

Rachel Fletcher
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6 January 2012

Dear Rachel

I have attached to this letter ELEXON's response to Ofgem's open letter consultation, "Potential expansion of the role of ELEXON", published on 21 November 2011. I will begin by clarifying that this detailed response is submitted on behalf of the ELEXON Executive Team, and the ELEXON Board is submitting a separate response. This is a deliberate approach, given the magnitude of the issues debated and that some questions are specifically concerned with the impact of the different models on the Board.

I would like to thank Ofgem for the opportunity to respond to this consultation. It has provided a vehicle for detailed and considered debate on the subject of ELEXON's future role, and I am encouraged by the level of engagement from colleagues across the industry.

Thank you, too, for your continued support for ELEXON carrying out activities beyond the operation of the balancing and settlement arrangements. I note your recognition of our experience and expertise in the fields of settlement, procurement and contract management, and I wholeheartedly agree with your observation that our skills and experience could enable synergies (and consequential cost savings) between the processes we currently run and the anticipated role of the DCC. However, I'd like to repeat that our aspirations are wider than the DCC. I believe that ELEXON's skills and experience equip us to assist the industry, government and regulator in areas beyond Smart and the DCC, providing support in meeting the challenges posed by the largest market transformation proposals in a generation and generating tangible savings through the simplification of central market arrangements.

You will be aware from our previous discussions that, over the past 12 months, ELEXON has advocated 8 objectives to assess possible business models against to result in a model that is fit for purpose, and in the interests of industry, government, regulator and consumer:

- Ensure that existing core BSC business services are maintained and that there is no dilution of BSC resources and expertise.
- Enable the creation of an appropriate corporate structure for existing and new activities of the ELEXON Group that supports current and future market developments.
- Provide for an appropriate legal and regulatory framework.
- Maintain independence.

- Allow for a fair reflection of current and future stakeholder interests.
- Ring-fence liabilities, costs and risks for current and new activities.
- Avoid any unfair competitive advantage/disadvantage.
- Enable appropriate funding.

We believe that these objectives are broadly analogous with the 4 conditions put forward in the consultation.

Our consultation response explains that, in broad terms, either model could be made to work. However, there are certain aspects of both models that would need careful consideration in order to align them with both Ofgem's expansion conditions and the eight objectives set out above. These considerations and associated characteristics (that we believe any solution must capture) are:

Ownership and control

The consultation is silent on ownership and, more important, control, under both models. This is an issue that is key and must be resolved. Domination of ELEXON by one or a small group of BSC Parties must be avoided in order to maintain independence. A Not for Distribution group structure (whereby members are drawn from a wide community and profits created within the group are invested in accordance with the group's stated aims, or used to defray overheads, rather than divided to shareholders) would ensure objectives are driven by what is best for industry and wider stakeholders rather than what is in the interests of shareholders.

Services

Any new ownership or governance model must ensure that all services currently provided by ELEXON are outsourced, rather than leave some within BSCCo. This would mitigate the concern that outsourcing only part of the services could lead to inefficiencies and potential duplication of effort and costs. In addition, this will provide greater safeguard against a reduction in the services and support provided to BSC Parties. There is currently more disclosure on ELEXON and its services and performance than any other central body.

Long term relationship

Under any new model, the relationship must be long term (e.g. 10 years) in order to provide stability and certainty for industry. We are concerned by the suggestion of a 3 year contract – we believe this would be detrimental to BSC Parties. Procurement and transition are expensive and given that ELEXON is already highly transparent on the resources used to deliver each element of the BSC, it is unclear what would be achieved by forcing a re-procurement after just 3 years. For example, as over half of ELEXON's existing cost base is already subject to frequent re-procurement (only the people and premises costs are not subject to regular re-procurement), which comes with the appropriate industry oversight, there is little to be gained by mandating that services are re-procured after 3 years. In addition, a 3 year contract would introduce cost and operational uncertainty at a time of already significant industry upheaval (Smart metering, EMR, BPO re-procurement).

Implementation costs

Implementation must be managed and costs kept low as they will be borne by the industry and, ultimately, the consumer. In order to achieve this, "as is" should be used as the starting point for

defining BSCCo services and price. Finally, assuming "as is" as the starting point, Parties should not be permitted to deviate into excessive detail or extend negotiations unreasonably as this will increase costs, the timetable, and potentially prevent ELEXON from pursuing other opportunities.

Timely access to funding for growth

ELEXON securing funding for new activities from willing third parties in sufficient time to enable preparation and participation in the DCC process and other opportunities is essential. If this is not achieved then the costs of implementing either model will not have delivered the desired outcome. As you are aware, we believe a window of 4 to 6 months is required.

Appropriate BSCCo Board

Under any model, it will be important that the BSCCo Board is strengthened with additional Non-Executive Directors with appropriate financial and commercial expertise.

Clear process and leadership

I have already referred to the need to avoid excessive negotiations around what is essentially adding some protections (in the subsidiary model) or incorporating into an agreement existing services (in the contract model). I firmly believe Ofgem must clearly signal its determination to achieve the required changes, including their coming into effect, within a given timeframe. Clarity of process and timeline will also reduce the uncertainty for ELEXON staff which is destabilising for them and for the settlement process.

I look forward to discussing ELEXON's response with you in more detail. In the meantime, if you or your colleagues need any further information, please don't hesitate to contact me. Neither this covering letter nor the attached consultation response is confidential.

Yours sincerely



Peter Haigh
Chief Executive

List of enclosures

Open letter consultation: "Potential expansion of the role of ELEXON" – ELEXON's response.