class B shares and flatten the voting rights of the largest six parties, by funding share, these six largest parties would be required to offer to release a minimum of 25% of their respective Class B shares each year that they initially receive based on their share of the funding costs.

For the avoidance of doubt these six largest parties would be permitted (but not required) to offer to release more than the minimum 25% of their Class B shares if they wished.

Based on the March 2013 annual funding share allocation set out in the Knight report (pages 44-46) the largest six parties would have held 77.52% of the Class B shares. Requiring them to offer to release 25% of their respective holdings would mean that at least 19.38% of the Class B shares would have been available for other BSC parties to receive, bringing the holding of Class B shares held by the largest six parties down, in this scenario, to 58.14% if all the shares they offer to release had been received.

For the avoidance of doubt, the largest six parties would not be able to apply annually to the Nominee Account to receive more Class B shares.

As noted above there are to be 10,000 Class B shares which means, in this scenario, that the largest six parties would hold 5,814 Class B shares (if other qualified parties received the 19.38% of Class B shares released to them by the largest six parties).

In addition to this there are up to 1,000 Class D and 1,000 Class E shares. As noted above, Class D and Class E shares have all the same rights, such as voting, and responsibilities as Class B shares.

Therefore if all 1,000 Class D and 1,000 Class E shares are allocated then the largest six parties (if they voted 'on-block' - which assumes they have the same view on the matter at hand, which is by no means certain) would have a minority of 48.45% (5,814 of 12,000 voting shares) and other parties would have the majority with 51.55% (6,186 of 12,000 voting shares). In this way the role of the largest six parties are flattened – if the other nine six largest parties wished to do so (by exercising their right to receive additional shares).

In seeking to flatten the role that the largest six parties have it will be important to avoid the creation of an anomaly which permits another BSC party to hold more votes than the largest six parties as this would be a perverse outcome. To avoid this situation occurring it is proposed that no BSC party could receive additional Class B shares over and above their funding share allocation of Class B shares if their total holding of Class B shares would exceed the average Class B holding (based on their initial funding share allocation) of the six largest parties, which would vary over time.

Based on the Knight report analysis of funding shares from March 2013 the six largest parties would have been initially allocated 77.52% of the Class B shares, which means an average holding of 12.92%. Thus, if this proposal had been in place in 2013/14 the maximum holding of Class B shares (made up of additional Class B shares received plus their funding share allocation of Class B shares) would have been 1,292 for that year for an individual funding share paying BSC party (which was not one of the six largest parties).